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Exchange of Information and Validity of Global
Standards in Tax Law: Abstractionism and
Expressionism or Where the Truth Lies

Ana Paula Dourado

European University Institute
Robert Schuman Centre for Advanced Studies
Global Governance Programme

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European University Institute

Badia Fiesolana

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Abstract

This paper analyses the question on whether a Hercules legislator would validly propose a global standard, in particular, exchange of information between tax officials and those taxpayers who have a connection with one of the countries involved. This suggestion covers tax matters, including tax crimes, and is being put forward by the Global Forum.

In recent decades, a global legal discourse has spread, but this trend has also been confronted with the acknowledgment that plural legalities coexist in domestic boundaries. Validity of a tax reform implies taking into account binding non-state and supra-state legalities.

Individual legalities in force in a certain state are the cause of an important tension, and can result in important obstacles to the validity of state law, if the latter is not the product of argumentative interaction. The risk that such interaction does not exist is higher in the case of supra-national legalities, as is the case of exchange of information.

It is herein claimed that a Hercules legislator would propose exchange of information on tax matters as an international standard, as long as the taxpayers' fundamental rights as acknowledged in rule-of-law states are not jeopardized. It is also suggested that transitional regimes should be adopted in respect of some States.

Keywords

Taxes and Exchange of Information; International Standards; Fishing expeditions; Taxpayers' fundamental rights

1. Introduction*

I have previously made use of a Hercules legislator in the context of tax reforms carried out by an external draft legislator who aimed at the validity of those tax reforms in which she or he was engaged.¹ I have also contended that validity of a tax reform implies taking into account the plural legalities in force in a certain jurisdiction, including non-state legalities that have been recognized as binding by tax officials and courts.² These legalities could include overlapping of taxes resulting in double taxation, different procedural tax rules, adoption of different accounting rules and languages in tax compliance duties.

In this paper, the question is whether a Hercules legislator would validly propose a global standard, in particular, exchange of information between tax officials on taxpayers who have a connection with one of the countries³, and suggesting that exchange of information is to be adopted universally. This suggestion is being put forward by the Global Forum. In its view, “[t]he international standard, which was developed by the OECD in co-operation with non-OECD countries and which was endorsed by the G20 Finance Ministers at their Berlin Meeting in 2004 and by the UN Committee of Experts on International Cooperation in Tax at its October 2008 Meeting, requires the exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged”.⁴

2. Plural Legalities, Global Standards, Recognition and Validity

It is undeniable that in recent decades a global legal discourse has spread and tax reforms with global solutions have been adopted but this trend has also been confronted with the acknowledgment that plural legalities coexist in domestic boundaries. This acknowledgment is relatively recent and covers every legal field.⁵ Legal pluralism has been debated in respect of developing countries where sub-state

* Professor of Tax Law, Faculty of Law, University of Lisbon, Portugal; since 2003 has been acting as expert at the legal department of the IMF, drafting and negotiating tax reforms in Portuguese-speaking countries; Scientific Coordinator (together with Pasquale Pistone) of the Executive Seminars and Conferences (EUI, Global Governance Programme) on: Tax Havens, Selected Theoretical and Practical Issues, A Legal and Economic Perspectives (2011); From Tax Havens to International Tax Coordination: a Focus on Developing Countries (2012).

¹ Ana Paula Dourado ‘Is this is a pipe? Validity of a tax reform for a developing country’, in: *Tax Law and Development* (ed. by Y.Brauner & M.Stewart), Elgar, 2013, at 127 et seq.

² Idem, at 130- 133: as a reference to Hart’s rules of recognition (secondary rules). Hart’s concept of law covers primary and secondary rules, accommodates sources of law that do not necessarily emanate from the state, since law exists and is valid if there are commonly accepted rules of recognition. H.L.A. Hart, “*The Concept of Law*”, Clarendon Law Series, Oxford University Press, Oxford, 1961, at 138-140.

³ See below, point 3.

⁴ OECD, *Tax Co-operation 2009: Towards a Level Playing Field* , 2009, available at www.oecd.org (last visited 24 October 2012) at 8.

