REPORT #610

TAX SECTION

New York State Bar Association

Report on the Multilateral
Convention on Mutual
Administrative Assistance in Tax Matters

April 19, 1989

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TAX SECTION
New York State Bar Association

April 20, 1989

The Honorable Kenneth W. Gideon
Assistant Secretary of the Treasury
for Tax Policy (Designate)
3120 Main Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Gideon:

Enclosed is a Report on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The principal draftsmen of the Report are Victor F. Keen and Richard M. Leder.

The Report recommends that the United States adopt the Convention. In addition to the potential advantage of helping to standardize practices among many of the principal industrial nations, it offers the very considerable potential advantage of modernizing relationships with many of the United States' principal treaty partners without the difficulty and delay that can be inherent in renegotiating tax treaties. The Report further supports the United States initially adopting only the exchange of information provisions.

The Report also recommends that the United States exercise the option to give notice (and a suitable opportunity to object) to affected taxpayers with respect to any exchange of information other than the routine exchanges to be done on an automatic basis.

It recommends that the implementation of the procedures for notice and opportunity to object be approached on a pragmatic basis so as to achieve the Convention's objective of increasing the exchange of information among tax authorities where the enumerated limitations in the Convention do not apply. The implementation approach suggested would leave room for adjustment based on administrative experience with the numbers and kinds of information requests received and the nature and substantiality of objections that may be raised with respect to various types of requests.

Sincerely,

WLB/JAPP
Enclosure

Wm. L. Burke

cc (w/encl):

Leonard B. Terr, Esq., International Tax Counsel, Department of the Treasury
Ann Fisher, Esq., Attorney Advisor, Office of International Tax Counsel, Department of the Treasury
The Honorable Claiborne Pell, Chairman, Foreign Relations, Committee
The Honorable Lloyd Bentsen, Chairman, Senate Finance Committee
The Honorable Dan Rostenkowski, Chairman, House Ways and Means Committee
The Honorable Ronald A. Pearlman, Chief of Staff, Joint Committee on Taxation
The Honorable Michael W. Murphy, Acting Commissioner of Internal Revenue, Internal Revenue Service
Peter K. Scott, Acting Chief Counsel, Internal Revenue Service
Steven Lainoff, Esq., Associate Chief Counsel, International, Internal Revenue Service

NEW YORK STATE BAR ASSOCIATION

TAX SECTION REPORT #610

LETTER DATED APRIL 20, 1989 TO KENNETH W. GIDEON, ESQ., ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY, ENCLOSING REPORT ON THE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS.

New York State Bar Association
Tax Section
Committee on Unreported Income & Compliance

Report on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters

April 19, 1989

I. INTRODUCTION[*]

On January 25, 1988, the Organization for Economic Cooperation and Development (the "OECD") and the Council of Europe opened for signature the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the "Convention"). The Convention, which goes into effect as to signatory countries approximately three months after five countries have signed, has not as yet been adopted by any of the 28 countries that are members of either the OECD or the Council of Europe.[1] It has been reported that the United Kingdom and Germany do not intend to sign.

The Convention covers three forms of administrative assistance: (i) exchange of information, (ii) assistance in recovery of taxes, and (iii) service of documents. While all signatories are required to adopt the exchange of information provisions, signatories may reserve the right not to provide assistance in recovery of taxes, service of documents, or both. In addition, certain other elections or reservations are permitted to signatories relating to a variety of matters.

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[*] This report was prepared by the Committee on Unreported Income & Compliance; its principal draftsmen were Victor F. Keen and Richard M. Leder. Other members of the working group were David Kahan, Jacqueline J. Wong, and Betsy Purintun. Helpful comments were provided by Richard O. Loengard, Jr., Arthur L. Kimmelfield, Ralph O. Winger, and William L. Burke.

[1] The following countries are members of both the Council of Europe and the OECD: Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Iceland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United Kingdom. The other members of the OECD are Australia, Canada, Finland, Japan, New Zealand, and the United States. The other members of the Council of Europe are Andorra, Cyprus, Liechtenstein, and Malta.

The Convention is expected to be signed by the United States and submitted to the Senate for ratification later in 1989. The Treasury is preparing a technical explanation and recommendation to accompany the text of the Convention. The Treasury explanation will, we understand, incorporate by reference the contents of the Commentary prepared by the drafters of the Convention, noting areas of disagreement (if any) with the Commentary.

The areas of the Convention that provide the most potential for dramatic change in the United States' relationships with foreign partners for mutual assistance in tax matters are those relating to (i) assistance in recovery of taxes, (ii) service of documents, and (iii) coverage of state and local (i.e., political subdivision) taxes. Treasury has indicated that it will recommend that the United States not participate in those aspects of the Convention, at least initially. We concur in the wisdom of deferring any consideration of the other provisions at this time. This Report therefore focuses only on the exchange of information provisions.

