The Treaty Request Agreement between the Swiss Confederation and the United States of America of August 19, 2009 (UBS Agreement):

Principles and Domestic Applicability

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Legal Opinion for the Federal Office of Justice

by

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Executive Summary

The 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 regarding UBS AG, a cooperation established under the laws of the Swiss Confederation, signed and entered into force on August 19, 2009 (UBS Agreement), was properly concluded by the Swiss Government under its constitutional and legal authority. It is subject to the principle of *pacta sunt servanda* and to be implemented by federal authorities. Decisions taken under the Agreement are subject to full judicial review under Article 190 of the Swiss Constitution. The UBS Agreement is self-standing, partly completing, partly amending the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Income of October 2, 1996 the Protocol, and the Mutual Agreement of January 23, 2003 regarding the administration of Article 26 of the Treaty. The relationship of the UBS Agreement to preceding instruments is defined in accordance with Article 30 para. 3 of the Vienna Convention on the Law of Treaties. The UBS Agreement, being part of a settlement of a particular dispute, precedes these instruments in terms of *lex posterior* and *lex specialis*. Determinations, in particular on tax fraud and the like, need to be made on the basis of the UBS Agreement, and other instruments are to be taken into account only to the extent they are compatible with the UBS Agreement. Authorities are obliged to construe these provisions in accordance with methods and principles of interpretation of Article 31 Vienna Convention, based upon the text, context and legitimate expectations. The UBS Agreement is suitable for direct effect, in particular the criteria established by the Annex and thus in a position to form the basis of specific determinations. It does not amount to a prohibited retroactive effect. Domestic procedures are based upon the UBS Agreement, the 1996 Treaty and internal regulations which are found to be compatible with principles of delegation of powers under the Swiss Constitution. Finally, the Agreement does not conflict with obligations of UBS to inform clients about their potential obligations under Sec. 18 USC § 3506.

Table of Contents

I. Remit

1. The undersigned were instructed by the Federal Office of Justice to deliver an expert opinion on the August 19, 2009, agreement with the USA on the request for information from the Internal Revenue Service from the international and tax law perspectives. Specifically, this Opinion seeks to answer the following questions[1]:

- Legal foundations (relevant treaties and classification under international law)
- Direct application (materially and procedurally; relationship with domestic legal foundations)
- The problem of retroactive effect from the international and domestic law perspectives
- Principles of interpretation in the context of the Agreement (VCLT, WTO practice, ICJ)
- Relationship between the executive and the judiciary on foreign policy matters (cognizance)
- Interpretation of Art. 26 of the Tax Treaty (TT) (tax fraud or the like) and the subsequent Agreement, in particular the provisions of the Annex
- Implications for the IRS-UBS Agreement

II. Background Materials

2. The principal made the following materials available in the drafting of this Opinion:

- 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, including Annex criteria for granting assistance pursuant to the treaty request, August 19, 2009.
- Declarations by the Swiss Confederation and the United States of America, August 19, 2009.
- Draft translation of the Agreement of August 19, 2009 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.
- Information on § 3506 USC, e-mail dated September 8, 2009.
- Settlement Agreement between the United States of America, the U.S. Internal Revenue Service and UBS AG, undated, including Exhibit A, United States District Court for the Southern District of Florida Miami Division, Stipulation of Dismissal, undated, Exhibit B, Proposed Draft Notice to UBS Account-Holders, Consent to publicly disclose settlement agreement and related information, August 19, 2009.
- Expert opinion by Prof. Dr. Xavier Oberson, draft working paper, July 27, 2009.
- Expert opinion by Prof. Dr. Robert Waldburger, working paper on the issue of which cases are eligible for official assistance under the terms of Art. 26 of the Swiss-USA TT for US taxpayers who have held accounts and custody accounts not containing any US securities with a bank in Switzerland, without declaring the revenue from these accounts on their US tax return, July 28, 2009.
- Summary expert opinion by Prof. Dr. Klaus A. Vallender, summary opinion of August 8, 2009 on the issue of eligibility for official assistance under Art. 26 USA-TT (confidential), August 8, 2009.
- Memorandum concerning 18 USC § 3506, Pillsbury Winthrop Shaw Pittman LLP, September 6, 2009.

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[1] E-mail from Dr. Kuster on September 21, 2009

III. Facts

A. History of the UBS Agreement

3. On August 19, 2009, the Swiss Confederation and the United States of America signed the Agreement on the Request for Information from the Internal Revenue Service (IRS) of the United States of America regarding UBS AG. The Agreement (referred to below as the "UBS Agreement"), entered into force up on signature[2].

4. The UBS Agreement is part of the out-of-court settlement of the dispute concerning the IRS's "John Doe Summons" proceedings against UBS AG. On February 19, 2009, the IRS filed a civil suit with the United States District Court for the Southern District of Florida that was intended to have the IRS's application – specifically, for information on the accounts of US clients – enforced by the courts.

5. The Swiss Confederation thus feared a conflict between the Swiss and US legal systems if the IRS were to succeed with its John Doe summons. The Swiss Confederation set out the situation under Swiss law, and its own perspective, to the Court in the form of an *amicus curiae brief*.

6. The parties subsequently agreed to suspend proceedings temporarily in order to seek an out-of-court solution. The UBS Agreement forms part of this settlement, which resulted in the US judge deferring the proceedings.

B. Core Provisions of the UBS Agreement

7. The Agreement is based on the contracting parties' desire to settle disputes by mutual consent and in compliance with their individual systems of law. Fundamental to the Agreement is Art. 26 USA-TT, which offers a mutually agreed mechanism for the regulated exchange of relevant information. Art. 26 USA-TT[3] enables the contracting parties' competent authorities to exchange information necessary to prevent "tax fraud or the like". Art. 25 USA-TT states that the competent authorities must endeavor to resolve by mutual consent any difficulties or doubts in the interpretation or application of the treaty (the mutual agreement procedure). The UBS Agreement concluded as part of the out-of-court settlement thus draws on Art. 25 USA-TT.

8. The core of the UBS Agreement is the accord between the states parties to halt enforcement proceedings in the John Doe Summons case in favor of a treaty request process in accordance with Art. 26 USA-TT. In doing so, the Swiss Confederation undertakes to process a request by the United States for information about US clients of UBS AG in accordance with the applicable Tax Treaty. In return, the United States undertakes not to seek further enforcement of the John Doe Summons and to withdraw the suit in full once the Agreement has been implemented successfully.

9. To handle the additional work anticipated owing to the implementation of the treaty request, Switzerland also undertook to establish a special task force within the Swiss Federal Tax Administration (SFTA). Applying the criteria in the Annex to the UBS Agreement, the SFTA must render its first 500 final decisions in the sense of Art. 20j USA-TT-O[4] within the first 90 days after the treaty request is received. Pursuant to Art. 1 para. 2 of the UBS Agreement, the remaining decisions must be issued within 360 days of receipt of the request.

10. In return for conducting the treaty request process in accordance with the UBS Agreement, the

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[2] Art. 8 UBS Agreement
[3] Treaty Between the Swiss Confederation and the United States of America to Avoid the Double Application of Taxes on Income, October 2, 1996, SR0.672.933.61
[4] Ordinance on the Swiss-American Tax Treaty of October 2, 1996, dated June 15, 1998, SR 672.933.61

United States undertakes in Art. 3 of the Agreement that, immediately the Agreement is signed, it and UBS AG will make a submission to the US court requesting that the enforcement action be dismissed. Formally, the action remains pending, but the USA will not seek any further court enforcement in the John Doe Summons proceedings while the UBS Agreement is in effect.

11. The USA further undertakes on December 31, 2009 to withdraw the action against those accountholders not covered by the treaty request, provided UBS AG has complied with its obligations as set out in Art. 4 of the UBS Agreement. Furthermore, on or after 1 January 2010 the United States will irrevocably withdraw the John Doe Summons with respect to the accounts covered by the treaty request, once the IRS has received information on 10,000 open or closed undisclosed UBS AG accounts. The results of both the treaty request process and the voluntary reporting program will be taken into consideration in this regard[5].

12. Finally, the USA will withdraw the John Doe Summons irrevocably with respect to the accounts covered by the treaty request no later than 370 days from the signing of the UBS Agreement. Such withdrawal is conditional upon compliance by UBS AG with Art. 4 of the UBS Agreement, as well as with the provisions of Art. 5 of the UBS Agreement on monitoring and consultations, as the Agreement is being executed.

C. Annex to the UBS Agreement

13. The criteria listed in the Annex are of key importance in conducting the treaty request process in accordance with the UBS Agreement. By way of introduction, in the first paragraph of the Annex the parties state that a request for the exchange of information generally requires the clear identification of the person(s) concerned. However, the parties agree that the names of UBS clients do not need to be mentioned in the context of the treaty request process under that UBS Agreement.

14. The contracting parties give the following reasons for waiving the requirement to name names: (i) the identified specific wrongful conduct by certain individual US taxpayers who maintained an undisclosed account (non-W9-account) at UBS AG Switzerland in their name or in the name of an non-operating offshore company of which they were a beneficial owner; (ii) the specificity of the group of natural persons described in section 4 of the statement of facts in the Deferred Prosecution Agreement of February 18, 2009 (DPA), and (iii) consistency with the conditions set by the ruling of the Swiss Federal Administrative court on March 5, 2009[6].

15. Under the terms of the Agreement, the general requirement to identify the persons subject to the request for information, as laid down in section 4 of the statement of facts in the DPA, is considered to be satisfied for the following persons:

16. *US-domiciled clients of UBS* who directly held and beneficially owned "undisclosed (non-W-9) custody accounts" and "banking deposit accounts" in excess of CHF 1 million (at any point in time from 2001 to 2008) with UBS and for which a reasonable suspicion of "tax fraud or the like" can be demonstrated (section 1.A of the Annex to the UBS Agreement).

17. *US-persons (irrespective of their domicile),* who beneficially owned "offshore company accounts" that were established or maintained in the period 2001 through 2008, and for which a reasonable suspicion of "tax fraud or the like" can be demonstrated (section 1.B of the Annex to the UBS Agreement).

18. The criteria for determining "tax fraud or the like" are defined as follows in section 2 of the Annex to the UBS Agreement:

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[5] Details in footnote 2 to the UBS Agreement.
[6] Federal Administrative Court ruling, March 5, 2009, ASA 77 (2009), p. 837 ff.

19. For "undisclosed (non-W-9) custody accounts and "banking deposit accounts" (as described in section 1.A of the Annex), where there is a reasonable suspicion that the US-domiciled taxpayers engaged in the following:

20. Activities presumed to be fraudulent (as described in para.10, subpara.2, first sentence of the Protocol), including such activities that led to a concealment of assets and underreporting of income based on a "scheme of lies" or submission of incorrect and false documents. Where such conduct has been established, persons with accounts of less than CHF 1 million in assets (except those accounts holding assets of less than CHF 250,000) during the relevant period would also be included in the group of US persons subject to this request for information; or

21. Acts of continued and serious tax offense for which the Swiss Confederation may obtain information under its own laws and practices (as described in paragraph 10, subparagraph 2, third sentence of the Protocol) which, based on the legal interpretation of the contracting parties, includes cases where (i) the US-domiciled taxpayer has failed to provide a Form W-9 for a period of at least three years (including at least one year covered by the request) and (ii) the UBS account generated revenues of more than CHF 100,000 on average per annum for any three-year period that includes at least one year covered by the request. For the purpose of this analysis, revenues are defined as gross income (interest and dividends) and capital gains (which for the purpose of assessing the merits of this administrative information request are calculated as 50% of the gross sales proceeds generated by the accounts during the relevant period).

22. For "offshore company accounts" (as described in section 1.B of the Annex), where there is a reasonable suspicion that the US beneficial owners engaged in the following:

23. Activities presumed to be fraudulent (as described in paragraph 10, subparagraph 2, first sentence of the Protocol), including such activities that led to a concealment of assets and underreporting of income, based on a "scheme of lies" or submission of incorrect and false documents, other than US beneficial owners of offshore company accounts holding assets of less than CHF 250,000 during the relevant period; or

24. Acts of continued and serious tax offense for which the Swiss Confederation may obtain information under its own laws and practices (as described in paragraph 10, subparagraph 2, third sentence of the Protocol) which, based on the legal interpretation of the contracting parties, includes cases where the US person failed to prove that, despite being asked to do so by the SFTA, they had fulfilled their statutory tax reporting obligations in respect of their interests in such offshore company accounts (i.e. by providing consent to the SFTA to request copies of the taxpayer's FBAR returns from the IRS for the relevant years). In the absence of such confirmation, the Swiss Federal Tax Administration will exchange information where (i) the offshore company account has been in existence for an extended period (i.e. at least three years including one year covered by the request), and (ii) generated revenues of more than CHF 100,000 on average per annum for any three-year period that includes at least one year covered by the request. For the purpose of this analysis, revenues are defined as gross income (interest and dividends) and capital gains (which for the purpose of assessing the merits of this administrative information request are calculated as 50% of the gross sales proceeds generated by the accounts during the relevant period).

25. Footnotes 1 to 3 of the Annex to the UBS Agreement describe the term "scheme of lies" in greater detail.

26. According to footnote 1, for individuals who fulfill the criteria of section 1.A of the Annex to the UBS Agreement a "scheme of lies" may exist based on the bank's records, where these beneficial owners (i) used false documents; (ii) engaged in a fact pattern that has been set out in the "hypothetical case studies" in the appendix to the mutual agreement concerning Art. 26 of the Tax Treaty for example, by using related entities or persons as conduits or nominees to repatriate or otherwise transfer funds in the offshore accounts); or (iii) used calling cards to disguise the source of trading. These examples are not exhaustive. Depending on the applicable facts and circumstances, the SFTA may consider certain further activities to be "schemes of lies".