⁵ Jeremy Waldron, “Legal Pluralism and the Contrast Between Hart’s Jurisprudence & Fuller’s”, *The Hart-Fuller Debate in the Twenty-First Century*, ed. by Peter Cane, Hart Publishing Oxford and Portland, Oregon, 2010, at 141 et seq.; Alessandra Facchi, *I Diritti nell’ Europa Multiculturale, Pluralismo Normativo i Immigrazione*, Editori Laterza, 4^a ed., Roma-Bari, 2008, at 38; Leopold Pospisil, *The Anthropology of Law: A Comparative Theory of Law*, Harper and Row, New York, 1971; John Griffiths, “What is Legal Pluralism?”, *Journal of Legal Pluralism and Unofficial Law*, 1986, n. 24, at 1-50; Sally Falk Moore, “Law and Social Change: The Semi-Autonomous Social Field as an Appropriate Subject of Study”, *Law & Society Review*, 1973, n. 7, at 719 et seq.; Sally Engel Merry, “Legal Pluralism”, *Law & Society Review*, vol. 22, 1988, n. 5, at 870 (869-901). David Nelken, “Eugen Ehrlich, Living Law, and Plural Legalities, *Theoretical Inquiries in Law, Legal Pluralism, Privatization of Law and Multiculturalism*” , 2008, n. 2, 446 -458;

legalities of existing communities coexist with state legality, but the discussion on legal pluralism is likewise applicable to OECD countries, Council of Europe countries, regional integration areas such as the European Union and the European Economic Area, and any other country especially when facing important immigration movements. The global legal discourse is moving fast in tax law as well, and is a product of global identity, solidarity, and a sense of global fairness and unfairness, global human and fundamental rights.⁶ The awareness of phenomena such as tax evasion and avoidance by certain groups of taxpayers, the consequences of bank and tax secrecy and tax havens for each and every country, the importance of exchange of information on tax matters, the right to a fair hearing in tax litigation, information duties and the *nemo tenetur se ipsum accusare* principle, are examples of global problems asking for global solutions and global tax standards.

Global tax standards are in most cases proposed by international organizations, where the horizontal influences of different state legalities are discussed, some of them taken as best practices (for example, exchange of tax information on request) and recommended afterwards as a vertical legality (an international best practice or standard) in soft law instruments to all Member States. Horizontal (Member States') and vertical (EU Law) legalities interact daily in the European Union, where, on the one hand the Court of Justice adopts principles that are considered to be inherent to the rule of law and fundamental rights in Europe, and on the other hand, Member States are required to adopt EU principles and concepts under the primacy principle.⁷

In respect of migration movements, there is a risk of reciprocal ignorance of the incoming and the state legalities involved that will affect recognition of rules and their binding character (I would call these cases blind vertical legalities). Consequences of blind vertical legalities can occur in the case of a state income tax that adopts a legal concept of taxpayer that corresponds to the dominant legal culture, and does not recognize any tax consequences to trusts; or in the case of marriage and family that corresponds to the dominant culture and religion within a country and does not recognize other types of marriages and families; or in the case of small and medium-sized enterprises constituted by immigrant groups organizing themselves according to the rules of their home culture and legal system and having therefore a dispute with the state tax officials and courts.

Plural legalities in force in a given state are facts for my purposes in this paper and they refer to legalities that are recognized as binding by the authorities that apply the law (and I am adopting the Habermasian meaning of facts and facticities⁸). But recognition that plural legalities are in force is insufficient: my concerns are related to the validity of law and by it I mean legal rules that are the product of genuine argumentative interaction among the representatives of different legalities (again in the Habermasian sense⁹) both within a state and at an inter-state level, the latter being either bilateral or multilateral. The concept of validity of law adopted herein covers tax reforms and any global rules

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Martha-Marie Kleinhaus/Roderick A. Macdonald, "What is a Critical Legal Pluralism", *Canadian Journal of Law & Society*, 1997, n. 12, at 25-46;

⁶ Amartya Sen, *Identity and Violence, The Illusion of Destiny*, W.W. Norton & Company, New York, London, 2006, e.g. chapters 2 and 7; Boaventura Sousa Santos, *Por uma Concepção Multicultural de Direitos Humanos, Reconhecer para Libertar, Os Caminhos do Cosmopolitismo Multicultural*, Boaventura Sousa Santos (org.), Civilização Brasileira, Rio de Janeiro, 2003, at 427-551.

⁷ On legal pluralism in the European Union, see: Miguel Poiaras Maduro, *We the Court, - The European Court of Justice and the European Economic Constitution*, Oxford, Hart Publishing, 1998; "Contrapunctual Law: Europe's Constitutional Pluralism in Action", in Neil Walker (ed.), *Sovereignty in Transition*, Oxford, Hart Publishing, 2003, at 501-537; *A Constituição Plural, Constitucionalismo e União Europeia*, Principia, São João do Estoril, Cascais, 2006, capítulos I e IV; Koen Lenaerts, "Constitutionalism and the Many Faces of Federalism", *American Journal of Comparative Law*, vol. 38, 1992, n. 2, at 205-263.

⁸ These concepts are therefore used here in the Habermasian sense and further discussed below: See Jürgen Habermas, *Faktizität und Geltung, Beiträge zur Diskurstheorie des Rechts und des demokratischen Rechtsstaats*, Frankfurt-am-Main, 1992, 2. Auflage, at 32-55.