II. CONCLUSIONS AND RECOMMENDATIONS

In general, the provisions relating to the exchange of information do not differ materially in substance from the assistance provisions contained in the current U.S. Model Treaty, which has been the basis for a number of recent treaties entered

into by the United States. Perhaps the most important new exchange of information feature of the Convention is its specific design for use in pre-indictment criminal proceedings. The Committee supports the adoption of the Convention as a sensible attempt to unify applicable rules and procedures in the international community regarding exchanges of information and to expand the levels of assistance among a wider group of participating nations.

The existence of standardized rules and procedures in our arrangements with many treaty partners should significantly reduce the administrative burden of promulgating regulations, issuing rulings and litigating similar issues. In addition, the Convention would have the effect of instantly updating the United States' assistance arrangements with a number of countries that are currently operating under outdated treaties and of extending the current provisions to new foreign partners. In practice, the ability to involve more than two countries in a joint effort to acquire information under one operative set of provisions seems likely to produce greater discovery in certain circumstances than is possible under the general bilateral system.

To achieve the Convention's objective of significantly increasing the flow of information among participating States, it is important that each participant approach its obligations to remit information in as cooperative a spirit as possible and not summarily decline to respond to reasonable requests for

information. (We recognize that the potential operational benefits of the Convention will likely deteriorate and break down into individual country dealings along bilateral lines if there is a significant level of varying restrictions imposed by the various participants.) For this reason, it becomes even more important to ensure that the rights and interests of citizens and residents of the United States are adequately safeguarded. The potential for greater assistance in criminal matters requires greater caution to insure that due process and other constitutional concerns are adequately addressed. There is a need for particular sensitivity to protect trade secrets and similar business interests. There is also a need to develop standards for identifying and rejecting re-quests that, among other things, are (i) fishing expeditions, (ii) for non-tax-related purposes, (iii) for information to be used (e.g., against multinational corporations) in a manner that would create the potential for double taxation, or (iv) made without the applicant State's having exhausted its own measures.

In light of these concerns, we recommend that the United States adopt (i) Treasury guidelines -- as specific as possible -- setting forth the principles and standards to be followed in determining what information will be provided under the Convention, and (ii) procedures affording the targets of information requests adequate written notice and a fair opportunity to respond, so that they can present arguments for

rejecting such requests based on the limitations on the obligation to provide information contained in the Convention, as amplified by the Treasury guidelines and Congressionally imposed limitations. We believe these guidelines and procedures should be developed from a pragmatic perspective that would accommodate the twin goals of providing adequate taxpayer safeguards and of promoting the exchange of information without unwarranted delay or undue administrative burden. For example, automatic exchanges presumably ought not to require notice and an opportunity to object, and experience may show that requests for certain types of information warrant imposing a particularly heavy burden on a taxpayer to justify administrative review, whereas requests for other types of information should always entitle taxpayers to administrative review at their election. We would be prepared to contribute to further dialogue on the development of such rules to implement the Convention.

III. OVERVIEW OF THE CONVENTION

A. Taxes to be Covered

Under the Convention, the taxes to be covered are grouped in two categories. The first, which includes national taxes on income, capital gains (if imposed separately) and net wealth, are taxes to which the Convention must apply if adopted. The second category includes taxes that a signatory may elect to bring under the Convention. These taxes consist of (i) taxes on income, capital gains, and net wealth imposed by political

subdivisions, (ii) social security taxes, (iii) a list of miscellaneous national taxes including “any other taxes,” except customs duties, and (iv) miscellaneous taxes imposed by political subdivisions. As to these taxes, a signatory may elect that the Convention apply to any or all. A party must provide assistance with respect to foreign taxes of a nature similar to those for which Convention coverage is elected. As to categories of taxes for which coverage is not elected, a party may reserve the right not to provide any form of assistance.

B. Exchange of Information

The Convention provides for the exchange of information foreseeably relevant to the assessment and collection of tax, the recovery and enforcement of tax claims and prosecution (or the initiation of prosecution) before an administrative (or judicial) body. Five methods of exchange are specified, namely: (i) exchange on request, (ii) automatic exchange, (iii) spontaneous exchange, (iv) simultaneous tax examinations, and (v) tax examinations abroad. If a party receives information from another party that conflicts with information in its possession, it must so advise the party that provided the information.

C. Assistance in Recovery of Taxes

The Convention provides, in substance, that a requested (collecting) State shall take the necessary steps to recover tax claims of the applicant (taxing) State as if they were its own

tax claims. Such claims must be enforceable in the applicant State and, generally, must be uncontested (in the case of a taxpayer not resident in the applicant State, uncontestable).