27. According to footnote 3, for individuals who fulfill the criteria of section 1.B of the Annex to the UBS Agreement a "scheme of lies" may exist if the bank's records show that the beneficial owners continued to direct and control, in full or in part, the management and disposition of the assets held in the offshore company account or otherwise disregarded the formalities or substance of the purported corporate ownership (i.e. the offshore company functioned as a nominee, sham entity or alter ego of the US beneficial owner) by: (i) making investment decisions contrary to the representations made in the account documentation or in respect of the tax forms submitted to the IRS and the bank; (ii) using calling cards / special mobile telephones to disguise the source of trading; (iii) using debit or credit cards to enable them deceptively to repatriate or otherwise transfer funds for the payment of personal expenses or for making routine payments of credit card invoices for personal expenses using assets in the offshore company account; (iv) conducting wire transfer activity or other payments from the offshore company's account to accounts in the United States or elsewhere that were held or controlled by the US beneficial owner or a related party, with a view to disguising the true source of the person originating such wire transfers; (v) using related entities or persons as conduits or nominees to repatriate or otherwise transfer funds to the offshore company's account; or (vi) obtaining "loans" to the US beneficial owner or a related party directly from, secured by, or paid by assets in the offshore company's account. These examples are not exhaustive. Depending on the applicable facts and circumstances, the SFTA may consider certain further activities to be "schemes of lies".

D. Further Provisions in the UBS Agreement

28. In Art. 2 of the UBS Agreement, the contracting parties undertake to sign the newly negotiated Protocol amending Art. 26 USA-TT, of June 18, 2009, by no later than September 30, 2009, and to use their best efforts, consistent with their respective constitutional processes, to ratify the new protocol without delay[7].

29. Art. 4 of the UBS Agreement obliges UBS AG to support the Swiss authorities in conducting the treaty request process. In doing so, it must comply with the deadlines and conditions laid down in the Agreement. The Federal Office of Justice and the Swiss Financial Market Supervisory Authority (FINMA) are responsible for overseeing UBS AG's compliance with its obligations.

30. Art. 5 of the UBS Agreement governs proceedings between the contracting parties. For example, para. 1 states that the competent authorities from both states must meet on a quarterly basis to assess the progress of the treaty request process and the voluntary disclosure program. In para. 2, it is agreed that either party may request further consultations to resolve problems with the implementation, interpretation or execution of the Agreement.

31. In the event that one of the parties fails to satisfy the provisions of the UBS Agreement, Art. 5 also provides that the other contracting party may request immediate consultations in order to ensure that the agreement is fulfilled. If, after 370 from the signature of the UBS Agreement, the actual and anticipated results differ significantly from what might reasonably be expected from the

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[7] The Protocol was signed by both contracting parties on September 23, 2009 and must now pass through the respective domestic ratification processes.

implementation of the Agreement at that time, and if the matter cannot be resolved mutually either by consultations or by amendments to the Agreement, then either contracting party may take appropriate measures to restore the intended balance of rights and duties in the UBS Agreement. However, such measures may not extend beyond those necessary to preserve the legal position of the party in questions, neither may they impose any new financial or non-financial obligations on UBS AG.

32. The confidentiality clause in Art. 6 of the UBS Agreement is particularly important. Here, the states parties undertake not to publish or publicly discuss the Annex to the UBS Agreement for 90 days after the latter's signature, i.e. until November 17, 2009. Notwithstanding this clause, in its decisions under Art. 20j USA-TT-O, the SFTV may inform the accountholders concerned about the specific facts that form the final basis for its decision, in other words, the criteria laid down in the Annex to the UBS Agreement. Those concerned face criminal proceedings if they disclose such facts to any third party before the Annex is published. Once the 90-day period has expired, the contracting parties are free to publish the Annex in the usual way[8].

33. The purpose of this provision is to motivate as many US clients of UBS AG as possible to work with the IRS within the Voluntary Compliance Program and thus to make the desired information available to the authorities.

34. Pursuant to Art. 10 of the UBS Agreement, it is terminated with the written confirmation from both contracting parties that they have fulfilled their obligations under the Agreement.

[8] The UBS Agreement and the Annex will be published in the Official Compilation of Swiss law (ASA), on November 17, 2009.

IV. Legal Evaluation

A. Binding Nature of UBS Agreement under International Law

1. Legal Nature of the UBS Agreement

35. The UBS Agreement was signed on behalf of Switzerland by the interim Chargé d'Affaires at the Swiss Embassy in Washington, and on behalf of the USA by the Deputy Commissioner (International) IPRs, and put into effect upon signature. This raises the question as to whether this was sufficient to ensure the validity of the Agreement under both international and domestic law.

36. A treaty is a legally binding agreement between two or more subjects of international law[9]. Under customary law, the parties concerned must hold the corresponding power of attorney for the agreement to be validly established. However, the form that the agreement takes is unimportant[10]. The legally binding effect of agreements under international law rests first and foremost on the will of the parties concerned to make certain undertakings[11]. Where the parties differ in this regard, commitments may arise owing to legitimate expectations, and thus owing to good faith[12]. This applies in the same way to all contracts. The same rules are applied irrespective of whether the document in question is a treaty approved by parliament or an agreement that is put into effect by the government directly.

37. The provisions of the Vienna Convention on the Law of Treaties (referred to below as the VCLT) are stricter than the general rules of customary law. Switzerland acceded to this convention on May 7, 1990[13]. Under Art. 2 para. 1 (a) VCLT, a "treaty" exists where there is an international agreement between two states that is in written form and governed by international law. Consequently, the scope of the VCLT is restricted to written treaties between states (Art. 1 VCLT). Neither the designation chosen by the contracting parties, nor the fact that such a treaty may consist of several instruments, is relevant to the legally binding establishment or the validity of a treaty (cf. Art. 2 para. 1 (a) VCLT). Registration under Art. 102 para. 1 of the UN Charter[14] is not a requirement for validity either.

38. The definition of "treaty" under Art. 2 VCLT expresses customary international law[15]. It applies in the present case in that the United States has signed the VCLT, but not ratified it. Provided they are recognized under customary law, the provisions of the VCLT are also applicable in the USA, and thus form the basis of an evaluation of the present contractual relationship. This is true specifically of the VCLT rules on concluding treaties (Art. 7 ff.), retroactive effect (Art. 28) and interpretation (Art. 31 ff.).

39. According to current practice, a treaty between two states exist where the states intend to enter into legally binding relations between themselves, and to comply and, where possible, to enforce the terms of these relations[16]. The case at hand concerns a binding treaty as part of settlement negotiations. Whether or not legal proceedings are held in the USA depends upon compliance with this contract.

40. The object of the treaty must therefore be to govern an international legal relationship. In other

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[9] Further discussion of what follows, taking Swiss practice into account: Müller/Wildhaber, p. 107-152.
[10] Dixon, p. 54.
[11] Seidl-Hoheveldern, p. 8.
[12] cf. also point 109 ff.
[13] SR 0.111.
[14] SR 0.120.
[15] Aust, p. 14; Villiger, Art. 2 margin note 23; generally cf. also Müller Wildhaber, p. 123 ff.
[16] *Frontier Dispute Case (Burkina Faso / Mali)*, ICJ Reports 1986 573 f, with further references

words, it is subject to the rules of international law and not the domestic regulations of one of the contracting parties. This condition is evidently met in the present case. The provision of information is subject to neither US nor Swiss law. Instead, the treaty request process will be conducted in accordance with the criteria agreed in the treaty.

41. Pursuant to Art. 11 VCLT, a state's consent to being bound by a treaty may be expressed in the form of a signature, an exchange of instruments that constitute a treaty, ratification, acceptance, approval, accession or by other agreed means. Consequently, the signature of a treaty by representatives of the contracting parties constitutes the consent of those states to be bound by the treaty, where the treaty itself provides that signature shall have that effect (cf. Art. 12 para. 1a VCLT). In the present case, signature is deemed to express consent to being directly bound by the treaty[17].

42. Pursuant to its Art. 8, the UBS Agreement and any amendments thereto (Art. 9 UBS Agreement) enter into force upon signature. Furthermore, when the Agreement was signed on August 19, 2009 the parties made and signed declarations which, according to their wording, form an integral part of the UBS Agreement. In these declarations, both the Swiss Confederation and the United States of America emphasize once again their will to be bound by the provisions of the UBS Agreement.

43. For an treaty to be concluded validly, the representative of the state giving its consent to be bound by it must hold appropriate full powers, or if it appears from the practice of the states concerned or from any other circumstances that their intention was to consider that person as representing the state for such purposes and to dispense with full powers (cf. Art. 7 para. 1 VCLT). Certain individuals within a state, such as heads of state, heads of government and ministers for foreign affairs, or even heads of diplomatic missions, are regarded ex officio as representatives of the state in questions, and are not required to produce full powers (cf. Art. 7 para. 2 VCLT).

44. Under the terms of Art. 2 para. 1 c VCLT, "full powers" in the sense of the VCLT means a document emanating from the competent authority of a state that designates one or more persons to represent the state in negotiating or authenticating the text of a treaty, in expressing the consent of the state to be bound by a treaty, or accomplishing any other act with respect to a treaty.

45. It must be noted in the present case that the UBS Agreement is based on Art. 25 para. 3 USA-TT. This provision explicitly grants the competent authorities powers to conclude mutual agreements. Under international law, it therefore creates competence to enter into the treaty at executive and administrative levels.

46. Pursuant to Art. 7 para. 1 in conjunction with Art. 2 para. 1c VCLT, it must be assessed according to domestic law whether the officials who concluded the UBS Agreement held sufficient authorization to represent the Director of the Swiss Federal Tax Administration and the Secretary of the Treasury respectively[18].

47. Pursuant to Art. 7a para. 1 of the Federal Government and Administration Act (FGAA, *Regierungs- und Verwaltungsorganisationsgesetz*) the Federal Council's powers include authority independently to enter into agreements under international law if corresponding provision is made in a treaty approved by the Federal Assembly.

48. The USA-TT is a treaty approved by Parliament. Art. 25 para. 3 USA-TT, on which the UBS Agreement is based, grants the competent authorities the authorization to conclude mutual agreements. The competent authority in Switzerland is the SFTA.

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[17] cf. Villiger, Art. 12 margin note 6
[18] Dixon, p. 62.

49. The "pull" principle is rooted in general administrative law and derives from the hierarchical structure of the federal administration[19]. The pull principle, also known as independent intervention, was implemented in law in the form of the FGAA, which states that the higher levels of the administration and the Federal Council may at any time step in and take over decisions for which an subordinate unit is responsible (Art. 41 para. 4 and Art. 38 FGAA).

50. Considering the statements made above, the Federal Council thus has the authority to take a mutual agreement process that essentially falls within the competence of an lower level of government, specifically the SFTA, upon itself, and to handle the matter itself.

51. Conversely, the Federal Council also has the competence under Art. 48a FGAA, to grant the authority to conclude treaties to lower levels of government. The Federal Council exercised this authority in the context of the UBS Agreement, in that it delegated the competence to sign the Agreement to a representative of the Swiss Embassy in Washington and applied its existing authority under the USA-TT.

52. Even if any doubts were to exist with regard to this delegation of authority, they would not impair the legality of the signature. Pursuant to Art. 46 para. 1 VCLT, a state may not invoke the fact that its consent to be bound by a treaty violated an internal law on competence and is therefore invalid. Such an invocation may be made only if the violation was manifest to the contracting partner in good faith, and concerned a rule of internal law that is of fundamental importance.

53. The Federal Supreme Court also frequently requires the "manifest violation" condition to be met for a treaty to be declared invalid[20]. The same is true of international law practice, under which treaties are only very rarely declared invalid owing to an absence of authority to conclude that treaty[21].

54. The Agreement was signed on behalf of the Swiss Confederation by a representative of the Embassy (Switzerland's interim Chargé d'Affaires). Furthermore, the concluding provisions of the Agreement contain the following passage: "IN WITNESS THEREOF, the undersigned, duly authorized thereto by their respective governments, have signed this Agreement" (emphasis added by the authors). As such, the parties gave mutual contractual assurances of full powers on the part of their representatives.

55. The Swiss Confederation therefore expressed its consent to be bound by the treaty by signing the latter. The counterparty may thus assume without reservation and in good faith that the Swiss Confederation is committed to that treaty.

2. The UBS Agreement as a Mutual Agreement under Art. 25 USA-TT

56. The UBS Agreement is based on Art. 25 USA-TT. This provision states that the competent authorities in the states parties must make every effort to eliminate by mutual consent any and all doubts or difficulties in the interpretation or application of the double taxation treaty. In particular, the competent authorities in the states parties may consult each other, in order to achieve agreement about their common interpretation of an expression[22]. Art. 3 para. 1 f USA-TT determines the "competent authority" as (i) in Switzerland, the Director of the Swiss Federal Tax Administration and (ii) in the United States of America, the Secretary of the Treasury or his representative.

57. Some of the academic literature in Switzerland puts forward the opinion that mutual

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[19] Tschannen/Zimmerli/Müller, p. 46
[20] Federal Supreme Court Ruling 120 Ib 360 E. 2c: "Thereafter, a state cannot plead that its consent to be bound by a treaty was given in violation of one of the provisions of its domestic laws on the delegation of powers and is thus invalid, unless the violation was evident and concerned a domestic legal regulation of fundamental importance".
[21] Dixon, p. 63.
[22] Art. 25 para. 3 f USA-TT.

agreements should not lead to amendments to or completions of existing material provisions in a way that would result in new rights or obligations for the states parties[23]. It must be noted, however, that some of these academic opinions mix issues of binding nature under international law with those of domestic applicability. These two levels must be treated separately. Once the binding nature under international law of mutual agreements which amend or complete other agreements has been established, we must ask the next question: is the amendment also binding on domestic courts[24]? The remarks that follow therefore begin by looking more closely at the nature of the mutual agreement procedure from the international law perspective.