⁹ Jürgen Habermas, *Faktizität ...*, cit., at 21, 32-55.

and standards applicable in cross-border situations and resulting from a compromise assumed under international law.¹⁰

Individual legalities in force in a certain state are themselves the cause of an important tension, and can result in important obstacles to the validity of state law, including the validity of a state tax reform if state law is not the product of the aforementioned argumentative interaction. The risk that such interaction does not exist is higher in the case of supra-national legalities, as is the case of exchange of information designed by the OECD in Article 26 OECD Model Tax Convention and the Model Agreement on Exchange of Information on Tax Matters (published in 2002 by the Global Forum on Taxation and it containing both bilateral and multilateral drafts).

My question is therefore whether a Hercules legislator would propose exchange of information on tax matters (including tax crimes) as an international standard, in the sense that exchange of information would be the best legal solution for every state in the world, and if so, without jeopardizing the taxpayers' fundamental rights as acknowledged in rule-of-law states. For the sake of clarity, it is herein further contended that every tax principle and rule demanded by the rule of law and the rule of law itself is an international standard and therefore, international standards exist and can be proposed universally. However, to propose a standard as universally valid implies a previous assessment of utmost responsibility, especially when it is proposed by international organizations powerful enough to lead their members to adopt such standards.

An international organization will have to play the Hercules legislator: it will perfectly grasp the tax system of a specific country, propose the best solutions for an efficient and equitable system in compliance with the rule of law, assess the complexity of those solutions and the consequences for the taxpayer and the tax administration, and in order to carry out this task it will have to deal with the plural legalities in force and be sure that a specific country has a constitutional system and procedural rules that will guarantee a genuine argumentative interaction before exchange of information is approved. If a parallel is drawn with abstractionism or expressionism in contemporary painting, the answer will be that the context will determine the style chosen by the artist and whether it is recognized as art. In other words, validity of exchange of information as an international standard will imply an assessment of the context and not be satisfied by its potential beneficial effects.

3. The Object and Purpose of Exchange of Information

Exchange of information will take place when it is foreseeably relevant to the correct application of treaty rules (minor information clause) or/and in order to carry out the administration and enforcement of domestic tax laws of the contracting states (major information clause). The condition of the "foreseeable relevance" of information exchanged was introduced in 2005, replacing the term "necessary" (OECD MC 1977). Previously to 2005, information was considered to be "necessary" in case it was relevant to correctly carry out the provisions of a convention¹¹ or to implement domestic taxes in the contracting state requesting the information.¹²

¹⁰ As a consequence, it is herein contended that the rules of recognition also have to be valid in the Habermasian sense: Jürgen Habermas, *Faktizität...*, cit., at 21, 32-55.

¹¹ See Federal Tax Court (Bundesfinanzhof) Munich, of 29 April 2008, Case n.° IR 79/07, company name not disclosed (the taxpayer) v. Federal Central Office for Taxation (formerly Federal Tax Office) (the tax authorities): 'In line with Article 26 OECD MC this provision also covered spontaneous exchange of information, 'but it required that the exchange was necessary for carrying out the provisions of the treaty. ... But the Exchange had to be limited to the facts that were necessary for enabling the Chinese authorities to tax X, such as his name, his address in China, the type and amount of his income. The fact that salaries are taxed with the assistance of the employer in Germany (deduction at source) did not justify naming the German employer to the foreign authorities.'

¹² The Swiss Federal Supreme Court (Schweizerisches Bundesgericht) has decided that 'the behavior of X was within the scope of the term "tax fraud and the like" as used in Art. 26 (1) of the treaty, Schweizerisches Bundesgericht of 27

Both in Article 26 OECD MC and in Article 2 Model Agreement, exchange of information is not limited to information relating to the affairs of residents of the Contracting Parties. The scope of Article 26 is broader in terms of taxpayers and taxes covered by the OECD MC, because it covers persons not entitled to the treaty benefits, not only because of the major information clause, but also when the information regarding those non-entitled persons is foreseeably relevant for carrying out the provisions of the tax treaty. That is the case for residents of a third country, although there are limits in respect of exchanging information about those persons. It is admitted that the tax liability in one of the contracting states of a person resident in a third country provides for the necessary connection to legitimate exchange of information between the mentioned contracting states: for example, where there is income with a source in one of the contracting states regarding a resident in a third country.

Exchange of information aims to fight tax evasion and to guarantee effective fiscal supervision and it is, as the other side of the coin, a condition to raise (otherwise lost) revenue, but neither of the two legitimates the standard per se. By providing transparency with regard to taxable events, exchange of information will both prevent evasion and potentially allow for a more efficient control, but this purpose is insufficient to justify it as an international standard, because the legitimate instruments and action taken by each tax administration will have to comply with the taxpayers' rights.