The applicable collection procedures are those of the requested State (which could raise questions in the event such State has no tax comparable to the tax being collected). In general, the time limitations for collection are those of the applicant State; in no event, however, is collection required more than 15 years from the date of the instrument to be enforced.

D. Service of Documents

The Convention provides that a requested State shall serve documents emanating from the applicant State by a method prescribed by its internal law for like documents or, to the extent possible, by a particular method requested by the applicant State.

E. Significant Operating Principles

1. Confidentiality

Information obtained under the Convention must be treated under the conditions of secrecy applying in the State obtaining or supplying the information, whichever are more restrictive. Such information may be disclosed in court proceedings only with the prior authorization of the supplying State. (The parties may agree to waive this condition.)

2. Notice

The Convention permits a party to indicate that its authorities may inform a taxpayer before transmitting information concerning him. The Convention is entirely silent as to the consequences of any such notice (e.g., the taxpayer's right to challenge the request).

3. Reciprocity

In general, under the principle of reciprocity (sometimes known as the least common denominator, or "LCD," principle) reflected in the Convention, a State is not required to carry out measures at variance with its own laws or the laws of the applicant State, or to furnish information not obtainable under its own laws or under the laws of the applicant State.

4. Conflicts with Bilateral Tax Treaties

It is apparent that two countries which ratify the Convention and which have also entered into a bilateral tax treaty containing an exchange of information provision may have conflicting rights or obligations under the two agreements with respect to the information which one country may, or is required to, provide to the other. Article 27 of the Convention ~ provides in this regard as follows:

> The possibilities of assistance provided by this Convention do not limit, nor are they limited by, those contained in existing or future international agreements or other arrangements between the Parties

concerned or other instruments which relate to co-operation in tax matters.[2]

IV. CONVENTION PROVISIONS ON EXCHANGE OF INFORMATION

A. Scope of Information to be Exchanged and Persons Covered

The Convention will apply with respect to income taxes, taxes on capital gains which are imposed separately from income taxes, and taxes on net worth, imposed on behalf of a party to the Convention. Except as otherwise specified by a party, the Convention will also apply to information pertaining to taxes on income, capital gains, or net worth imposed by political subdivisions or local authorities, to social security taxes, and to other taxes imposed by a State or political subdivision thereof. Article 2.1(b).

The Convention provides that the parties thereto shall exchange any information "foreseeably relevant" to the assessment and collection of tax, the recovery and enforcement of tax claims, and "the prosecution before an administrative authority." Article 4.1. Parties to the Convention are also required to exchange information foreseeably relevant to the initiation of a

[2] Paragraphs 256 through 258 of the Commentary explain that more restrictive provisions in other agreements will not prevail over the Convention but that less restrictive provisions in other agreements may be used instead of the provisions of the Convention, with the competent authority of the applicant State being able to request assistance under the agreement likely to be most effective in a particular situation. The Commentary also indicates, however, that parties to the Convention could not simultaneously apply more than one agreement in a particular case.

criminal prosecution. Once criminal proceedings have begun before a judicial body, however, the Convention will not apply. In addition, information obtained under the Convention can be used as evidence in criminal proceedings only with the prior authorization of the supplying State (which condition may be mutually waived by two or more parties to the Convention). Article 4.2.

The Convention requires that information be supplied with respect to an affected person whether or not that person is a national or resident of either the applicant or requested State. Article 1.3.

B. Means of Exchange of Information

Information may be exchanged by request, with respect to specified persons or transactions (Article 5); automatically, with respect to categories of cases and in accordance with procedures determined by mutual agreement (Article 6); and spontaneously, under the circumstances enumerated in paragraph 1 of Article 7. The Convention also provides for exchanges of information through simultaneous tax examinations (Article 8) and participation in a tax examination conducted by another State (Article 9). Finally, the Convention provides that if a State receives information about a person's tax affairs which appears to conflict with the information in its possession, that State must so advise the State which provided the information (Article 10).

1. On Request

A State is required to provide, upon request, any information within the scope of the Convention (as described above) which concerns particular persons or transactions. The Convention requires that a requested State which does not have the information in its files take “all relevant measures” (subject to limitations discussed below) to obtain the requested information.

2. Automatic

The types of information to which the automatic exchange provision is expected to apply are described in paragraph 63 of the Commentary as follows:

> Information which is exchanged automatically is typically bulk information comprising many individual cases of the same type, usually consisting of payments from, and tax withheld in the supplying State, where such information is available periodically under that State's own system and can be transmitted automatically on a routine basis.

The Commentary anticipates that this form of exchange will occur pursuant to agreements entered into by competent authorities as to the information to be supplied and procedures to be used, and that the usefulness of this form of exchange may be enhanced through the use of standardized forms and formats determined by agreement between a substantial number of parties to the Convention.