58. Mutual agreements are an extremely flexible instrument for dealing in an agreeable and straightforward way with difficulties that may arise within the scope of a double taxation treaty, without states having to renegotiate an agreement and go through the ratification process again, with the attendant delays[25].

59. According to the commentary to the standard OECD Convention, which is of central importance to the interpretation of the double taxation treaty according to the precedent of the Federal Supreme Court[26], as part of the mutual agreement procedure the competent authorities may *subsequently complete or clarify expressions that are defined incompletely or ambiguously in the Agreement, in order to prevent any difficulties*[27]. The OECD Commentary states that, in the context of mutual agreements to resolve a specific case, the contracting parties are authorized not only to interpret the agreement, but also to add to it and to close any loopholes.

60. The literature therefore classifies the mutual agreement procedure as a political dispute resolution instrument that, rather than presenting a solution under strict legal criteria, seeks instead to consider all of the circumstances involved and facilitate an equitable, unforced agreement between subjects of international law[28]. The states parties endeavor to loosen up the legal rigidity of treaties by introducing a more flexible element, which is often better able to meet casuistic needs as they change over time[29]. In our view, this ultimately also expresses the idea of equity, which should allow case-by-case solutions even under international law for other groups of cases[30]. From this perspective, then, the mutual agreement clause in Art. 25 USA-TT contains authorization to institute new rules and to amend old ones under international law[31]. Academic literature thus also regards the interpretation agreement as a treaty which completes the double taxation treaty. It centers on an authentic interpretation of the TT and, where necessary, on its amendment[32]. If a mutual agreement serves the execution and interpretation of an existing treaty, it is deemed to be a non-self-standing agreement. However, if it results in a change to existing agreements or to the establishment of new regulations under international law, it constitutes a self-standing mutual agreement[33] that completes the existing tax treaty. As such, it is clear that, when entering into mutual agreements, Art. 25 USA-TT does not impose any content restrictions on the two states

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[23] For example, see Boss, 602; Ludwig, p. 75; Lüthi, p. 398 f; Lüthi 1993 p. 435
[24] Just as Kerath, p. 258
[25] cf. also Lüthi, p. 389; Studer, p. 192.
[26] Federal Supreme Court of 6 May 2008, 2C.276/2007, E 3.4; Locher, p. 130 f; Matteotti 2003, p. 261
[27] OECD Commentary, section 34 on Art. 25 para. 3
[28] Pertinent: Reich, p. 40
[29] Explicitly: Reich, p. 40 with further references
[30] On the current position of equity in international law, please refer to Christopher R. Ross, *Equity and International Law, A Legal Realist Approach to International Decision-making*, New York 1993; Kolb, p.105 ff; V.D. Degan, *L'equité et le droit international*, The Hague 1970; Charles de Visscher, *De l'equité dan le règlement arbitral ou judiciaire des litiges en droit international public*, Paris 1972; Judge Weeramantry, *Separate Opinion, Case Concerning Maritime Delimitation in the Area between Greenland and Jan Mayen (Denmark v. Norway)*, ICJ Rep. 1993 p. 211-279; Müller/Wildhaber, p. 60-69
[31] cf. Koch, p. 42; Reich, p.104.
[32] Lehner, in: Vogel/Lehner, DBA, Art. 25 margin note 154 – in this regard please refer also to Studer, p. 190, 198,200, where reference is made among other things that mutual agreements are also used in practice to close "false gaps".
[33] Reich, p. 104

parties, provided the object of the regulation falls within the specific scope of the tax treaty, and it concerns the application or interpretation of *incompletely or ambiguously defined provisions in the treaty*.

61. The UBS Agreement constitutes a mixed accord that contains provisions that both complete and interpret the treaty. Switzerland undertakes to conduct the process (i.e. handle the cases falling within the treaty request) within certain periods. Here, the criteria given in the Annex for the identification of those US-domiciled UBS clients affected by the information exchange, as well as the Annex provisions that determine what constitutes "tax fraud or the like" in the context of this specific request for information, form the legal foundations for the SFTA's rulings under Art. 20j USA-TT-O.

62. The clause concerning the number of decisions that the SFTA must render within specific periods, the contractual waiver of naming the individuals concerned, and the contracting parties' agreement that Deferred Prosecution Agreement fulfills the "reasonable suspicion" condition for a treaty request process and presents the grounds sufficiently, constitute additions to the existing Tax Treaty and to the agreements on the evaluation of facts – and thus to the application of the agreement – in the treatment of the UBS case. Meanwhile, the criteria listed in the Annex serve contractually to clarify the precise meaning of "tax fraud or the like" in the handling of this specific UBS case in the here and now. The rules laid down in the UBS Agreement therefore comply with Art. 25 USA-TT, even if under Art. 26 USA-TT they are regarded as completing certain aspects of the treaty request process for handling the UBS affair, and also seek to amend the states parties' original understanding of the rather vague "and the like". In consideration of the opinion given in the OECD Commentary, the UBS Agreement remains binding under international law for as long as the competent authorities do not amend or terminate it[34].

[34] OECD Commentary, margin note 36 on Art. 25.

3. Relationship between the UBS Agreement and the USA-TT and its Protocol

63. In the opinion put forward here, the UBS Agreement therefore constitutes a treaty under international law that contains elements that not only create contractual obligations, but also interpret other contractual provisions. We must thus address the question of the relationship between the UBS Agreement and the USA-TT and its Protocol, as well as the extent to which clashes between the two instruments are to be resolved.

64. Under international law, the two agreements are at the same level. With the exception of the UN Charter, there is no hierarchy among treaties under international law[35]. Art. 30 VCLT governs the mutual relationship as follows:

65. Pursuant to Art. 30 para. 3 VCLT, the *lex posterior derogat legi priori* rule applies if the parties to an earlier treaty (the USA-TT in the present case) conclude a new treaty without suspending or terminating the earlier treaty. In this case, the earlier treaty applies only to the extent that its provisions are compatible with the later treaty[36]. Conversely, if a treaty specifies that it is subordinate to, or that it is not to be considered as incompatible with, an earlier or later treaty, then under Art. 30 para.2 VCLT, the provisions of that other treaty prevail.

66. As the UBS Agreement, in comparison with the USA-TT, represents not only a *lex posterior*, but also a *lex specialis*, which takes precedence over *legi generali*, it need not be decided here whether one or the other of these principles takes precedence[37].

67. Whether the UBS Agreement is subject to the USA-TT and its protocol in the sense of Art. 30 para. 2 VCLT (meaning that the TT and its protocol take precedence), or whether the different agreements are of equal status (which would mean that the principles of *lex posterior* and *lex specialis* apply*)*, must be established by an interpretation of the relevant provisions.

68. The UBS Agreement contains no explicit provision concerning its relationship with the USA-TT. The declaration made by the states parties in the preamble, that they have a mutual respect for each other's rule of law and that the UBS Agreement is based on Arts. 25 and 26 USA-TT cannot, in isolation, be construed to mean that the UBS Agreement is subordinate, because it is recognized from the international legal perspective that a mutual agreement may include provisions that complete or amend a treaty in order to resolve an existing conflict between states.

69. With regard to the treaty amendment function, the Agreement constitutes a self-standing treaty, which exists alongside the existing USA-TT and serves to regulate a specific case. As a result, the *lex posterior* rule under Art. 30 para. 3 VCLT applies. Consequently, the UBS Agreement essentially takes precedence over the USA-TT in the specific case of the UBS treaty request process. The UBS Agreement is therefore authoritative under international law and, in conjunction with the USA-TT, forms the basis of the treaty request process in the UBS affair to the extent that the two instruments are compatible. In the present case, the USA-TT and its Protocol, or other mutual agreements, must be interpreted and applied in the light of the UBS Agreement, and may be applied in the UBS treaty request process only if the UBS Agreement does not contain any provisions to the contrary.

70. The argument that information exchange *per se* is not possible beyond the scope of the Art. 26 USA-TT that the contracting parties originally agreed cannot be used either to support the subordinate nature of the UBS Agreement. The academic literature has, based on the wording and the purpose of the treaty request clause, good reason to take the position that information exchange should be possible

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[35] Seidl-Hoheveldern, p. 7.
[36] cf. Villiger, Art. 30 margin note 13
[37] On the academic debate in this regard, please refer to Vranes, p. 392

beyond Art. 26 para. 1 of the OECD's model agreement if a sufficient legal foundation exists[38]. As a result, foreign tax authorities may obtain information via either the official assistance or judicial assistance channels, providing the corresponding conditions are met[39]. The same must also apply where treaties contain additional foundations. The conclusion of the UBS Agreement under Art. 25 and 26 USA-TT gives the United States and Switzerland a further instrument under international law, on the basis of which information may be exchanged in handling the UBS case.

71. This finding is consistent with the principles of interpretation laid down in the VCLT. Pursuant to Art. 31 para. 1 VCLT, a treaty must be interpreted in good faith in compliance with the meaning ordinarily attached to its provisions in the given context and in the light of its object and purpose. Art. 31 para. 3 a VCTL states that, beyond this context, any subsequent accord between the contracting parties concerning the interpretation of the treaty or the application of its provisions must be considered in the same way. Consequently, according to Art. 31 para. 4 VCLT a special meaning must be attached to a specific expression if the parties so intended.

72. To the extent that the UBS Agreement applies a number of criteria to give a more precise definition of the vague expression "tax fraud or the like" in Art. 26 para. 1 USA-TT for the purposes of the UBS treaty request process, it takes on the nature of a "subsequent agreement on the interpretation of the treaty or the application of its provisions", and thus represents an authentic interpretation by the contracting parties in connection with this specific UBS case. According to the OECD Commentary[40], a subsequent agreement on interpretation or application is permitted and may be sought by the states parties, especially if the parties originally took a conscious decision to formulate a clause in the treaty in open terms. This was the case with the phrase "tax fraud or the like", in order to prevent the failure of treaty negotiations. Owing to changing circumstances, this creates a need at a later date for a certain mutual interpretation of the originally unclear or open clause.

73. Based on the precept that the contracting parties alone hold power over a treaty that has been duly concluded, a subsequent agreement on an authentic interpretation must not only fall within the ordinary meaning as per Art. 31 para. 1 VCLT, but may also attach a different, special meaning in the sense of Art. 31 para. 4 VCLT to an expression in the agreement, this meaning differing from the earlier understanding. This helps the person or authority applying the law, because it corresponds to the expectations of the contracting parties[41].

74. In summary, it should be stated that, from the perspectives of international law, *lex posterior* and *lex specialis*, the UBS Agreement is to be given precedence over the USA-TT and the related Protocol. The Tax Treaty and the Protocol are applicable to the UBS treaty request process only to the extent that they are compatible with the UBS Agreement. Insofar as the UBS Agreement contains an authentic interpretation of a vague TT provision it must be observed, irrespective of whether it merely confirms an earlier interpretation, or changes it.

4. Retroactive Effect of the UBS Agreement

75. The UBS Agreement has the potential to worsen retroactively the legal position of the UBS clients who are domiciled in the USA or are US citizens, whether by lowering the requirements for the treaty request process under procedural law, or by expanding the material scope of the Tax Treaty. We must examine whether the UBS Agreement being linked retroactively to past tax periods complies with provisions under international law.

76. Pursuant to Art. 28 VCLT, treaty provisions under international law are not binding on a contracting party in respect of any act or fact that occurred before the treaty entered into force. This principle, which is recognized as a general principal of law and thus also under customary international

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[38] Engelschalk in: Vogel/Lehner, DBA, Art. 26 margin note 26.
[39] See also Honegger/Kolb, p. 793.
[40] OECD Commentary, margin note 34 to Art. 25 para. 3
[41] Van DAmme, p. 347; Villiger, Art. 31 margin note 16: Vogel in Vogel/Lehner, DBA, introduction margin note 135.

law[42], is negated if it is clear from the treaty or from the circumstances that the intention is otherwise. Specifically, this is the case if the object of the treaty relates solely to pre-existing facts and acts[43].

77. It is not entirely certain from the wording of Art. 28 VCLT whether the UBS Agreement has any kind of retroactive effect that is relevant under international law. It might be argued that the UBS Agreement has a retroactive effect because it creates a new legal basis for a current treaty request process, even though official assistance is to be granted only in cases that occurred in the period between 2001 and 2008. Conversely, however, it may also be argued that there is no real retroactive effect, because the Agreement does not apply to treaty request processes that are already pending, and that the general public must expect changes to legal foundations at any time, with these changes also relating to facts in the past.

78. With regard to the temporal scope set out in Art. 26 OECD-MA, the OECD Commentary takes the position that, even without any specific retroactive effect clause, double taxation law does not stand in the way of an official assistance clause being applied to the exchange of information that existed before the Agreement came into effect, provided the official assistance is provided in respect of this information in accordance with the Agreement, and the provisions of the article have become applicable[44]. According to the OECD Commentary, the retroactive linking of official assistance to past tax periods therefore does not constitute an unlawful retroactive effect. This point of view has also been taken by the Federal Supreme Court on a number of occasions that concerned the USA-TT[45]. Whether the broad perspective of the OECD and the Federal Supreme Court is reconcilable with Art. 28 VCLT need not be determined here, since it is the will of the contracting parties that the UBS Agreement should have a retroactive effect.