Exchange of information will create the conditions to raise revenue, but it is neither an anti-abuse measure, since it does not re-characterize tax facts, nor an interpretive tool counteracting tax avoidance. It is common sense that taxes always aim at raising revenue and therefore this purpose cannot guide the application of tax law by the administration.¹³ Moreover, exchange of information, as a standard, is a condition for a balanced allocation of taxing rights, since it will lead to transparency on the tax burden raised by each jurisdiction and to fair competition among the jurisdictions wanting to attract investment. The lack of exchange of information can jeopardize a balanced allocation of taxing rights between two states that have concluded a bilateral tax treaty, if a conduit company is interposed in a third state not exchanging tax information. This is also applicable in a multilateral relationship, such as the European Union or the Economic European Area, if at least one of the Member States does not exchange information, jeopardizing in this manner the balanced allocation of taxing rights among all of them.

In bilateral relationships, if important amounts of investment are being diverted to conduit companies, states can react by terminating tax treaties or by introducing unilateral discriminatory tax measures and expanding the concept of source. It is therefore herein assumed that enforcement of domestic tax law in the case of cross-border situations, elimination of juridical double taxation, application of non-discrimination clauses and in general the design of an international tax policy by a state, namely whether the purpose is to achieve import or export neutrality, can only be reached if there is exchange of information. The lack of exchange of information is an alien that will introduce distortions in the approval of a tax reform including where different legalities are represented.

Because without exchange of information, there is no effective fiscal supervision and the law cannot be enforced, in the European Union, the European Court of Justice accepts the lack of exchange of information as a valid justification for a discriminatory treatment against a third country or an EEA country.¹⁴ In contrast, the European Court of Justice presumes that the existence of a

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January 2004, Case n.º BGE 2A. 185/2003, Not disclosed (the taxpayer) v. Eidgenössische Verwaltung. The Court determined that there were several occasions when X, most probably tried to hide the commissions by giving incorrect evidence and using wrong or misleading certificates. The Court emphasized that the IRS was not obliged to provide strict evidence. The Court stated that it was sufficient if the suspicion of tax fraud or the like was justified. The Court held that such conduct constitutes "tax fraud or the like" in the sense of Art. 26 (1) of the treaty.

¹³ Klaus Vogel & Christian Waldhoff, *Grundlagen des Finanzverfassungsrechts, Sonderausgabe des Bonner Kommentars zum Grundgesetz (Vorbemerkungen zu Art. 104 a bis 115 GG)* Heidelberg, at 199, 309 et seq.

¹⁴ For example, ECJ, 18 December 2007, C-101/05 (*Skatteverket v A.*).

directive on exchange of information is a sufficient tool to assure enforcement of domestic law.¹⁵ Until the recent peer-review work by the Global Forum, the scope of exchange of information as proposed by Article 26 OECD MC was often limited in the bilateral conventions, because of domestic constraints and often led either to its non-inclusion in the bilateral conventions or to its non-application.

All in all, it is herein also assumed that the current international trend toward global tax transparency and exchange of information is the most efficient tool to counteract global aggressive tax planning, but it has to be questioned whether it is a valid international standard.

4. The Assessment of Exchange of Information as a Valid Standard

The universality of a tax standard can neither be merely justified in the interest of the international community, nor in the interest of state revenue, or by the prevention or combating tax evasion as a menacing scenario (not to be proved on a case-by-case basis), or in the interest of survival of a certain category of taxes (for example, corporate income tax). Each of these is too abstract to guarantee compliance by states involved in exchange of information with the fundamental rights of each and every taxpayer potentially or effectively affected by that standard. An international standard cannot be justified in the interest of enforcement of law either; otherwise the use of torture could be justified as a means of evidence to enforce criminal law as happened in the Middle Ages.

It has to be kept in mind that information exchanged concerns taxpayers, and therefore it has to respect their fundamental tax rights, unless the public interest is superior to the former. It is herein considered that exchange of information aims at preventing and combating tax evasion and this is a behaviour adopted both by individual taxpayers and corporations.¹⁶ This behaviour occurs in a scenario of worldwide income tax on individuals (global and progressive personal income tax), and of source income tax on companies, where the major information clause covers any situations of the correct allocation of taxing rights and any taxpayers involved.

It has to be verified, for example, whether and to what extent a right to be notified of an exchange of information procedure is foreseen in one, both or all of the tax systems involved, whether confidentiality will be guaranteed, whether and to what extent the statute of limitations is respected, whether information obtained illicitly by a tax administration can be validly used and transmitted. It also has to be discussed whether bilateral or multilateral exchange of information is consistent with the principle of separation of powers and more generally with the rule of law in a certain state or whether it is detached from domestic legalities. Exchange of information will not be valid, in the sense adopted in this paper, if it is introduced in the domestic law of an authoritarian state, as a condition to attract important foreign services industries, but without the necessary underlying organization for collection and storage of reliable data and without a guarantee of the due confidentiality.