Information to be supplied automatically will deal primarily with dividends, interest and royalties with respect

to which a withholding agent has withheld income and/or filed an information statement (e.g., Form 1042S). Other candidates for automatic exchange include information received by the IRS in connection with sales of U.S. real property by foreign persons (Code sections 897 and 1445) and effectively connected income of partnerships having foreign partners (Code section 1446) and information on the amounts of taxes paid by foreign persons who file United States tax returns.

3. Spontaneous

Under the spontaneous exchange provision, a party to the Convention is required, without prior request, to forward information to another State under the following circumstances:

a. the first-mentioned Party has grounds for supposing that there may be a loss of tax in the other Party;

b. a person liable to tax obtains a reduction in or an exemption from tax in the first-mentioned Party which would give rise to an increase in tax or to liability to tax in the other Party;

c. business dealings between a person liable to tax in a Party and a person liable to tax in another Party are conducted through one or more countries in such a way that a saving in tax may result in one or the other Party or in both;

d. a Party has grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises;

e. information forwarded to the first- mentioned Party by the other Party has enabled information to be obtained which may be relevant in assessing liability to tax in the latter Party.

The Convention further requires that the necessary measures be taken and procedures implemented so as to insure that the required information is made available for transmission to another party. Thus, steps must be taken to bring to the attention of the supplying State's competent authority information likely to be of interest to another State.

4. Tax examinations

The Convention also provides for simultaneous examination by two or more parties to the Convention of the tax affairs of a person or persons in which the States have a common or related interest, with a view to the exchange of any relevant information so obtained. Article 8. The requested State may accept or reject the request on a case-by-case basis. In addition, the competent authority of a requested State may allow representatives of the competent authority of an applicant State to be present at a tax examination in the requested State. Article 9.

C. Limitations on Obligation to Supply Information

A State may decline a request for information under the Convention if the applicant State has not pursued all means available in its own territory to obtain the information requested, except where recourse to such means would entail "disproportionate difficulty." Article 19. In addition, Article 21 provides generally that the provisions of the Convention are not intended to affect the rights and safeguards secured to

persons by the laws or administrative practice of the requested State. Specifically, a requested State has no obligation:

(a) to carry out measures at variance with its own laws or administrative practice or the laws or administrative practice of the applicant State;

(b) to carry out measures which it considers contrary to public policy (order public) or to its essential interests;

(c) to supply information which is not obtainable under its own laws or its administrative practice or under the laws of the applicant State or its administrative practice;

(d) to supply information which would disclose any trade, business, industrial, commercial or professional secret, or trade process, or information the disclosure of which would be contrary to public policy (order public) or to its essential interests;

(e) to provide administrative assistance if and insofar as it considers the taxation in the applicant State to be contrary to generally accepted taxation principles or to the provisions of a convention for the avoidance of double taxation, or of any other convention which the requested State has concluded with the applicant State;

(f) to provide assistance if the application of this Convention would lead to discrimination between a national of the requested State and nationals of the applicant State in the same circumstances [e.g., because of differences in procedural safeguards or in substantive matters such as the applicable rate of tax. Commentary, ¶ 203].

D. Confidentiality

Article 22 requires that information obtained under the Convention be treated in the same manner as information obtained under the domestic laws of the State receiving the information or, if more restrictive, under the conditions of confidentiality imposed by the laws of the State supplying the information. Information obtained under the Convention may be disclosed in

court proceedings only with the prior authorization of the State supplying the information. Article 22.2. The Convention authorizes disclosure of information to persons or authorities (including administrative or supervisory bodies) involved in the assessment and collection of taxes and enforcement or prosecution in respect of such taxes.

V. EXCHANGE OF INFORMATION PROVISIONS OF THE OECD AND U.S. MODEL TREATIES

A. OECD Model Treaty

Article 26 of the OECD Model Income Tax Convention (the "OECD Model") provides for the exchange by the competent authorities of the contracting States of information necessary to carry out the provisions of the convention or the domestic laws of the contracting States concerning taxes covered by the convention. The exchange of information provision therefore applies to the taxes enumerated in Article 2 of the OECD Model, i.e., to taxes on income and capital imposed by a contracting State or its political subdivisions or local authorities. The information exchanged may relate to residents of either contracting State or to persons not residing in either State (but who are otherwise subject to tax by the requesting State).

Information received under the OECD Model must be kept confidential in the same manner as information obtained under the domestic laws of the requesting State (but without regard, apparently, to the confidentiality requirements of the domestic laws of the State providing the information), and may be disclosed only to persons or authorities (including courts and administrative authorities) involved in the assessment,

collection or enforcement of covered taxes. Information obtained under the OECD Model may be disclosed by the tax authorities in court proceedings.