79. It is clear from the Agreement that the parties are not referring to facts in the future, but rather wish to conduct a treaty request process on the basis of the UBS Agreement in respect of facts that occurred in the past. Indeed, the Agreement was created specifically to govern those facts. Even if a retroactive effect is assumed, this is the clear intention of the parties and ensues from the purpose of the Agreement. The criterion laid down in Art. 28 VCLT, which states that the intention of the parties to circumvent the ban on retroactive effect must be evident from the Agreement or by other means. No unlawful retroactive effect thus exists under international law.

80. One of the particular features of the UBS Agreement is that, under its Art. 6, publication of the Annex was deferred, to November 17, 2009. The objective was to create an incentive for US-domiciled UBS clients to participate in the IRS Voluntary Compliance Program. This raises the issue as to whether this is ultimately associated with an unlawful retroactive effect. It might be argued that the criteria in the Annex were known to the authorities alone, but not the individuals concerned, for 90 days, thereby limiting the latter's rights of defense. The authorities would thus have been able to prepare decisions, without private individuals having the same resources to conduct their own enquiries during this period. However, a key point here is that this effect had been contractually agreed, and would therefore not be a retroactive effect in breach of Art. 28 VCLT. Consequently, the criteria were in the public domain when the decisions were published, and could be used in full during the 30-day appeal period. Furthermore, pursuant to Art. 6 of the UBS Agreement, the SFTA will inform those concerned about the content of the Annex even before the 90-day period expires, so that these individuals may begin examining the relevant documentation before the Annex is published in the Official Gazette. In this sense, the UBS Agreement does not apply the Annex criteria with retroactive effect to matters that have already been decided. From the international law perspective, this does not constitute an after-the-fact legal situation that cannot be remedied in appeal proceedings.

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[42] Villiger, Art. 28 margin note 13.
[43] Australian High Court, Case *Victrawl Pty Ltd v Telstra Corporation Ltd et. al.* (1995), para. 30, as well as the *Ambatielos* case, ICJ Reports (1952) 40
[44] OECD Commentary, margin note 10.3 on Art. 26
[45] Federal Supreme Court on February 6, 2002, 2A.250/2001 E.3 = Pra 2002, no. 52 p. 283 = StR 57/2002, p. 410; Federal Supreme Court on March 12, 2002, 2A. 416/2001, E.2.2.; Federal Supreme Court on April 12, 2002, RDAF 2002 II, 303, E.2a; Federal Supreme Court on December 22, 2003, 2A.233/2003, E.1.

B. Domestic Applicability of the UBS Agreement

1. INTRODUCTORY REMARK

81. This section investigates the conditions that must be met for the UBS Agreement to be applied domestically. It looks into the authoritative nature of international law and then goes on to analyze the extent to which the provisions contained in the UBS Agreement are directly applicable. Finally, the applicable foundations for legal action, and their relationship to the Agreement, are established.

2. PRECEDENT AND AUTHORITATIVE NATURE OF INTERNATIONAL LAW

82. In regular constitutional practice, Switzerland observes the principle that international law takes precedence over national law, including the federal constitutional law[46]. It follows the monistic tradition. Treaties are thus not transformed into national law. They are binding on authorities and the courts and are suitable for direct application. Art. 5 para. 4 and Art. 190 of the Federal Constitution[47] are authoritative also in the present case. These provisions state that the federal government and the cantons must observe international law. Federal statutes and international law are binding on the Federal Supreme Court and the authorities that apply the law.

83. The present context raises the question as to how the phrase "international law", as used in Art. 190 of the Federal Constitution, should be understood. According to prevailing opinion and legal practice, international law encompasses all forms of agreement under international law that Switzerland has concluded, irrespective of their place in the legal hierarchy, i.e. regardless of whether these contracts were approved by the Federal Assembly or, in some cases, by the Swiss people[48].

84. This definition of international law also encompasses treaties that are valid under international law but which were concluded by the Federal Council in breach of constitutional and statutory provisions on the delegation of authority[49]. The Federal Supreme Court confirmed this explicitly in its benchmark ruling of October 27, 1994[50]. The dispute in this ruling was the validity under international law and applicability by the courts of convention on the settlement of Swiss and Austrian citizens concluded by the Federal Council and the Austrian government. The version that was valid at that time stated that, after an uninterrupted stay of ten years in Switzerland without incident, Austrian citizens were entitled to a permanent residence permit. The Federal Supreme Court established that neither the treaty on which this right was based, nor national legislation, contained a provision that gave the Federal Council, in concluding the convention, the competence to grant a permanent residence permit. It nonetheless regarded the treaty as binding and applicable by the courts. In support of its decision, it cited Art. 46 VCLT, which states that a state may not invoke the fact that its consent to be bound by a treaty was expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance. However, were Switzerland to be bound to a treaty outside its competence on the basis of Art. 46 VCLT, then all state agencies would have to comply with and apply the international law regulation to the extent it were in force for Switzerland. Consequently, not even a judge could invoke the fact that domestic competence arrangements were not observed when the treaty was concluded in order to prevent the application of a treaty that is binding under international law.

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[46] In detail: Cottier/Hertic, p. 13 ff and Cottier/Ackermann/Wüger/Zellweger, p. 33 ff.
[47] SR 101
[48] In detail: Cottier/Ackermann/Wüger/Zellweger, p. 33 ff.; Thürer, p. 187 f.
[49] Hangartner, in Ehrenzeller et al, *Kommentar BV*, Art. 190 Federal Constitution margin note 25.
[50] Federal Supreme Court ruling 120 Ib 360 E. 2-3.

85. As a result, the entire body of international law that becomes binding on Switzerland on the principle of good faith falls within the proportionality precept of Art. 190 of the Federal Constitution[51]. This also applies to the UBS Agreement, even if the latter, according to an opinion not shared here, should not have been concluded on the basis of Art. 25 USA-TT alone, and should have been approved by Parliament under Art. 7 para. 2 a FGAA. Furthermore, attention should be drawn to the fact that the Federal Assembly, in executing Art. 1 of the UBS Agreement, approved an increase in the number of judges at the Federal Administrative Court in order to handle the anticipated additional work. The corresponding parliamentary ordinance entered into force on November 1, 2009[52]. From this, it can be concluded that the Federal Assembly also assumes that the Agreement is binding. In good faith the executive's competence to conclude treaties therefore cannot be questioned again *ex post.*

86. In the light of these considerations, even if it was concluded in violation of competency regulations, the UBS Agreement constitutes international law in the sense of Art. 190 of the Federal Constitution.

3. Direct Applicability of the UBS Agreement

87. The question as to how far the provisions of the UBS Agreement are applicable directly is a separate issue from the Agreement's validity under international law and its authoritative nature in domestic law. Within the scope of their binding nature, provisions in international law may be applicable directly or may require enactment and implementation in national law as programmatic statutes. The issue can be decided under international law, but is generally a matter for constitutional law and must be decided by an autonomous interpretation by the authorities and the courts.

88. According to the consistent legal precedent of the Federal Supreme Court, a provision under international law is applicable directly if its content is sufficiently specific and clear to form the basis of a decision in a given case. Regulations which merely outline a matter, which permit the state party considerable scope to exercise its own discretion or to make its own determinations, or which simply contain guidelines intended for legislators rather for the authorities applying the law, are not deemed sufficiently specific[53].

89. Consequently, three conditions must be fulfilled for a provision in a treaty to be suitable for direct application: (i) The provision must give rise to rights and duties on the part of private individuals. (ii) The content of the provision must be specific and clear; in other words, it must concern a clearly defined fact and it must describe its legal consequences. (iii) Finally, the provision must be intended for the executing authorities[54]. Furthermore, in some of its rulings the Federal Supreme Court has also considered the overall nature and objective of the entire treaty[55].

90. More recent teachings emphasize the justiciability maxim. Regardless of a regulation's wording, density and clarity, this approach looks at whether it fits with the remit of an execution authority or a court – in other words whether it falls within their jurisdiction given the division of powers, and whether the authority is suitable to apply that regulation[56]. From this perspective, even vague and unspecific provisions on basic rights would be justiciable to a large degree. In fact, adding flesh to legal bones is one of the core tasks of the courts. Such provisions are thus directly applicable.

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[51] Hangartner, in Ehrenzeller et al, *Kommentar BV*, Art. 190 Federal Constitution, margin note 25
[52] SR 173.322; AS 2009 5023.
[53] cf. Federal Supreme Court Ruling 126 I 240, E.2.b, with references
[54] Wüger, p. 233 ff.; cf. also Kälin/Epiney, p. 108
[55] cf. Federal Supreme Court Ruling 105 II 49, E.3.a
[56] Cottier/Ackermann/Wüger/Zellweger, p. 24; Wüger p. 248.

91. This raises the question as to whether the present Agreement is directly applicable not only under Federal Supreme Court precedent, but also according to more recent teaching. The Agreement and the Annex must be examined separately in this regard.

92. The provisions of the Agreement are aimed primarily at the relevant authorities in Switzerland and the USA. The Agreement sets deadlines for the treaty request process and the gradual withdrawal of the John Doe Summons enforcement proceedings. It imposes obligations on FINMA and the Federal Office for Justice in respect of the supervision of UBS AG, and lays down the procedure that the contracting parties must follow should differences arise in the implementation of the Agreement. However, the obligations it contains also affect the legal position of private individuals. They are of direct concern to UBS AG and to its clients. Considerable legal disadvantages would be the result if the authorities did not comply with the regulations set out in the treaty. Just as very little distinction is made today between statutory and administrative ordinances with a purely domestic effect[57], it is almost impossible to distinguish between purely internal provisions on the basis of their indirect reflective effect. Essentially, then, the provisions of the Agreement are not excluded from direct application. Whether or not such direct application is possible in practice will have to be decided on a case-by-case basis according to the degree to which the legal positions of legal subjects are affected in a given dispute. The situation is different only where there are cases involving third parties. Art. 7 of the UBS Agreement determines that it does not confer any rights or benefits on any third party other than as provided with respect to UBS AG. Therefore, third parties cannot claim to be directly affected by the Agreement.

93. The will of the parties (cf. Art. 1 para. 1 of the UBS Agreement) is that the criteria given in the Annex form the legal foundation for the treaty request process under Art. 26 USA-TT. The final decisions of the SFTA in accordance with Art. 20j USA-TT-O rest on these criteria. They concern the legal positions of natural and legal persons. If the latter fall within these criteria, and the "identified specific wrongful conduct" condition has been met, then they are included in the treaty request process and must expect information on them to be handed over to the US tax authorities.

94. The provisions in the Annex to the UBS Agreement contain criteria that may be used to determine whether or not the identification condition has been fulfilled (cf. section 1 of the Annex to the UBS Agreement), yet they also lay down conditions that must be fulfilled to give a reasonable suspicion of "tax fraud or the like" (cf. section 2 of the Annex to the UBS Agreement).

95. The criteria in the Annex are tightly defined and leave the executing authorities with little or no room to exercise their discretion. The precondition for the actions that are described is a reasonable suspicion, arising from certain behaviors that are laid down in detail in the Annex. These behaviors include the deliberate withholding of information using "schemes of lies", or the submission of incorrect or false documents over a longer period. Certain thresholds also apply. The regulations contain a high level of detail. They are clearly formulated and are therefore suitable as a basis for specific and separate application in individual cases.

96. The direct applicability of the Agreement and its Annex would be called into question only if it were assumed that the Agreement had been concluded in breach of domestic competence regulations. Contrary to Federal Supreme Court practice, recent teaching takes the view that direct applicability should be ruled out in such cases in favor of implementation by the competent legislator. This would have to be the case in particular where fundamental aspects of basic rights, such as intervention in the property, personal freedom and privacy of the individual are concerned[58].

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[57] Tschannen/Zimmerli/Müller, p. 372.

[58] Cottier/Ackermann/Wüger/Zellweger, p. 25.

97. These conditions for official implementation are not met here, however. As discussed above, the Agreement was concluded on the basis of the relevant provisions of the USA-TT, which grant the executive the corresponding authority to conclude treaties. The Agreement was also indirectly and tacitly approved by Parliament, which instituted the corresponding support measures. In our view, no domestic competence regulations have been violated, neither can any such violation be claimed in good faith. Since the Agreement of November 17, 2009 is to be published in the Official Compilation of legislation, in accordance with Art. 3 para. 1 b of the Official Publications Act[59], it will also have a legal effect on the taxpayers it covers.

[59] *Bundesgesetz von 18. Juni 2004 über die Sammlungen des Bundesrechts und das Bundesblatt* (Federal Act of 18 June 2005 on the compilations of federal law and the Federal Gazette); SR 170.512

98. In summary, the provisions of the Annex, as well as (under certain circumstances) those of the UBS Agreement are directly applicable. They are suitable as a basis for specific decisions according to both the criteria of Federal Supreme Court practice and those of justiciability under the modern school. The Agreement can be applied without the need for the competent authorities and courts to enact further legal regulations. Such authorities and courts are much better suited than the legislators to administering the Agreement.

4. Procedural Foundations

99. The procedure that applies to the treaty request process under the UBS Agreement rests on the one hand on Art. 26 USA-TT and on the other on section 4a of the USA-TT-O. These provisions thus become a part of the Agreement. In the present process, they must be observed by Switzerland and recognized by the USA.