All of these aspects should be weighted and verified by an international tax organization and its members, before extending the standard on exchange of information to any country in the world. They should at least be part of a peer-review assessment within the Global Forum. In other words, exchange of information will only bring the level playing field back if the states committed to exchange information are rule-of-law states and are organized to collect and store reliable data in conditions of

¹⁵ ECJ, 15 de May 1997, C-250/95 (*Futura Participations SA and Singer v Administration des contributions*).

¹⁶ N. Johannesen & G. Zucman, "The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown", *WP*, 2012; J.R. Hines, and E.M. Rice, "Fiscal paradise: Foreign tax havens and American business", *Quarterly Journal of Economics*, 109, 1995, n. 1 at 149–182; D. Dharmapala & J.R. Hines Jr., 'Which Countries become Tax Havens', 93 *Journal of Public Economics*, 2009, at 1058; D. Dharmapala, 'What Problems and Opportunities are Created by Tax Havens' 24 *Oxford Review of Economic Policy*, 2008, at 661.

confidentiality. A preliminary analysis of the validity of exchange of information therefore raises serious doubts on its universal validity.

5. The Global Forum and the Peer-Review Criteria

The Global Forum is the division of the Centre for Tax Policy and Administration of the OECD that is heading the implementation of the “internationally agreed standard” on exchange of information as an answer to the call for improved tax transparency.¹⁷ The current international standard on exchange of information results from Article 26 OECD MC, Article 1 2002 OECD Model Agreement on Exchange of Information and its 2005 Commentary and the 2010 Protocol to the Council of Europe/OECD Convention on Mutual Administrative Tax Matters

Since the G20 in its November 2008 meeting in Washington DC, and 2009 under the auspices of the restructured Global Forum on Transparency and Exchange of Information, there is strong policy pressure in order to implement exchange of information standards, and obstacles under domestic law based on bank secrecy, lack of domestic interest and lack of reciprocal investigative efforts by the other contracting state cannot be directly invoked. The restructured Global Forum ensures that all its members are on an equal footing and will fully implement the standard on exchange of information they have committed to implement. Technically, the Global Forum on Transparency and Exchange of Information for Tax Purposes is a part II programme of the OECD.

It is a fact that treaties on exchange of information (TIEAs) have increased exponentially since 2009. TIEAs are to be concluded with countries for which tax treaties are not considered appropriate, i.e., that have technically been considered to be tax havens. For example, countries, such as Luxembourg, that had strong bank secrecy and did not engage in information exchange until recently, but were never considered to be tax havens in the technical sense, did not conclude TIEAs. Their changing policy towards exchange of information has been dealt with under the respective DTCs.¹⁸

The context of this proposed international standard, can be further understood on the webpage of the Global Forum on Transparency and Exchange of Information for Tax Purposes, where it can be read: “The Global Forum called together 178 delegates from 70 jurisdictions and international organisations on 1-2 September in Mexico to discuss progress made in implementing the international standards of transparency and exchange of information for tax purposes, and how to respond to international calls to strengthen the work of the Global Forum. In the context of the need of governments to protect their tax bases from non compliance with their tax laws, the main objectives for the meeting were to: Agree on restructuring the OECD Global Forum to expand its membership and ensure its members participate on an equal footing; Agree on how to establish an in-depth peer review process to monitor and review progress made towards full and effective exchange of information; and identify mechanisms to speed-up the negotiation and conclusion of agreements to

¹⁷ There are commitments from all of the G20 members, as well as incorporation of the standard into the UN Model Double Tax Convention, the Multilateral Convention on Mutual Assistance in Tax Matters, and the OECD Model Tax Convention. The Global Forum is also working with the International Financial Corporation of the World Bank, the International Monetary Fund and the Financing for Development arm of the United Nations Department of Economic and Social Affairs in order to expand its membership and to execute technical assistance programmes to build capacity for effective exchange of information, particularly among developing countries. The aforementioned international organizations are active observers at the Global Forum, participating in its meetings; the Global Forum on Transparency and Exchange of Information for Tax Purposes, *Information Brief*, 29 October 2012, <http://www.oecd.org/tax/transparency/Journalist's%20brief%20October%202012.pdf> last visited 24 October 2012, at 2 and 7.

¹⁸ Luxembourg adopted the OECD mutual assistance standards by law on 31 March 2010: See A. Steichen ‘Information Exchange in Tax Matters: Luxembourg’s New Tax Policy’ in: A. Rust.& E. Fort (eds.), *Exchange of Information and Bank Secrecy*, 2012, at 32, 44-53; see also the case of Belgium: C. Docclo, ‘Exchange of Information’ in: A. Van De Vijver (ed.), *The New US-Belgium Double Tax Treaty – A Belgian and EU Perspective*, 2009, at 537–553.

exchange information and to enable developing countries to benefit from the new more cooperative tax environment”.¹⁹

The strong push on exchange of information under the Global Forum and now involving 118 states is a result of the financial crisis of 2008, but prior to the current trend, other rules were also recommended by the OECD to counteract the aforementioned global tax planning: Exchange of information in tax matters and global fiscal transparency are being proposed on the basis of an international standard as drafted by the Global Forum and as a tool to counteract harmful tax competition as a global issue.