Paragraph 2 of Article 26 of the OECD Model provides that a contracting State is not obligated to carry out administrative measures inconsistent with the laws or administrative practice of that State or the other contracting State, to supply information which is not obtainable under the laws or administrative practice of either State, to disclose trade or business secrets, or to make any disclosure which is contrary to public policy.

B. U.S. Model Treaty

The first paragraph of Article 26 of the United States Model Income Tax Convention (as proposed June 16, 1981) (the "U.S. Model") is virtually identical to paragraph 1 of the OECD Model. The scope of the information that is subject to the exchange of information provision is substantially narrower, however, since in the U.S. Model the exchange of information provision does not apply with respect to taxes imposed by political subdivisions or local authorities of a contracting State. Unlike the OECD Model, the U.S. Model explicitly permits the disclosure of information to persons involved in the administration of taxes, so that information obtained by the United States may be disclosed, for example, to the General Accounting Office in the course of an audit by the GAO of the activities of the Internal Revenue Service. See Code section 6103(i)(7); Internal Revenue Manual ("I.R.M.") 1272 (23)10.

The limitations on the obligation to supply information which are set forth in the OECD Model as described above are also incorporated in the U.S. Model. Paragraph 3 of Article 26 of the U.S. Model, however, imposes certain obligations on contracting States regarding the collection and furnishing of information that are not present in the OECD Model. Specifically, it requires (i) that a State requested to provide information endeavor to obtain it in the same manner and to the same extent as if the tax of the State requesting information were that of the requested State and were being imposed by the requested State and (ii) that upon specific request the information be furnished through authenticated documents and depositions of witnesses (i.e., materials generally admissible in U.S. courts) to the extent such depositions and documents can be obtained under the laws and administrative practice of the requested State with respect to its own taxes.

C. Comparison of the Convention with the Model Treaties

The Convention provides that the parties thereto shall exchange any information "foreseeably relevant" to the assessment and collection of tax, a standard arguably broader than the "such information as is necessary" standard in the OECD Model and the U.S. Model.

The Convention adopts the requirement in the U.S. Model that a requested State which does not have the information in its files take "all relevant measures" (subject to various limitations) to obtain the requested information.

As discussed below, automatic and spontaneous exchanges of information have in fact occurred under bilateral treaties with information exchange provisions similar to those in the OECD

Model and the U.S. Model described above; however, the spontaneous exchange provisions of the Convention require exchanges of information under a variety of specific circumstances, whereas such exchanges which have occurred to date under bilateral treaties have been discretionary and, we understand, somewhat sporadic. Moreover, the Convention explicitly requires the adoption of administrative procedures designed to ensure that the required information will be available. Here, a balance must be struck between the need to develop channels of communication for field information to reach the central competent authority in Washington and the undesirability of placing significant additional stress on already thin IRS resources.

As under the OECD Model and the U.S. Model, the requested State is not obligated under the Convention to carry out measures inconsistent with or supply information not obtainable under the laws or administrative practice of the applicant State or the requested State, disclose trade or business secrets, or carry out measures or disclose information in a manner contrary to public policy.

In the past, the United States has encountered difficulty in obtaining information from some treaty partners where it was to be used in connection with a criminal investigation. The Convention specifically addresses this issue by requiring the exchange of information that is “foreseeably relevant” to* “the prosecution before an administrative authority or the initiation of prosecution before a judicial body.” Thus, subject to the Convention's generally applicable limitations on the obligation to provide information, the provision of information for use in the pre-indictment stage of criminal

proceedings is required. However, the use of such information as evidence in the criminal trial is absolutely prohibited without prior authorization of the party which supplied the information.

The Convention appears to impose a higher standard of confidentiality in many cases than would the OECD Model or the U.S. Model, since it requires that information obtained under the Convention be treated in the same manner as information obtained under the domestic laws of the State receiving the information or, if more restrictive, under the conditions of confidentiality imposed by the laws of the State supplying the information. Article 22.1. Another distinction is that information obtained under the Convention may be disclosed in court proceedings only with the prior authorization of the State supplying the information. Article 22.2. The Convention is similar in substance to the U.S. Model in authorizing disclosure of information to persons or authorities (including administrative or supervisory bodies) involved in the assessment and collection of taxes and enforcement or prosecution in respect of such taxes.

VI. EXCHANGE OF INFORMATION UNDER BILATERAL TREATIES

A. U.S. Experience

Almost all of the income tax treaties entered into by the United States provide for the exchange of information. The information exchanges that have occurred under bilateral treaties include automatic and spontaneous exchanges of information, information provided on request, information exchanged to prevent double taxation of particular persons or transactions through competent authority proceedings (see generally Rev. Proc. 82-29, 1982-1 C.B. 481), and information exchanged in a simultaneous

examination of a multinational company or a simultaneous criminal investigation. See I.R.M. 1272 (25)10.