100. While Art. 26 USA-TT contains the general conditions for an exchange of information as part of a treaty request process, the related Ordinance sets out the information exchange procedure in greater detail. The relevant section 4a of the Ordinance not only governs in greater depth the procedure between the authorities involved, but also sets out the rights of the individuals concerned and the implementation of any coercive measures that prove necessary. Further, this section addresses the issue of legal protection. Persons against whom the SFTA has issued a final decision in the sense of Art. 20j USA-TT-O permitting the handover of information to the US authorities, may lodge an appeal against that decision with the Federal Administrative Court. Legal protection is thus guaranteed.

101. The Ordinance on the USA-TT was enacted by the Federal Council on June 15, 1998 on the basis of the Federal Decree of June 22, 1951[60] concerning treaties entered into by the federal government to avoid double taxation, and in execution of Art. 25 para. 5 USA-TT.

102. The Federal Decree of 1951 was issued on the basis of Art. 8 a and Art. 85 points 2 and 5 of the old Federal Constitution, and approved by the Federal Assembly. It was also subject to a voluntary referendum[61] – an option that remained unused.

103. Individual commentators have expressed the opinion that the procedural provisions of the USA-TT-O might encroach upon basic rights and that the Ordinance together with the Federal Decree do not constitute a sufficient foundation in law[62]. The Federal Administrative Court rejected this argument. It identified no encroachment on basic rights, especially since the provisions of the Ordinance observe guarantees of due procedure and permit legal protection for those concerned. It therefore deems the Federal Decree of 1951, in conjunction with the USA-TT-O, as a sufficient legal basis on which to conduct the information exchange procedure[63].

104. In its ruling 2A.250/2001, based on the delegation clause in Art. 2 para. 1 d of the Federal Decree of 1951, the Federal Supreme Court also expressly recognizes the provision of Art. 20k USA-TT-O that governs channels of appeal in the exchange of information as constituting a sufficient legal foundation[64]. In a variety of other judgments, the Federal Supreme Court does not make any further explicit statements in this regard, but instead tacitly assumes that a sufficient legal foundation exists[65].

105. The Federal Administrative Court also deemed there to be no justification for the criticism

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[60] SR 672.2
[61] See Federal Council Message to the Federal Assembly on the administration of international agreements concluded by the Federal Government to avoid double taxation, Federal Gazette 1951 II 296, 304.
[62] Schweizer, margin note 5 ff.
[63] Federal Administrative Court ruling of March 5 2009, ASA 77 (2009) p. 840 ff, E. 1.1.
[64] Federal Supreme Court of February 6,2002, 2A.250/2001 E. 3 = StE 2002, A. 31.4 no. 6 = StR 57/2002 p. 410 ff.
[65] cf. Federal Admininstrative Court ruling of January 26, 2009 A-5529/2008 E.1.1; Federal Supreme Court on January 27, 2004, 2A.185/2003; Federal Supreme Court on December 22, 2003, 2A.233/2003 E. 1 and 2; Federal Supreme Court on March 12, 2002, 2A.416/2001, E.1.1 and 5.3

leveled by some commentators that the comprehensive delegation of authority in the Federal Decree was unlawful, and that the procedural provisions had therefore been enacted at too low a level of law. The Court found that, instead, the legislator had consciously delegated powers to the Federal Council in order not to encumber the Federal Decree with individual regulations of a technical and procedural nature, especially since the regulations should factor in practical needs, and the regulation would repeatedly have to be revised quickly if there were any unforeseen change in circumstances, such as amendments to tax legislation[66].

106. This consideration on the part of the Federal Administrative Court is consistent with Federal Supreme Court precedent, according to which the requirements that must be met to satisfy the legality principle may not be set too high if the material is highly technical or if the circumstances that are to be governed are subject to constant change, which might in turn result in frequent changes to the legal situation[67]. According to the highest court in Switzerland, the detail that must be given in the delegation provision depends on several factors, and is a matter for evaluation primarily by Parliament and the people, as legislators[68].

107. In summary, it should be noted that the courts have, to date, always deemed the legal basis for the treaty request process to be sufficient. They have steadfastly rejected the opinion expressed in the literature, that the Ordinance does not constitute a sufficient legal foundation for coercive measures. Art. 2 para. 1 d of the Federal Decree of 1951 declares the Federal Council competent to lay down the procedure that must be followed in the exchange of information required under treaty. In particular, this "procedure" includes enforcement using coercive means. This is particularly important, since the effectiveness of a procedure cannot be guaranteed at all if there is no action to enforce it. In this sense, the Federal Administrative Procedure Act[69], which governs administrative procedure, also provides for means of enforcement. Consequently, the ordering of coercive measures lies within the scope of action delegated to the Federal Council by Art. 2 para. 1 d of the Federal Decree of 1951 when the relevant provisions are interpreted from both the grammatical and systematical perspectives. That the subject of the Federal Decree of 1951 primarily concerned the exchange of existing information as part of minor official assistance proceedings does nothing to change this. Since, according to Federal Supreme Court precedent, less importance is attached to the historical aspect of the interpretation[70], it does not challenge the grammatical and systematic approaches. This is especially true since the findings of analysis from these perspectives best reflect Switzerland's obligations under international law to exchange information. Despite the criticism that has been voiced by academics, we thus do not anticipate any change in legal practice to date.

108. Finally, it must be stated that the procedural provisions of section 4a USA-TT-O and the

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[66] Federal Administrative Court Ruling of March 3, 2009, ASA 77 (2009), p. 840 ff. E.1.1
[67] cf. also Cottier 1991, p. 173 ff
[68] Federal Supreme Court ruling Ia 369, 384 E. 6.g.
[69] *Bundesgesetz über das Verwaltungsverfahren* of December 20, 1968, SR 172.021
[70] Federal Supreme Court ruling 100 II 57 – equally Federal Supreme Court ruling of March 14, 2001, 1A.12/2001 E.4.e.bb ("Even according to the general methodological rules of interpretation, the political will of the legislator (...) [must] be expressed adequately in the wording (or "word sense" of the law"); Federal Supreme Court ruling of December 20, 2000, 2A.165/2000 ("However, preparatory work will be taken into consideration only where it clearly resolves an ambiguous legal formulation and is expressed in the wording of the law itself."; Federal Supreme Court ruling 124 II 201 E. 5.c. ("According to Federal Supreme Court precedent, in an interpretation the background materials may be consulted and the will of the historical drafters of the constitution or of legislation may be considered, provided the same are expressed in the text of the statute."); Federal Supreme Court ruling 122 III 325 ("A historical interpretation is not, in itself, authoritative. Preparatory work may not be taken into consideration unless it clearly resolves an ambiguous legal formulation and is expressed in the wording of the law itself."; Federal Supreme Court ruling 114 Ia 191, 196 f ("According to legal practice, background material carries weight only if it can give a clear answer to an unclear legal provision; its importance declines over time (...). Furthermore, they can be accorded decisive importance only where they are reflected in the text of the law.").

associated law established in the UBS Agreement are integrated by reference[71] and thus have a foundation in international law. They must therefore be observed. Even if doubts were to exist about the legal foundation for conducting the treaty request process, they would be eliminated in the specific dispute at hand here.

C. Interpretation of the UBS Agreement

1. Principles of Interpretation Under International Law

109. The interpretation of a treaty always assumes a specific problems that must be assessed. In the present case we can refer only to the general rules and the predominant principles of interpretation which alone are authoritative in the interpretation of the UBS Agreement. An important point is that these principles do not correspond to what is usual in domestic law: an emphasis on object (teleological interpretation), with less attention paid to the actual text and wording. International law is based first and foremost on the ordinary meaning of the wording, but context and good faith are also very important elements[72].

110. Within the bounds of the customary law principles and rules on interpretation laid down in the VCLT, states are essentially autonomous in interpreting treaties. It is therefore entirely possible that contracting parties reach differing interpretations of the same provision[73]. They are, however bound – partly by customary law, partly by contract – to the following basic points.

111. In international law, the principles of interpretation are codified in Arts. 31 to 33 VCLT. Commentaries point out that they are principles and methods, but not hard and fast rules. Under the precept of *pacta sunt servanda* (Art. 26 VCLT), they allow states a degree of scope in choosing which method to apply. The principles are generally followed in state practices, and correspond to the relevant prevailing practice[74].

112. It is now recognized that Art. 31 VCLT – the key interpretation rule in the convention – is a declaratory regulation that restates the basic principles of customary international law[75]. In particular, in a variety of judgments, the International Court of Justice has repeatedly used "customary international law", "reflected in Article 31", and other, similar phrases[76].

113. Rulings issued by the WTO's dispute settlement bodies confirm this approach. Art. 3.2. DSU[77] refers to the "customary" rules of interpretation of public international law which must be applied to clarify the provisions of agreements. In interpreting contractual provisions, the Panels and the Appellate Body have applied Art. 31 VCLT since 1995. In *US – Gasoline*, the Appellate Body held: "[T]hat general rule of interpretation has attained the status of customary or general international law." [78] This legal precedent has since been confirmed many times over[79].
It thus applies to the application and interpretation of all WTO agreements.

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[71] Art. 1. para. 4 UBS Agreement
[72] Matteotti 2007, p. 791; Matteotti 2009, p. 227; Müller, p. 121 ff.
[73] For example, in the assessment of the free trade agreement between Switzerland and the EU, as well as bilateral agreements I and II, where the application and interpretation of the Federal Supreme Court and the European Court of Justice may differ; cf. Cottier/Diebold, p. 237
[74] Van Damme, p. 34 with references.
[75] Villiger, Art. 31 margin note 37
[76] e.g. the *LaGrande Case* (USA/Germany), ICJ Reports 2001 501, para. 99, or the *Kasiliki/Sedudu Island case* (Botswana/ Namibia), ICJ Reports 1999 1059, para. 18
[77] Annex 2 to the Agreement Establishing the World Trade Organization, Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding, DSU), SR 0.632.20
[78] Appellate Body Report on *US – Gasoline*, WT/DS2/AB/R, III.B
[79] Appellate Body Report on *Japan – Alcoholic Beverages* II, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, D., Appellate Body Report on *US – Shrimp*, WT/DS58/AB/R, para. 114, Appellate Body Report on *India – Patents (US)*, WR/DS50/AB/R, para.46

114. The practice of the international courts, and specifically also the WTO Appellate Body, is also recognized by the USA, even though the VCLT is not yet in force there. It is interesting here to take a look at the relevant regulation under US law on the interpretation of treaties. It is contained in § 325 of the Restatement of the Foreign Relations Law of the United States. It states that treaties must be interpreted "in good faith in accordance with the ordinary meaning to be given to its terms in their context and the light of its object and purpose". In addition, as in Art. 31 para. 3 VCLT it states that each subsequent agreement between the parties on the interpretation of a treaty, as well as the parties' subsequent practice in applying the agreement, must be taken into consideration in the interpretation.

115. If we compare the wording of the US provision and that of the VCLT, their material commonalities become clear. Ultimately, the USA applies interpretation rules that are very close to those in the VCLT and in customary law. Although US courts tend to refer to other instruments in their interpretations[80], they regularly reach the same conclusions as the international courts which apply the VCLT interpretation rules[81].

116. Insofar as Switzerland applies the rules of the VCLT to the application and interpretation of the UBS Agreement – as is the practice of the Federal Supreme Court – then it will comfortably be able to satisfy the legitimate expectations of the USA[82].

117. The VCLT's principles of interpretation are laid down in Arts. 31 to 33. Art. 31 VCLT contains the general interpretation rule which regularly forms the starting point and basis for the interpretation of provisions under international law. The supplementary interpretation approach of Art . 32 VCLT is used only if interpretation under Art. 31 VCLT does not produce an unambiguous or rational result. The historical method therefore takes something of a back seat. Finally, Art. 33 VCLT is concerned with the interpretation of treaties authenticated in two or more languages.

118. According to Art. 31 para. 1 VCLT, a treaty must be interpreted by the contracting parties in good faith in accordance with the ordinary meaning attached to the terms of the treaty in their context, and in the light of its object and purpose[83]. Para. 2 states that, in addition to the text, including preamble and annexes, "context" comprises any accord relating to the treaty which was created between all the parties in connection with the conclusion of the treaty, as well as any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. Furthermore, para. 3 stipulates that any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions must be taken into account in the same way. The same applies to any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation. Ultimately, any and all other applicable and relevant legal provisions under international law that are relevant to the relationships between the contracting parties must be taken into account. Particular importance must be attached to one expression if this was the intention of the parties. The following individual perspectives are worth highlighting:

119. The starting point for the interpretation of treaties is thus the text of the contractual provisions concerned, since this text forms the basis of the agreement and thus the shared will of the parties. The text must be interpreted in accordance with the ordinary meaning of the provisions it contains. In contrast to domestic law, as well as the European Court of Justice, the practice of the international courts revolves heavily around the textual interpretation[84]. Here, repeated use is made of legal

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[80] cf. here the practice of the US courts in their interpretation of the double taxation treaty in Matteotti 2005, p. 329
[81] ALI Restatement, p. 198
[82] e.g. Federal Supreme Court ruling 132 II 423, 440.
[83] Brownlie, p. 630 ff.; Jennings/Watts, p. 1266-1275; Müller/Wildhaber p. 127 ff; Villiger Art. 31 margin note 6 ff
[84] cf., for example, Appellate Body on *US – Shrimp*, para. 114

dictionaries, especially in English-speaking countries[85]. In the sense of Art. 31 para. 1 VCLT, the text of the treaty includes all of that treaty's components, including the preamble and the annexes.

120. The context of an agreement is a key element in its interpretation. "Context" in this sense refers not only to the textual context, but also to the broader context of the agreement and the circumstances in which it was concluded. The broader situation and background of a contractual instrument may thus be taken into account in its interpretation. This is of particular importance in the present case, especially.