This results from the OECD research and reports: lack of effective exchange of information was the main criterion for identifying tax practices harmful to competition²⁰ in the OECD Report on “Harmful tax competition: an emerging global issue” of 1998. The Report concerned and identified tax havens and harmful preferential tax regimes. Tax havens were therein defined as providing for no or nominal income taxes, combined with other legislative or administrative features, such as minimal administrative and regulatory constraints (they corresponded to jurisdictions with no taxes, no transparency, no exchange of information and no real activity). In turn, preferential tax regimes provided favourable locations for holding passive income or book keeping profits. Three features were identified as common to tax havens and preferential tax regimes: absence of true taxes, lack of effective exchange of information, lack of transparency.²¹ In tax havens there was no substantive activity and in the case of preferential tax regimes ring fencing of benefits in order to attract non-resident investors was a main feature.²² The Report was focused on income taxes, and the provision of financial services and tax incentives to attract investment in plant and equipment was left aside.

Still in the same OECD Report of 1998, the OECD recommended its Member States to identify non-cooperative jurisdictions in domestic lists and to subject cross-border investments to or from those jurisdictions to a higher tax burden, either by way of controlled foreign company rules, higher tax rates, non-deductibility of interest paid to a taxpayer in such a jurisdiction. The Report makes 19 recommendations, divided in three groups and aimed at improving international cooperation and responding to harmful tax competition: recommendations dealing with domestic legislation and practices (for example, introduction of controlled foreign company rules; adoption of information reporting rules of international transactions; access to banking information for tax purposes), addressing tax treaties (for example, greater and more efficient use of exchange of information) and recommendations to increase international cooperation in response to harmful tax practices (for example, publication of a list of tax havens).

The 1998 Report, the subsequent 2001 OECD Progress Report, the Model Agreement on Exchange of Information on Tax Matters in 2002, by the Global Forum Working Group on Effective Exchange of Information for Tax Purposes, include recommendations on the topic. These recommendations are soft law and not legally binding instruments, until included in international treaties.

¹⁹ <http://www.oecd.org/tax/transparency/abouttheglobalforum.htm>

²⁰ These developments in the OECD MC resulted from the G7 Lyon Summit in 1996 where the OECD was mandated to produce a report on harmful tax competition. In 1998 the OECD issued the report on “Harmful tax competition: an emerging global issue” (hereinafter: the Report). Harmful tax competition was characterized in the Report as a worldwide problem and it was concluded that the lack of effective exchange of information was the main criterion for identifying tax practices harmful to competition: See M. Engelschalk, Article 26, in: K. Vogel & M. Lehner (eds.), *DBA Kommentar*, 2008, at m.no 21; and P. Malherbe & M. Beysberger, ‘The Year of Implementation of the Standards?’ in: Rust A. & Fort E. (eds), *Exchange of Information and Bank Secrecy*, 2012, at 122-124.

²¹ *Harmful tax competition: an emerging global issue*, OECD Report, 1998, at 23-25.

²² *Harmful Tax Competition...*, cit., at 24; S.C. Ruchelman & S. Shapiro ‘Exchange of Information’, 30 *Intertax*, 2002, at 409.

What the legal implication of exchange of information as an international standard is then has to be discussed, why it is targeted at all states, and to what extent states are free to adopt it or not. In this context, bilateral or multilateral exchange of information is an example of a more general issue involving the recognition and validity of global standards and new (tax) standards to be adopted in cross-border situations.

In a legal perspective, the obligation to exchange of information under a (tax) treaty and even if subject to peer review by the Global Forum is insufficient to create a level playing field and a valid international standard. In fact, neither a provision on exchange of information included in an international treaty nor the action by the Global Forum is able to harmonize domestic legislation and therefore they cannot themselves create a domestic legal basis for correctly implementing a request for exchange of information.

The Global Forum has acknowledged that the domestic legal basis is a condition to implement the international standard on exchange of information, by submitting members to a peer-review procedure aimed at verifying exchange of information in practice.²³ According to the Global Forum, the standard requires in each member State the existence of mechanisms for exchange of information upon request; the availability of reliable information, where bank, ownership, identity and accounting information are the most relevant; and powers to obtain and provide such information in response to a specific request in a timely manner; and respect for safeguards and limitations and strict confidentiality rules for information exchanged.²⁴ Whether the standard is observed or not is to be checked in the peer-review phases and all members are subject to peer-review.