The greatest number of exchanges of information appear to occur under the automatic exchange program, at least in terms of numbers of documents exchanged.[3] In 1984, approximately 704,000 documents were received by the IRS under this program and approximately 217,000 documents were provided by the IRS to other countries. At least as of 1986, information exchanged under this program generally dealt with investment income, such as the information reported on Form 1042S regarding U.S. source income subject to withholding and taxes withheld. See I.R.M. 1272 (25)30. The utility of this information has been reduced, however, by the use of different formats by exchanging States in providing the information and by the lack of a standardized reference (such as standardized taxpayer identification numbers) through which such information might be organized.

The volume of information received under the spontaneous exchange program has been much lower; thus, from 1981 through 1985, the IRS reportedly received 450 documents and provided 189 documents to other countries.[4]

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[3] Much of the discussion below regarding current administrative practice with respect to exchanges of information is based upon an article published by Richard A. Gordon (formerly Special Counsel for International Taxation, IRS) and John Venuti (formerly Chief, Tax Treaty and Technical Services Division, IRS) in the Tax Management International Journal (Vol. 15, No. 8) dated August 8, 1986, entitled Exchange of Information under Tax Treaties -- An Update.

[4] Id. at 296.

The volume of specific requests for information is similarly low; at least as of 1986, the IRS typically received and made only a few hundred such requests per year.[5] One practical difficulty frequently encountered is that information is often supplied in a form not admissible as evidence in court. The U.S. Model would require the provision of information in forms which, in general, would be admissible in U.S. courts. The Convention follows this by providing that the information is to be furnished in a form requested by the applicant State. Under the Convention, however, a State supplying information may nevertheless decline to permit use of the information supplied in a criminal prosecution or any other public court proceeding.

B. Caribbean Basin Exchange Agreement

Section 274(h) of the Code offers an inducement to any "beneficiary country" as defined in the Caribbean Basin Economic Recovery Act (but also including Bermuda) to enter into an exchange of information agreement -- specifically, the potential deductibility of expenses of U.S. taxpayers in attending conventions in the beneficiary country. To qualify under this provision, the exchange of information agreement must provide for the exchange of information (not limited to information concerning residents of the United States or the beneficiary country) that is necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country, including information the disclosure of which

[5] Id. at 294.

is otherwise barred under the law of the beneficiary country. The information must be made available for use in both criminal and civil proceedings. Under certain circumstances, however, an exchange of information agreement may qualify even if it does not provide for the exchange of "qualified confidential information" (regarding bank secrecy and ownership of bearer shares) which is sought for civil tax purposes only.

It remains to be seen how much useful information will be gathered under the qualified agreements that have been signed, and whether the Caribbean States that are known as leading tax havens (such as the Cayman Islands) will enter into such agreements at all.

VII. LCD ISSUES AND TAXPAYER RIGHTS UNDER THE CONVENTION

As indicated above, a State's obligation under the Convention to furnish information requested by another State is limited substantially by Article 21, Protection of Persons and Limits to the Obligation to Provide Information.[6] In addition to provisions dealing with trade secrets, public policy, etc., Article 21 contains two lowest common denominator ("LCD") previsions: The Convention imposes no obligation on the requested

[6] In addition, disclosure is not required where (i) the information is unlikely to be relevant to the Convention's specified purposes (Article 4), (ii) the information relates to a criminal proceeding before a judicial body (Article 4; Commentary, ¶ 56), or (iii) the applicant State has not pursued all means available in its own territory to obtain the information (Article 19). Also, a State has the discretion to accede to or reject a request for a simultaneous examination on a case-by-case basis.

State to (i) carry out measures at variance with either State's laws or administrative practice or (ii) supply information not obtainable under either State's laws or administrative practice. The Commentary makes clear that (i) the purpose of Article 21 is to enable the requested State to refuse to furnish information in order to safeguard the rights of taxpayers, as well as the public policy and "essential interests" of the requested State, and (ii) Article 21 is not a mandatory provision -- the requested State is always at liberty to comply with the request if it so chooses. The Convention grants no procedural rights to taxpayers with respect to whom requests for information are made.

A number of questions arise regarding the manner in which the United States will operate under Article 21 (and the other limitations on the obligation to provide information) in considering requests. Are there any built-in constraints on what Treasury may voluntarily provide that are imposed by statutory or case law? Should any such constraints be specifically imposed on the Treasury by Congress? Should different standards apply depending on whether or not the target of the request is a U.S. national or resident? To what extent should the persons who are the subject of the request have the right to participate in the decision-making process?