121. In interpreting the text of a treaty, consideration must be given to the principle of good faith (*bona fides*), to which prominent reference is made in Art. 31 para. 1 VCLT. Good faith is also the core principle of international law, and must always be taken into consideration in the creation and fulfillment of the contracting parties' legal obligations[86].

122. Wide-ranging consequences are attached to the principle of good faith. In interpreting a treaty, the primary focus is on protecting the legitimate expectations that one party has of the other on the basis of perceived attitudes, statements and promises[87]. Consequently, the provisions of the treaty must be accorded the meaning that one might legitimately expect. Furthermore, the principle obliges to parties to act in an honest, fair and reasonable manner, and to refrain from creating an unjustified advantage for themselves. Finally, the principle also prohibits parties from abusing the law. It is intended as a disincentive to parties to evade their obligations or to exploit existing law to cause damage or loss to the other party[88].

123. The ultimate goal of a treaty is another aspect which must be taken into account in the latter's interpretation. Here, the two terms "object" and "purpose" are understood as a unit. With this teleological or functional element, the person interpreting the treaty is also able to consider the parties' intentions beyond the restricted wording of the text itself[89].

124. If we view findings concerning the object and purpose of a treaty in concert with the principle of good faith, then we achieve an effective interpretation of that treaty's provisions (*effet utile*). In practical terms, this means that optimum effect is attached to all of the terms of the treaty[90]. It must be remembered at all times that the text of the treaty itself sets the legal boundaries. An effective interpretation may not extend beyond these boundaries[91].

2. Elements in the Interpretation of the UBS Agreement in General

125. The UBS Agreement constitutes a settlement agreement between the Swiss Confederation and the United States of America. As described above, although the Agreement is based on the USA-TT, it is not subordinate to it. Rather, it complements its provisions or amends them in respect of this specific dispute. It is not only *lex posterior*, but also *lex specialis* with regard to the USA-TT. The following perspectives are of particular importance in its interpretation:

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[85] The Panels and the Appellate Body in the WTO dispute settlement process regularly use this method. cf. Wolfrum, ARt. 3 DSU, margin note 20.
[86] *Nuclear Tests Cases*, ICJ Reports 1974 268, para. 46
[87] Fundamentally Müller p. 134-153, 143; Müller/Wildhaber p. 40-69; for details on the practice Kolb, p. 260-278. Kolb emphasizes the importance of good faith, specifically in autonomous interpretation, p. 264 and in closing gaps, p. 274, without actually addressing the doctrine of the protection of legitimate expectations explicitly.
[88] Villiger, Art. 31 margin note 7
[89] Villiger, Art 31, margin note 11
[90] Wolfrum Art. 3 DSU margin note 36
[91] e.g. Appellate Body Report on *US – Gasoline*, p. 23 with references to the practices of the International Court of Justice

126. The Agreement is limited in scope to a very specific request for information under Art. 26 USA-TT. It is applicable in a defined context (the UBS case) and only temporarily, specifically until the treaty request process has been completed. This point is particularly important. The Agreement must be understood as part of a settlement of a particular dispute, and applied and interpreted accordingly.

127. From the Swiss perspective, the object and purpose of the Agreement is to avert a potential violation of sovereignty by an executory ruling from a US court, and to ensure that Swiss law is enforced in the context of the treaty request process. On the other hand, the Americans wish to identify as many potential UBS clients as possible who may have violated US tax laws. The Parties negotiated the UBS Agreement to achieve these ends (cf. Preamble to UBS Agreement). Both of these perspectives must be taken into consideration in interpreting the UBS Agreement.

128. To eliminate this conflict of interest, the USA undertakes to withdraw its enforcement action for its claims in the John Doe summons proceedings and instead, as agreed by treaty, to pursue the request for information process laid down in Art. 26 USA-TT. This eradicates the risk of a violation of sovereignty.

129. In return, Switzerland undertakes to conduct the treaty request process within the periods laid down in the UBS Agreement and, in doing so, to observe the criteria stipulated in the Annex to the UBS Agreement. The Annex criteria determine (i) when it is necessary to identify an individual in a request for information, and (ii) the conditions that must be met for there to be a reasonable suspicion of "tax fraud or the like". Both the process and the material criteria are decisive elements in the application of the Agreement. They must therefore be interpreted in a way that best considers the differing objectives of the treaty.

130. In other words, the Annex forms the legal foundation for the treaty request process. The decisions of the SFTA under Art. 20j USA-TT-O must be rendered on the basis of these authoritative criteria.

131. Since the UBS Agreement is classified as both *lex posterior and lex specialis,* the existing provisions on information exchange in Art. 26 USA-TT and its Protocol may be invoked only when the provisions laid down in the Annex to the UBS Agreement are not relevant to a specific individual case. It must always be remembered, however, that these provisions are compatible with those of the UBS Agreement (conclusion from Art. 30 para. 3 VCLT).

132. It ensues from the foregoing statements that, in rendering decisions and in appeal proceedings before the Federal Administrative Court, there may be no review of whether or not the provisions of the UBS Agreement conform to Art. 26 USA-TT. The evaluation must be made on the basis of the UBS Agreement alone. It is the will of the contracting parties that, in the context of the specific treaty request process under the UBS Agreement, the vague phrase "tax fraud or the like" be interpreted in a specific way that need not necessarily conform to the practice to date[92].

133. The contracting parties are competent to determine such an interpretation. The OECD Commentary states, in fact, that settlement agreements may provide additional detail on expressions that are defined incompletely or ambiguously in a treaty – as is the case here with "tax fraud or the like". This finding would seem to support the possibility of amending certain parts of a treaty by means of settlement agreements. Consequently, doctrine also regards the agreement on interpretation as an agreement under international law that completes the Tax Treaty, the agreement being based on an authentic interpretation of the Tax Treaty, and possibly aimed at amending it[93].

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[92] See also point 59 ff
[93] Lehner, in: Vogel/Lehner, DBA, Art. 25 margin note 154

134. Such agreements constitute subsequent agreements between the contracting parties on the interpretation of a treaty or the application of its provisions. Pursuant to Art. 31 para. 3 VCLT, such agreements must be taken into consideration in interpreting the treaty in question. In conformity with the rules of international law, the OECD Commentary also states clearly that agreements to resolve general difficulties of interpretation or application are binding on government authorities for as long as the competent authorities do not amend or cancel that agreement.

135. The UBS Agreement should also be understood in this context, although it is unique in that it exclusively concerns the implementation of a specific treaty request, and will end when the treaty request process has been concluded (cf. Art. 10 UBS Agreement). This means that the provisions of the UBS Agreement cannot be applied generally to future requests for information. The provisions of Art. 26 USA-TT apply exclusively to cases which fall outside the scope of the Agreement. The UBS Agreement and the practice based upon it do not reflect upon other treaty request processes.

136. The safeguard clauses in Art. 5 UBS Agreement indicate that the parties themselves regard the Agreement as extra-ordinary. Should there be problems with the administration of the Agreement, then it is these clauses in the Agreement, and not those of Art. 25 USA-TT, which are relevant.

137. Furthermore, in interpreting the UBS Agreement importance must be attached to the legitimate expectations of the contracting parties. Based on the fundamental principle of *pacta sunt servanda* laid down in Art. 26 VCLT, both contracting parties may legitimately expect the Agreement to be implemented. Just as Switzerland may expect that the USA will not enforce its claims by means of an enforcement action before a US court, thereby violating Swiss sovereignty, the United States may assume that Switzerland will conduct the treaty request process in the case of UBS in compliance with the agreed provisions and within the agreed framework.

138. Given the clarity of the situation, there need be no review of alternative interpretation methods under Art. 32 VCLT, neither is Art. 33 VCLT relevant here. Although the UBS Agreement was published in German in Switzerland, the wording of the Agreement gives no indication that it has been authenticated in two languages, German and English. The English text is therefore equally binding.

3. QUESTIONS OF COGNIZANCE IN APPEAL PROCEEDINGS

139. For Switzerland's part, the UBS Agreement is a means of maintaining its legal sovereignty in relations with the USA. It was an answer to a crisis and therefore, to a large degree, an element of foreign policy. This raises the question as to the relationship between executive and judiciary and whether, in evaluating relevant issues, the latter must exercise restraint with regard to the decisions of the executive and of government. The traditional view is that acts of foreign policy may not be examined by the courts. Even today, the Federal Supreme Court Act and the Federal Administrative Court Act stipulate that no appeal may be lodged against such decisions, unless international law grants such a right[94]. Even where decisions may be challenged on the basis of treaties or special laws, the general practice of the Federal Supreme Court is characterized by a certain restraint and respect for the views of the executive. It reflects an earlier tradition, according to which foreign policy was not really subject to the principle of legitimacy, but understood rather as an instrument of power politics. A specific example of this restraint is the application of foreign trade treaties, where their direct application was frequently denied, or restraint shown clearly otherwise by restricting the ban on arbitrariness. This view is no longer appropriate to modern circumstances[95].

140. In the light of globalization, it is no longer materially or legally appropriate to separate domestic and foreign policy. Affected parties deserve full legal protection in both areas. The courts must therefore be able to examine with full cognizance the legitimacy of foreign policy-related action. In doing so, they are bound like all other state bodies by international law and the principle of *pacta sunt servanda*. In other words, they are just as responsible as other state bodies for ensuring compliance with treaties and agreements. Even in delicate foreign policy matters, Switzerland does not apply any doctrine that would be comparable with the US *political question doctrine*. The practice of the Federal Supreme Court permits a deviation from international law in exceptional cases only where provision for that deviation was made deliberately and subsequently by the legislator, and non-compliance with international law is therefore a calculated political move (the Schubert Practice)[96]. Restraint is therefore exercised where issues in the above sense are not really justiciable and require implementation by political and legislative means. These are areas in which the executive and legislation take precedence owing to the division of power and the legality principles. A system of *checks and balances* must therefore be instituted. International law is thus not applied directly.

141. None of these circumstances apply in the present case. The decisions on treaty assistance are primarily based directly on a treaty, and there is no conflict with domestic law. Their eligibility for appeal is based on criteria, rights and obligations laid down in a treaty. As such, appeals may be admitted as legitimate, even if the decisions themselves might be described as an act of foreign policy. It is worth noting in this context that the courts have always allowed appeals in matters of official and legal assistance, and have never dragged their feet in examining the corresponding decisions. They have ruled on these decisions with full and free cognizance, with a view to the legal protection of the interests of those concerned.

142. This practice must also be applied in the present case. The contractual John Doe Summons criteria in the Annex contain rights and obligations for individuals, compliance with which must be ensured to the fullest extent by the courts. In the case of appeal proceedings, the Federal Administrative Court must examine whether or not the SFTA has applied the provisions of the Annex to the UBS Agreement correctly. The courts enjoy full cognizance in this respect.

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[94] *Bundesgesetz über das Bundesgericht* of 17 June 2005, SR 173.110, and *Bundesgesetz über das Bundesverwaltungsgericht* of 17 June 2005, SR 173.32

[95] Here, please refer to Cottier 2007, p. 99; Cottier 2009, p. 307

[96] Federal Supreme Court ruling 99 Ib 39; here, please refer to Müller/Wildhaber, p. 171 f with further references; Cottier/Hertig, p. 13 ff; Cottier/Achermann/Wüger/Zellweger, p. 43-65.

4. The Application of the John Doe Summons Criteria in the UBS Agreement in Particular

143. The Annex to the UBS Agreement describes in detail the formal and material conditions that must be fulfilled for Switzerland to provide treaty assistance. Appeal bodies must, if necessary, examine compliance with the John Doe Summons criteria set out in the Annex. Since those producing this Opinion have no specific points of dispute to address, the following statements concentrate on fundamental issues in connection with the application of the John Doe Summons criteria in the treaty request process under the UBS Agreement. Points of dispute that arise independently of the UBS Agreement fall outside the scope of the following analysis and will therefore be restricted to what is necessary for a legal finding in the UBS treaty request process.

144. *Formally*, the contracting parties determine that the absence of names of US-domiciled UBS AG clients in the request for information is not an obstacle to the granting of treaty assistance. On the basis of the presentation of facts in section 4 of the Deferred Prosecution Agreement between the United States and UBS dated February 18, 2009, the contracting parties determine the group of individuals that is to be included under treaty assistance enquiries should further investigations give additional reason to suspect "tax fraud or the like".

145. In describing the formal requirements for the UBS treaty request process, the contracting parties explicitly center their position on the decision of the Federal Administrative Court on March 5, 2009 with respect to the United States' request for information of July 16, 2008[97]. This states with regard to formal requirements that it is irrelevant in the context of treaty assistance whether or not the investigating tax authorities can already name those taxpayers who may have committed tax offenses. Rather, the decision states, it is sufficient that there are grounds to suspect that tax offenses have been committed by third parties which appear in the case dossiers (i.e. taxpayers other than the suspects who are subject to a criminal investigation)[98].If there are sufficient grounds for such initial suspicions – which the states parties have agreed is the case here in their Deferred Prosecution Agreement – then in the view of the Federal Administrative Court, the SFTA can and must undertake its own enquiries into whether sufficient suspicion of tax fraud or the like exists. According to the Court's deliberations, information must be provided if the facts at the time the decision on the request is made support suspicions of tax fraud or the like. It is enough here that the requesting authority's presentation of facts does not contain any obvious errors or gaps and is not self-contradictory, and that it gives sufficient grounds to suspect that a tax offense or the like might have been committed.