Both ex-tax havens members of the Global Forum signing TIEAs and all other members of the Global Forum are submitting themselves to peer-review by the Global Forum. Part of the assessment by the Global Forum on whether the standard is being accomplished lies in quantification criteria, namely whether a member has concluded at least 12 TIEAs. Where a substantial number of the TIEAs have been concluded with other ex-tax havens, the assessment should be negative and exchange of information ineffective, because easily manipulated by the Member States of the Global Forum.

6. Assessment of Validity of Exchange of Information as an International Standard

6.1. *Ex-Ante, Ex-post Assessment*

The current international standard on exchange of information requires exchange of information on request (see Protocol on Exchange of Information to the Austria-Slovenia tax treaty)²⁵, in the case of foreseeable relevance to the tax administration without regard to the domestic interest of the requested State, bank secrecy²⁶ or dual criminality.²⁷ The standard is limited to information exchange on request because that corresponds to the scope of TIEAs.

²³ See the description of the peer-review mechanisms and the description of and comments on the Mauritius experience in: P. Malherbe & M. Beynsberger, cit., at 140-150.

²⁴ See http://www.oecd.org/document/33/0,3746,en_21571361_43854757_44200609_1_1_1_1,00.html.

²⁵ Protocol dated 7 October 2011.

²⁶ M.nos 19.10 and 19.11 OECD MC on Art. 26 (5).

²⁷ P. Malherbe & M. Beynsberger, cit., at 131; Switzerland traditionally had a different approach: J. Malherbe, 'Entraide Judiciaire Pénale et Délits Fiscaux: Évolution du Droit Suisse', *Journal de Droit Fiscal*, 1982, at 358 et seq. See M. F. Huber M. F. & F. Duss, Switzerland: Recent Developments in International Tax Law – Part 1' *Bulletin for International Taxation*, 2009, at 567.

Article 26 para. 2 OECD MC and Article 8 Model Treaty on Exchange of Information provide for confidentiality rules.²⁸ Moreover, Article 26 para. 3, together with paras. 4 and 5 OECD MC, draws the limits to the obligation to supply information. They complement para. 1 and the scope of exchange of information. The legal technique used to draw the scope and corresponding limits of exchange of information is as follows: Para. 3 a. and b. refers to domestic limits (administrative measures are to be taken within the framework of domestic laws and administrative practice and the supply of information has to be in compliance with domestic legality). Para. 3 c. (disclosure of trade or professional secrets) already follows from general international public law principles (*ordre public*). Paras. 4 and 5²⁹ in turn limit the scope of para. 3, since they enumerate what cannot be included in (limited by) para. 3.

The validity of exchange of information as an international standard can be assessed on the basis of the legal criteria ruling the aforementioned exchange of information on request, as well as on the basis of the criteria underlying the peer review phases and mentioned above. The relevant criteria for the validity assessment are the existence of foreseeable relevance and consequent prohibition of “fishing expeditions”; respect for domestic safeguards and limits; the prohibition of disclosure of trade or professional secrets; the existence of reliable data, and strict confidentiality rules.

However, the respect for safeguards and limitations is a formal and ultimately void criterion, because as such it does not require the existence of any or specific domestic safeguards and limitations. It only requires a non-discriminatory treatment of cross-border situations, taking into account the existing domestic safeguards and limitations. A related issue is whether information obtained illicitly can be validly used either in domestic or cross-border situations. Article 26 OECD MC does not contain any prohibition in this respect, as long as para. 2 is respected, and a prohibition of use being made of such evidence in the requesting contracting state depends on the latter state’s domestic law.³⁰ An international standard on exchange of information that does not prohibit the use of illicitly obtained data will contribute to and stimulate a global market where those data can be sold and bought, and where the confidentiality rules will not be observed.

The concept of validity of law requires a communicative discourse (separation of powers and different legalities represented), safeguards of fundamental taxpayers’ rights and related limitations on the activity of administration and courts, a clear prohibition of use of illicitly obtained data and absence of corruption, among other things. None of these are conditions to become a Member of the Global Forum (or of the Council of Europe or OECD); they are not criteria subject to peer review either. Furthermore, validity of exchange of information as a standard also has to be assessed taking

²⁸ “Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.” The 2012 update of Article 26 para. 2 adds that “*Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.*”

²⁹ Article 26 (4): If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no interest in such information.

Article 26 (5): In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interest in a person.

³⁰ Concurring, M. Engelschalk, cit., at m.no 98.

into account what is going to happen when it is effectively used by the contracting states in their bilateral or multilateral relations - a law-in-action approach.

Violation of taxpayers' fundamental rights (as would be required by the rule of law) can occur when either the requesting or the requested state (or both) do not comply with the rule of law, but when asking for information or providing it, a contracting state is not obliged to check if the other contracting party will comply with the rule of law.