A. Applicable Statutory Provisions

Code section 6103(a) provides that tax returns and return information shall be confidential and, with specific exceptions, prohibits disclosure by all government employees of any such information. There is an exception in section 6103(k)(4) for disclosures "to a competent authority of a foreign government

which has an income tax or gift and estate tax convention or other convention or bilateral agreement relating to the exchange of tax information with the United States but only to the extent provided in, and subject to the terms and conditions of, such convention or bilateral agreement." The Convention would not appear to constitute an income tax convention or a bilateral assistance agreement, but would appear to qualify under section 6103(k)(4) as an "other convention."

Code section 7602(c) bars the issuance of a summons, or the commencement of an action to enforce a summons previously issued, with respect to any person once a Justice Department referral is in effect with respect to that person. The United States Supreme Court has recently held that section 7602(c) is not applicable to subpoenas for information relating to foreign revenue laws, notwithstanding the fact that the foreign investigation may have reached a-stage analogous to a Justice Department referral by the IRS. The Court of Appeals for the Ninth Circuit had held to the contrary. United States v. Stuart, 109 S. Ct. 1183 (1989), rev'g 813 F.2d 243 (9th Cir. 1987).

B. Applicable Cases

In United States v. Powell, 379 U.S. 48 (1964), the Supreme Court held that the IRS need only demonstrate good faith (and need not meet the higher standard of probable cause) in issuing a summons in connection with a domestic tax investigation. The Court delineated the good faith standard as requiring the Commissioner to show that (i) there is a legitimate purpose for the investigation, (ii) the inquiry with respect to which the information is requested is relevant to that purpose, (iii) the information is not already in the Commissioner's

possession, and (iv) all of the administrative steps required by the Code -- including written notification of the taxpayer with respect to whom the information is requested — have been followed. The taxpayer must demonstrate that the enforcement of the summons would constitute an abuse of the court's process in order to set it aside once the indicia of good faith have been established by the IRS.

In Stuart, the Supreme Court reaffirmed its holding in Powell and held, further, that the IRS had met the good faith standard and could enforce a summons to obtain information requested by a foreign treaty partner notwithstanding the fact that the IRS could not have issued a summons to obtain the same information for domestic tax law purposes. Stuart involved a request by the Canadian tax authorities pursuant to the 1942 United States-Canada Treaty to provide certain U.S. bank records in connection with a Canadian investigation of the tax liability of certain Canadian citizens and residents. The Court of Appeals for the Ninth Circuit had held that the good faith standard of the Powell case required the Commissioner to determine that the Canadian investigation had not reached a stage analogous to a Justice Department referral. The Supreme Court disagreed that the Powell good faith standard should be so extended and held that the IRS had only to demonstrate that both the Powell standard and the applicable statutory requirements had been complied with, unless it could be shown that the applicable treaty provisions further limited the issuance of a summons. The 1942 Canadian Treaty contained a requirement that the IRS be able to “obtain the information under U.S. law.” The Supreme Court construed this provision, however, to refer to the type of information that could be obtained and not to the procedural rules, such as

section 7602(c), that by their very terms related only to U.S. investigations.[7]

In United States v. Lincoln First Bank, 45 AFTR 2d 942, 80-1 USTC ¶ 9231 (S.D.N.Y. 1980), it was held that the Commissioner had no power to enforce a summons under circumstances where the requesting country could not itself have obtained the information under its own internal procedures. Lincoln First Bank arose under the 1972 Income Tax Treaty between the U.S. and Norway. Both civil and criminal investigations were underway in Norway against certain Norwegian corporations and one individual. Under the Treaty, the U.S. was not obliged to take measures which were inconsistent with Norwegian law, but the language of the applicable provision of the Treaty did not by its terms require the IRS to refuse to provide the information under those circumstances. The IRS had argued that the Treaty provision established a minimum level of obligation on the part of the United States but did not limit the measures that it might voluntarily take. The court, obviously pained by the notion that the United States could be employed to provide information to a foreign country in connection with a criminal investigation which could not be obtained under the laws of that country itself, refused to accept the IRS' construction absent "express authority which supports its position."

The Commentary to Article 21 of the Convention attempts to specifically override the result of the Lincoln First Bank case by stating that the LCD provisions are intended to establish only "a kind of minimum position" as to what assistance must be provided but are not intended to preclude the requested State from supplying more extensive assistance. Commentary, ¶ 195.

[7] In accord is United States v. Manufacturers & Traders Trust Co., 703 F.2d 47 (2d Cir. 1983).

In the Stuart case, in outlining the steps undertaken by the IRS to demonstrate its prima facie good faith showing, the Court specifically referred to the IRS' determination "that the same type of information could be obtained by the Canadian authorities under Canadian law." It seems possible that the Supreme Court was indicating that the good faith standard of the Powell case requires a determination that the measure could be carried out under the domestic laws of the requesting foreign country.