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[97] Federal Administrative Court ruling of March 5, 2009, ASA 77 (2009) p. 837 ff.
[98] Federal Administrative Court ruling of March 5, 2009, ASA 77 (2009) p. 851.E 4.3.4

146. Many commentators view the Federal Administrative Court's statements on the formal requirements for the treaty request process as problematic[99]. The United States' request for information dated July 16, 2008 was described as a typical case of a "fishing expedition", for which there is no legal foundation[100].

147. It must be remembered, however, that where the treaty assistance process according to the UBS Agreement is concerned, the Federal Administrative Court is not required to respond to criticisms made in academic literature. From the international law perspective it must uphold the formal requirements described in its decision of March 5, 2009. These requirements rest by reference on a valid international treaty, which is legally binding under international law in completing the existing Art. 26 USA-TT in respect of the UBS case, and is binding on all Swiss state authorities under the terms of domestic law. In those cases in which the UBS Agreement is not applicable, the Federal Administrative Court does not see any reason in international law to rethink the practice founded on its decision of March 5, 2009 and respond to the criticism leveled at it from academic quarters.

148. Completing Art. 26 USA-TT and section 10 of its Protocol, in the UBS Agreement the contracting parties agree the criteria determining "*tax fraud or the like*". The Agreement describes fraudulent conduct with the aim of paying less US income tax, as well as acts of continued and serious tax offense on which the Swiss Confederation may obtain information under its own law and administrative practice, as eligible for treaty assistance.

149. *Fraudulent conduct* in the sense of the UBS Agreement Activities comprises the conduct described in paragraph 10, subparagraph 2, first sentence of the Protocol, including such activities that would lead to the concealment of assets and underreporting of income based on a "scheme of lies" or the submission of incorrect and false documents. They are covered by the UBS Agreement in connection with both undisclosed (non-W-9) custody accounts and bank deposit accounts held by US-domiciled taxpayers, as well as in connection with offshore company accounts beneficially owned by US persons.

150. In footnotes 2 and 3 to the Annex, the contracting parties agreed on certain fact patterns which, in the context of the treaty request process according to the UBS Agreement, indicate the existence of "schemes of lies". They grant the SFTA authority to classify other activities as schemes of lies according to the pertinent facts.

151. The description of *fraudulent conduct* contained in the UBS Agreement centers on past precedent from the Federal Supreme and Federal Administrative Courts, which have ruled that fraudulent conduct that is eligible for treaty assistance does not necessarily have to involve the use of incorrect and false documents. According to the legal precedent, fraudulent conduct in the sense of the USA-TT may also be assumed if a taxpayer employs complex, opaque devices to conceal assets from the tax authorities and thereby unlawfully make considerable tax savings. However, the legal precedent always requires the presence of certain wheelings and dealings, tricks or actual schemes of lies before malicious fraud can be assumed[101]. In its concluding ruling of March 5, 2009, the Federal Administrative Court stated that maliciousness also exists if the perpetrator prevents the defrauded party checking false information, or if they believe that the other party will forego such checks, where such a belief is founded on a particular relationship of trust, or on clear rules or assurances, and is not simply an expectation based on certain observations. Incorrect information which the counterparty – the tax authority in this context – can check without any great effort is not deemed to be malicious, however[102].

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[99] cf. e.g. Behnisch, p. 760 f; Honegger/Kolb, p. 800 f

[100] Behnisch, p. 759

[101] Federal Supreme Court ruling of January 27, 2004, 2A.185/2003 E.4; Federal Supreme Court ruling 125 II 250 . 3b with references; also Federal Supreme Court ruling 96 I 737 E, 3 d; Federal Supreme Court on February 6, 2002, 2A.250/2001, E. 6 = StE 2002, A. 31.4 no.6

[102] Federal Administrative Court ruling of March 5, 2009, ASA 77 (2009), p. 857 f. E.5.2

152. Legal practice upholds that fraud-like conduct under the USA-TT is deemed committed under the following circumstances:

- if the taxpayer is simultaneously a charitable donor and a borrower owing to a circular transaction involving several companies that is not disclosed to the US tax authorities, thereby enabling them to deduct both their charitable donations and their debit interest in their tax return[103];
- if the taxpayer instructs intermediary companies to issue excessively high invoices and these companies in turn transfer the excessive sums to a private Swiss bank account[104];
- if taxpayers send out promotional materials in the name of a person who does not exist and set up a domiciliary company to receive advance payments for address lists that they will not deliver, and this money is then directed to a Swiss bank account[105];
- if taxpayers claim very high mortgage interest deductions over a period of years, where the amount of such deductions is not, as declared, transferred to an independent US financial institution, but to a company in Vaduz, Liechtenstein, with which the taxpayers are associated – and the latter refuse to make a written declaration that no further links exist with the foreign company apart from the mortgage arrangement[106];
- if the taxpayer uses bank accounts to divert corporate income while listing only certain accounts in their books[107];
- if the taxpayer fails to declare significant commission payments and makes untrue statements or presents false or misleading attestations to conceal these payments[108];
- where an offshore company is used for the purposes of tax evasion, if the actual rights of disposal over the assets held by the companies and the returns generated by them remain with the shareholder, and the US QI (Qualified Intermediary) system is circumvented owing to false information on the actual beneficial owner being given on the "W-8BEN" or a comparable substitute form[109].

153. To our knowledge, no cases have been published in which the Federal Supreme or Federal Administrative Court has denied treaty assistance in connection with the USA-TT. However, where legal assistance under the Federal Mutual Legal Assistance Act (*Bundesgesetz über die internatinale Rechtshilfe in Strafsachen*) is concerned, the precedent of the Swiss courts is consistent in rejecting the precept that simply setting up a tax-privileged company constitutes tax fraud. In their view, a domiciliary company is a legal instrument under company and fiscal law that enables its beneficial owners to save or even avoid tax. According to Swiss legal precedent, fraudulent conduct that is eligible for legal assistance exists only when, in assessing the overall situation, the tax authorities find it difficult to establish the methods being used to evade tax because the taxpayer is using additional concealment methods[110].

54. It may be questionable in individual cases whether the fact patterns described in para. 2/a in conjunction with footnote 1 and para. 2/b, in conjunction with footnote 3 of the Annex to the UBS Agreement actually constitute schemes of lies in the sense of past legal practice in Switzerland. The very reason that those applying the law are granted a degree of discretion in classifying facts as a "scheme of lies" is behind the contracting parties' agreement, in handling the UBS case, that the fact patterns described in para. 2/4 in conjunction with footnote 1 and para. 2/b in conjunction with footnote 3 are to be deemed such "schemes of lies" This is a mutually agreed, authentic interpretation of the term "schemes of lies" and the Law of Treaties, and it must be observed by the practicing administrative and judicial authorities on the basis of Art. 30 para. 3 and Art. 31 para. 3

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[103] Federal Supreme Court on January 6, 2006, 2A.352/2005 E. 2.3.2.
[104] Federal Supreme Court on February 6, 2002, 2A.551/2001 = StE 2002, A. 31.4 no. 6. E. 5b.
[105] Federal Supreme Court on March 12, 2002, 2A.416/2001 E.6.3.
[106] Federal Supreme Court on August 10, 2006, 2A.608/2005 E.4.
[107] Federal Supreme Court on December 22, 2003, StR 59/2004, p. 475 E.5.
[108] Federal Supreme Court on January 27, 2004, 2A.185/2003 E. 6.
[109] Federal Administrative court ruling of March 5, 2009, ASA 77 (2009), 837 ff.
[110] cf. the decision of the Federal Criminal Court of October, 28 2008, RR.2008.165E.5.8; Federal Supreme Court of March 1, 2006, 1A.316/2005 E.2.3. with further references.

a VCLT. Given the binding nature in national and international law of the "schemes of lies" criteria agreed in the UBS Agreement, the Federal Administrative Court is not required to examine their use in the context of treaty assistance proceedings under the UBS Agreement for compliance with previous legal precedent in Switzerland. However, were the SFTA to classify other activities that are not listed explicitly in the Agreement as "schemes of lies", as it is permitted under the terms of the UBS Agreement, then the judicial authorities would have to review the Tax Administration's legal assessment in respect of its compliance with the USA-TT and the related protocol in the light of past legal precedent. Where the line between a scheme of lies and a simple lie is drawn in those cases not specified explicitly by the UBS Agreement can only be determined on a case-by-case basis by the SFTA, because the full circumstances must be taken into account. However, legal precedent does not permit the administrative and judicial authorities to go so far as to classify the involvement of a tax-privileged company alone as fraudulent conduct. In cases like these, they must examine whether or not there has been tax evasion that would be eligible for treaty assistance under the UBS Agreement.

155. In handling the UBS case, the Annex to the UBS Agreement also describes *acts of continued and serious tax offense* for which the Swiss Confederation may obtain information under its own laws and practices, as eligible for treaty assistance. Here, the contracting parties make explicit reference to paragraph 10 subparagraph 2 third sentence of the Protocol, which states that "tax fraud" in the sense of the USA-TT may also include activities which, at the time the request is submitted, constitute fraudulent conduct for which the recipient state party may obtain information under its own laws or practices.

156. By explicitly including acts of continued and serious tax offense, the UBS Agreement draws on Art. 190 of the Direct Federal Taxation Act (DFTA, *Bundesgesetz über die direkte Bundessteuer*), which states that special investigative measures may be ordered if there is reason to suspect serious tax offenses, which also covers the continued evasion of large sums of tax. According to administrative and judicial practice, such special measures include obtaining bank information by compulsory order[111].

157. Pursuant to the contracting parties' legal interpretation, acts of continued and serious tax offense for which bank and other information may be obtained also include cases in which US persons:

- have failed to comply with their tax reporting obligations for at least three years, and
- have held a UBS account either directly or indirectly via an intermediary company for at least three years, where this account has generated average annual revenues of more than CHF 100,000 over any three-year period that includes at least one year covered by the request.

158. Under the terms of the UBS Agreement, a violation of reporting obligations is deemed to have occurred if the suspect failed to submit form W-9, although they were obliged to submit it or if, despite a request from the SFTA as part of the treaty request process, they have been unable to furnish proof that they have fulfilled their statutory reporting obligations in respect of their interests in accounts held directly or indirectly via an offshore company.

159. For the purpose of establishing average revenues during the aforementioned three-year period, the contracting parties have defined revenues as gross income (interest and dividends) and capital gains (which, in assessing the main subject of this treaty assistance request, are calculated as 50% of the gross sales proceeds generated by the accounts during the relevant period).

160. Under previous legal practice, official assistance was never granted in connection with the USA-TT in the "mere" case of acts of continued and serious tax offense where there was no additional fraudulent conduct as described above. That said, to our knowledge the Swiss courts

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[111] Federal Administrative Court ruling of March 5, 20009, ASA 77 (2009), p. 847 E. 4.3.2.; Federal Supreme Court of October 14, 1999, 8G.57/1999; administrative practice of the federal authorities 67.85 E. 4c; judgment of the Federal Criminal Court of May 21, 2008, BV.2008.1-3 E.3.

never had to rule on any facts relating to the USA-TT that could not already be subsumed under the offense of tax fraud. In this sense, the UBS Agreement sets a standard that extends beyond those of past legal practice. The Federal Administrative Court, which was the first judicial body to address the "or the like" add-on that is laid down in Art. 26 para. 1 USA-TT, subsumed all offenses with the same degree of wrong as tax fraud under this phrase "or the like"[112]. In the opinion of the courts, tax evasion may entirely be viewed as containing the same degree of wrong as tax fraud, specifically when it concerns the "continued evasion of large sums of tax". This is illustrated by the fact that, under these circumstances, coercive measures in criminal procedure under the Administration of Criminal Justice Act (*Bundesgesetz über die Bundesstrafrechtspflege)* have been applied even to the evasion of direct taxes, meaning among other things that bank client confidentiality was ineffective, even domestically[113].

161. It is difficult to assess whether or not it has already been possible to provide treaty assistance under the USA-TT in cases of the continued evasion of large sums of tax. Reflecting the deliberations of the Federal Administrative Court, the broad phrase "tax fraud or the like" does indeed permit the exchange of information to be extended in cases of the continued evasion of large sums of tax, as per Art. 190 of the DFTA. Historical considerations might, however, militate against an expansion of treaty assistance, as when the Protocol was concluded, Art. 190 of the DFTA was already in force, and it might have been expected in good faith that the states parties would have included the continued evasion of large sums of tax explicitly in the treaty itself – if there had been consensus between the contracting parties that extended treaty assistance would be granted on this point. It must be remembered in this regard, however, that historical elements of interpretation play only a subordinate role in the interpretation of agreements under international law[114].

162. In the present case, we do not need to examine whether or not acts of continued and serious tax offense, in the sense of the continued evasion of large sums of tax, are eligible for treaty assistance under USA-TT, as an explicit foundation in international law now exists at least for the treaty request process under the UBS Agreement, which takes precedence over the USA-TT and interprets the latter authentically for the UBS treaty request process exclusively. Since the UBS Agreement determines a definition of the term "tax fraud or the like" that is binding on the administrative and judicial authorities, where treaty assistance under the UBS Agreement is concerned the Federal Administrative Court need not yet examine whether or not extended official assistance in the case of continued and serious tax offense conforms to the USA-TT. However, it must examine this legal issue with full cognizance in treaty request processes beyond the scope of the UBS Agreement. The UBS Agreement and the judgments passed on the basis of it do not have any prejudicial effect in this regard.