C. Comments

We believe that the cases have developed a reasonable policy line which should be followed in the implementation of the LCD provisions of the Convention, notwithstanding the clear language of the Commentary that the intention was to provide maximum flexibility to the requested State. Thus, e.g., where the U.S. is requested to issue a summons, the "good faith" test of Powell should be adhered to. In cases where the request requires U.S. action that is not available to the IRS in enforcing its own tax laws, or is available but not normally used (and assuming the statutory machinery for implementation of the measure exists), the determination should be, as in Stuart, whether the reason the IRS cannot (or does not) pursue the same measure is founded in constitutional or other fundamental safeguards or in merely procedural aspects of the U.S. system not particularly germane to the applicant country. In the first case, the IRS should not be authorized to carry out the requested measure. In the second case, it should be.

We also believe that the IRS should not generally carry out measures on behalf of a foreign country that could not be carried out in that country. This general rule would not apply where the difference in the measures available here and in the foreign country were procedural in nature, e.g., simply reflecting differences in the two systems. In Stuart, for example, the limitation of Code section 7602(c) was considered to be tied to our grand jury system, and thus not germane to systems not employing grand juries. The prohibition should be against providing foreign countries with avenues for avoiding restrictions that are built into their own systems to safeguard the rights of their citizens.

Similarly, to protect U.S. citizens, the IRS should not make a request to a treaty partner to take advantage of measures available in the requested country that are not available in this country.

Consideration should be given to incorporating in Treasury's technical explanation and in the Senate committee report specific limitations on Treasury's ability to furnish information above minimum requirements in situations involving the most fundamental concerns. These would include constraints with respect to the LCD provisions, as discussed above, and the furnishing of trade secrets.

We also believe it is essential that the IRS be required to give written notice to the particular taxpayer that is the subject of a foreign country's request for information, because of the possible applicability of one or more of the limitations on the obligation to provide information. This right should be extended to all persons who are the subject of a request for

information, spontaneous exchange or other exchange of information provision (except an automatic exchange), whether or not nationals or residents of the United States.

In this regard, we note that Article 4.3 provides:

> Any Party may, by a declaration ad-dressed to one of the Depositaries, indicate that, according to its internal legislation, its authorities may inform its resident or national before transmitting information concerning him....

The literal language of Article 4.3 would suggest that the failure of a State to inform a Depositary of its intent to provide notice prior to transmitting information would not bar the State from providing such notice. Such a reading also suggests that notice may be given to persons who are neither nationals nor residents of the United States as well as to those who are. One wonders, however, why Article 4.3 was inserted unless the declaration to a Depositary was intended to be a precondition to providing advance notice. Moreover, we realize that Article 21.2(a), under which a State is not obligated to "carry out measures at variance with its own laws or administrative practice," provides the basis for the United States to give notice to taxpayers in certain cases, e.g., when a third-party summons is issued. In light of the importance of notice, in the absence of clarification of the meaning of Article 4.3, we believe that approval of the Convention should be predicated on the United States' giving notification in writing to a Depositary to preserve the right to give notice to an affected party before any requested information is supplied.

Once notice is given, the taxpayer should be allowed a reasonable period of time to respond, so that a full presentation can be made of the reasons why he or she believes that a particular limitation on the obligation to provide information should be invoked by the IRS. It will not be possible, in many cases, for the IRS to be in a position to make an appropriate evaluation of the existence of limiting circumstances without the input of the affected taxpayer. Examples of such cases include the existence of trade secrets, a non-tax motive on the part of the applicant State, a legal bar to obtaining the same information in the applicant State, or a failure by the applicant State to exhaust its own resources.

We do not mean to suggest that, having preserved the right to give notice, the United States should exercise such right in every instance. The right must be exercised, and procedures for considering objections implemented, without unduly impairing the exchange of information with our treaty partners that the Convention is intended to foster. For example, we do not believe that notice should be required for the automatic exchange of information. Experience also may show that other types of information frequently requested or potentially coming under the spontaneous exchange provisions are sufficiently unlikely to fall within any of the limitations in the Convention that an objection by an affected party should be considered only on an especially clear showing of the existence of an issue under one of the limitations. We believe that this question is best handled pragmatically in response to experience with the numbers and types of cases involving notice requirements. In developing procedures for giving notice, the same pragmatic approach should apply in order to achieve an acceptable balance between the effective communication of notice and administrative efficiency.

Treasury should develop and publish initial guidelines, subject to revision on the basis of such experience, which set forth the procedures for giving notice in different circumstances and, in as much detail as possible, the basis on which it will decide cases involving each of the limitations on the obligation to provide information.

We would also favor some limited form of judicial review of any denial of the taxpayer's application by the IRS if and to the extent compatible with the overriding goal of achieving meaningful exchanges of information with our treaty partners.