163. However, it must be noted in the application of para. 2/A/b and para. 2/B/b of the Annex that treaty assistance may be granted in the case of acts of continued and serious tax offense only *for which the Swiss Confederation may obtain information under its laws and practices.* The UBS Agreement thus refers to Swiss law, which is why those authorities administering the law must examine whether or not the facts given in the UBS Agreement constitute reasonable grounds to assume that *acts of continued and serious tax offense* have been committed. In addition to tax fraud as per Art. 186 of the DFTA, Art. 190 para. 2 of the DFTA describes the continued evasion of large sums of tax as a serious tax offense. The UBS Agreement seeks to include the latter, in particular, in the treaty request process.

164. With regard to *suspicion of a criminal offense*, we refer to the statements made under section 147 ff. With regard to the international treaty request process, the Federal Administrative Court derived from domestic law the standard laid down in Art. 26 of the USA-TT with regard to the initial suspicion

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[112] Federal Administrative Court ruling of 5 March 20009, ASA 77 (2009), p. 860 E. 5.4.
[113] Federal Administrative Court ruling of 5 March 20009, ASA 77 (2009), p. 847 E. 4.3.2.
[114] Art. 32 VCLT

and stated that, under domestic law, the suspicion of a criminal act it itself was sufficient as an initial suspicion, and that there need be no suspicion concerning a particular person as the perpetrator.

165. It must be stated with regard to the fact of serious tax offense, in the sense of the continued evasion of large sums of tax, that the classification of "*large sums of tax*" has not yet been examined by the Federal Supreme Court. DONATSCH proposes a threshold of CHF 5,000[115]. Legal practice to date has confirmed the key feature of "large sums of tax" to mean millions[116] in the case of unrecorded transactions, and CHF 40,000,000 (tax owed approx. 4,600,000[117]) in the case of secret private withdrawals. In practice, however, it is not the amount involved in the offense, but the complexity of the relations to be unraveled, that is the key point in conducting special investigative proceedings under Art. 190 of the DFTA[118].

166. Doctrine states that *continued evasion* in the sense of Art. 190 para. 2 DFTA should be assumed if a perpetrator has repeatedly evaded tax in the same way or even systematically. The continued failure to meet obligations i.e. behavior in violation of interests worthy of protection, need not necessary concern several tax periods[119]. The academic opinion is that it is enough for offenses to be committed repeatedly in the same way, or even systematically. Where duration is concerned, as mentioned above such behaviors do not necessarily have to cover several tax periods[120].

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[115] Donatsch, in: Zweifel/Athanas, Kommentar DBG, Art. 190 margin notes 16,10
[116] Administrative practice of the federal authorities 66.100 and 66.101
[117] StE 1994, B 101.8 no. 14
[118] Richner et al, Handkommentar DBG, Art. 190 margin note 3 with further references
[119] Richner et al, Handkommentar DBG, Art. 190 margin note 4
[120] Donatsch, in: Zweifel/Athanas, Kommentar DBG, Art. 190 margin note 14 f

167. A look at legal precedent and the relevant literature reveals that legal practice to date has not made the term "continued evasion of large sums of tax" any more tangible. The core of this is the complexity of the individual cases examined, which appear to justify ordering a special investigation. With their open wording, legislators afford the tax authorities significant room for maneuver with regard to the question of when a special investigation under Art. 190 ff. DFTA in conjunction with Art. 19 ff. ACLA may be ordered.

168. The facts described by the contracting parties in the UBS Agreement do not infringe the limits set by legal practice, and are within the authorities' scope for discretion in the interpretation of unclear legal expressions. They are to be applied by the Swiss administrative and judicial authorities in the treaty request process under the UBS Agreement, because they permit the Agreement to be administered in conformity with international law (interpretation in conformity with international law).

169. This finding is not contradicted by the fact that the initial suspicion of acts of continued and serious tax offense rest, among other things, on a schematic calculation of capital gains and the US persons' failure to comply with their duties of information to the SFTA, as codified in the UBS Agreement. In a request for information process, legal precedent merely requires the requesting authority to present sufficient suspicious circumstances to indicate a tax offense that is eligible for official assistance. In the opinion of the court of highest instance, in examining its duty to provide information the requested authority should not simultaneously be acting as a criminal judge in establishing whether or not all of the elements of a tax offense that is eligible for treaty assistance have actually been fulfilled in that specific case[121]. On the contrary: the information should enable the authorities in the requesting state, not the requested state, to make the final decision. The ESTV nonetheless can (and must) make its own enquiries as to whether or not grounds exist for the suspicion of a tax offense eligible for treaty assistance. Prior to handing the documents over to the requesting state, it must check that they are suitable as evidence of the suspected offense given in the request for information[122].Further, actual enquiries are then a matter for the tax authority requesting assistance. If the persons covered by the treaty request process are unable to allay initial suspicions of acts of continued and serious tax offense, then the doctrine states that official assistance must be given[123].

170. If US investigations into UBS really have found that the financial services offered by UBS have continuously been abused by US taxpayers to evade US taxes, then the scope and international implications of the UBS affair make it a textbook example of a complex case of suspected systematic tax offenses. If the tax dodges associated with UBS had happened in Switzerland, they would be covered by proceedings under Art. 190 DFTA, even if individual taxpayers had evaded only small sums of tax. With this in mind, the schematic calculation of capital gains, made for reasons of practicability, would be unlikely to hinder the granting of treaty assistance. However, the suspicion of acts of continued and serious tax offense would be disproved should the SFTA's enquiries find that precise calculations of capital gains result in average revenues of well below CHF 100,000, or no revenues at all. In such a case, the principle of proportionality – to which Art. 26 para. 1 USA-TT refers by limiting the exchange of information to that *necessary* for the prevention of tax fraud or the like – would require that individuals who were initially under suspicion are not included in the treaty request process. If revenues are so far below CHF 100,000 that the gap is regarded as significant, an evaluation decision must be made. This decision may be reviewed with full cognizance by the Federal Administrative Court.

171. The fact that persons whose accounts exceed the CHF 100,000 threshold are included in the treaty request process if they are unable to prove that they have fulfilled their reporting obligations may

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[121] Federal Supreme Court ruling 96 I 737 = ASA 40, p. 437 E. 3 e.; Federal Supreme Court on February 6, 2002, A 31.4 no. 6 E. 6.; Federal Supreme Court on December 22, 2003, StR 59/2004 p. 475 E. 5
[122] Federal Supreme Court on August 10, 2006, 2A.608/2005 E.2.
[123] Federal Administrative Court ruling of March 5, 2009, ASA 77 (2009) p. 860, E. 4.4.2. with further references

seem astonishing from the criminal procedure perspective. In itself, the treaty request process constitutes administrative proceedings, not criminal ones. The Federal Supreme Court thus concluded in its ruling of August 10, 2006 that the suspicious circumstances described by the requesting state must be regarded as consisting reasonable grounds if the person covered by the treaty request process fails to answer specific questions from the requested tax authority that might have disproved the suspicion[124]. In a treaty request process in accordance with the UBS Agreement, suspicions of an act of continued and serious tax offense are supported if the conditions that establish grounds for initial suspicions against a particular taxpayer are fulfilled, and that taxpayer does not provide evidence that they have fulfilled their tax reporting obligations under US tax law, despite being asked to do so by the SFTA. Given legal precedent, in such a case the SFTA has no choice but to deliver the requested information in accordance with the Agreement to the foreign tax authorities for further investigations. The decision as to whether or not the persons covered by the treaty request process actually committed tax offenses under US law lies with the US criminal prosecution authorities.

172. In summary, it can be said that, in the treaty request process according to the UBS Agreement, the Federal Administrative Court is not required to examine whether or not acts of continued and serious tax offense as per Art. 25 USA-TT are eligible for treaty assistance, because the UBS Agreement takes precedence over the USA-TT, and on the basis of Art. 31 para. 3 a of the VCLT, the latter must be interpreted in the sense of the UBS Agreement. That said, the criteria listed in the Annex must be examined in terms of their compliance with Swiss practice. Since the interpretation of the term "acts of continued and serious tax offense" under the UBS Agreement lies within the scope granted by doctrine and practice to the tax authorities in their application of Art. 190 FDTA, it must be protected by the Federal Administrative Court.

D. Significance of Sec. 18 USC § 3506 to the Treaty Request Process under the UBS Agreement

173. Part of the remit for this Opinion is to state our opinion the relationship between Sec. 18 USC § 3506, which is addressed in the settlement agreement between the IRS and UBS AG, and the UBS Agreement.

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[124] Federal Supreme Court on 10 August 2006, 2A.608/2005 E.4.

174. § 3506 forms part of the Comprehensive Crime Control Act of 1984, and obliges US citizens to inform the US Justice Department if they challenge in a foreign state a decision made by that state on a US request for information exchange. This provision is intended to allow US public prosecutors to respond appropriately to the foreign proceedings and, where appropriate, to take the necessary steps in US proceedings at the same time. Failure to comply with § 3506 is not punishable, but a US court may order a person to comply with it. No direct coercive action is taken if this order is not observed, although failure to comply may later disadvantage the person concerned in US proceedings. The process is limited to offenses under criminal law and is not applicable to claims under civil law. There is nonetheless debate about how far the process violates the 5th Amendment that enables US citizens to avoid incriminating themselves. The process has been used in connection with official assistance from Switzerland, and we must assume that its precedents will also be applied in the future[125].

175. In the context of the treaty request process under the UBS Agreement, UBS AG must inform those clients who are the subject of the request for information of their obligations under Sec. 18 USC §3506. Pursuant to Article 3 of the settlement agreement between the USA (the IRS), on the one hand, and UBS AG on the other, UBS undertakes to point out to its US clients in a letter[126] that – should they be considering challenging the ESTV decision before the Federal Administrative Court – they should consider that they may have an obligation under 18 USC § 3506 […]". UBS therefore undertakes that the corresponding information will be worded in such a way that the persons concerned can consult an expert to review their obligations under US law. If the UBS clients concerned authorize the bank to hand over the relevant data to the IRS, then UBS AG is obliged to do so.

176. The release of the client's name to the IRS during the appeal proceedings without any preconditions is not related to this, neither can it be without circumventing the proceedings. An obligation on the part of the client to inform the IRS would nullify appeal proceedings. For that reason, from the Swiss perspective it cannot be considered until those proceedings have been closed. US clients must weigh up for themselves whether or not they wish to alert the IRS of the legal proceedings in advance, and thus also release their name.

177. If a UBS AG client decides voluntarily, on the basis of the information provided by the bank, to instruct UBS AG to hand over the relevant data and documents to the IRS, then the client forfeits channels of appeal and therefore the legal protection in Switzerland that they would otherwise have been afforded under USA-TT-O.

178. In view of the fact that whether to use available channels of appeal in Switzerland or to hand over information directly to the IRS is the decision of the UBS AG client alone, there is no conflict with the UBS Agreement or the general rules on the treaty request process for information exchange purposes under Art. 26 USA-TT.

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[125] Memorandum on "18 USC § 3506" from Pillsbury to the Federal Office of Justice, September 6, 2009, making reference to Marcos v. United States, 1989 U.S. Dist LEXIS 12853 (S.D.N.Y. 1989)
[126] The settlement agreement contains a binding draft text for this letter as Exhibit B.

V. Conclusions

179. The following conclusions may be drawn on the basis of the above analysis:

180. The UBS Agreement is a valid agreement under international law. It entered into force upon signature on August 19, 2009. The principle of *pacta sunt servanda* is applicable;

181. The collision clause in Art. 30 para. 3 VCLT applies to the relationship between the existing USA-TT and the UBS Agreement. The principles of *lex posterior a*nd *lex specialis* thus apply. Where there is a conflict between the USA-TT and the UBS Agreement, the UBS Agreement takes precedence within its area of application. The USA-TT is irrelevant only to the extent that it is compatible with the UBS Agreement;

182. The UBS Agreement does not have a retroactive effect in the sense of international law, since the Agreement's application to existing facts is the actual object of the treaty, and is desired and agreed by the parties. The same also applies to the delayed publication of the Annex;

183. Under Art. 190 of the Federal Constitution, the UBS Agreement is authoritative for the Federal Supreme Court and the authorities applying the law, regardless of whether or not domestic rules on the delegation of powers were violated when the agreement was signed.

184. The UBS Agreement and its Annex are suitable for direct application and need no further implementation in domestic law. Since the UBS Agreement has both a direct and an indirect effect on private individuals, certain of its provisions may also be directly applicable in the event of dispute. The Annex criteria are directly applicable. The constitute a genuine, direct decision-making basis for the corresponding rulings.

185. The treaty request process under the UBS Agreement is based on the procedural law principles of

information exchange laid down in Art. 26 USA-TT and Art. 20c ff. USA-TT-O. Furthermore, the Ordinance has a sufficient legal foundation;

186. The provisions of Art. 31 ff VCLT are authoritative in the interpretation of the UBS Agreement. They accord particular importance to the text and context of the Agreement and the legitimate expectations of the parties. The result of the interpretation is that the UBS Agreement, specifically its Annex, must form the legal basis for the treaty request process (SFTA decisions and possible appeal proceedings before the Federal Administrative Court). The UBS Agreement need not be examined in terms of its conformity with Art. 26 USA-TT, and such examination would contravene both the VCLT and Art. 190 of the Federal Constitution;

187. The reference to Sec. 18 USC § 3506, to which, under the settlement agreement, UBS must draw the attention of the clients concerned, is compatible with the UBS Agreement. The decision as to whether the person concerned wishes to comply with the obligations of Sec.18 USC § 3506, rather than exhausting the channels of appeal in Swiss proceedings, lies entirely with the person themselves. UBS AG's contractual obligation to make the reference to Sec. 18 USC § 3506 therefore does not undermine the treaty request process under the UBS Agreement. An obligation to inform the IRS of names while the process is ongoing is unconnected to this.

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B. ***Background Materials***

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