In this context, exchange of information will neither reach neutral results nor accomplish a level playing field. Besides, tax relationships still strongly lie either in bilateral or in regional relations and the standard will be interpreted in different ways. International organizations suggesting exchange of information as an international standard ought to assess its validity from a joint law-in-the-books and law-in-action perspective, taking into account what may happen after it becomes legally binding and enters into force. In the case of multilateral treaties such as the OECD/Council of Europe Multilateral Treaty on Exchange of Information (on request), and in the case of multilateral automatic exchange of information (which is not yet an international standard but may become one in the near future), the risk of violation of taxpayers' rights is proportionally higher.

All in all, except for the foreseeable relevance of the request and confidentiality of the information exchanged, no minimum legal standard concerning taxpayers' rights in domestic legal systems is required as a condition for bilateral or multilateral exchange of information, and it is not certain that both legal requirements will be duly observed by the contracting states.

6.2. Foreseeable Relevance

It is assumed in this paper that the international standard on exchange of information has developed in the direction of intensifying and broadening the scope and reducing domestic obstacles to an effective exchange of information, accommodating the best practices developed among some of the contracting states. Among those facilitating conditions are the ones that are to be invoked by the requesting state when asking for information. For example, in 2005, the condition of "necessity" under Article 26 para. 1 was changed to "foreseeable relevance", and became consistent with Article 1 Model Agreement on Exchange of Information on Tax Matters. The standard of foreseeable relevance had also been adopted by the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters of 1985 (Article 4 para. 1).

As the criterion has been changed from necessity to foreseeable relevance, any (detailed enough) request to confirm the origin, amount and beneficial owner of foreign-source income, for example, can justify a request by a contracting state, even if in the end the data provided do not lead to a different tax result (what matters is an a-priori assessment). Information requested is foreseeably relevant, if it is "of some demonstrable benefit or assistance to the other country"³¹, and as long as it identifies the taxpayers and tax-relevant situations (i.e., as long as it is not a 'fishing expedition').³² It has also been argued that 'foreseeably relevant information' stems from a 'probably appropriate request'.³³ 'Probably appropriate' allows for the a-priori assessment by the requesting State and leaves some margin to the requested State, preventing a 'fishing expedition'.³⁴ According to the Commentary 4 on Article 1, "The Agreement uses the standard of foreseeable relevance in order to ensure that

³¹ Adrian J. Sawyer, 'Tax Havens "Coming in from the Cold": A Sign of Changing Times?' *BFIT* November, 2010, at 549.

³² It is not necessary, however, that before making its request the requesting State must have already collected enough information to indicate that fraud exists: differently S. Braum & V. Covolo, 'European Criminal Law and the Exchange of Tax Information: Consequences for Luxembourg's Bank Secrecy Law' in: Rust A. & Fort E. (eds.), *Exchange of Information and Bank Secrecy*, 2012, at 47.

³³ P. Saint-Amans, *Europolitics*, Internet: <www.europolitics.info> (last visited 24 October 2012).

³⁴ P. Malherbe & M. Beynsberger, cit., at 128.

information requests may not be declined in cases where a definite assessment of the pertinence of the information to an on-going investigation can only be made following the receipt of the information". An inquiry or investigation does not have to strictly correspond to an audit, although the typical case will regard an audited taxpayer, and the checking of the corresponding information during the audit.

According to the OECD, the new expression "foreseeably relevant" is a clarification, but there are good arguments to claim that it has a broader meaning than necessity, including because the purpose is to extend exchange of information as much as possible, in the context of globalization.³⁵

In contrast, if necessity of information were to be interpreted in very strict terms by the requested state, it could be difficult in a concrete case to demonstrate it. The meaning of necessity could mean necessity after an audit, necessity because information obtained would lead to a different tax assessment or necessity in case an offence occurred and the exact extension of the offence was being investigated, necessity in case an additional assessment has occurred in the requesting state and further data were sought.

The wide scope of exchange of information on request finds its ultimate boundary in the prohibition of the below-mentioned "fishing expeditions". But there is a risk that the new expression facilitates fishing expeditions and it may be more difficult to determine the boundaries between foreseeable relevance and fishing expeditions. Fishing expeditions are defined in the Manual on Exchange of Information as "speculative requests for information that have no apparent nexus to an open inquiry or investigation".

If the taxpayer is identified in a request, the connection between the information sought and the taxpayer can be controlled (and all the other elements of the above-mentioned check list also contribute to that) and the request will not be speculative. Foreseeable relevance implies "a link to taxation with regard to the individual taxpayer, including the fiscal prosecution implementation"³⁶, but it can also cover a particular group of taxpayers. In the latter case, exchange of information will serve "the administration or enforcement" of domestic tax laws and comply with the requirements of paragraph 1, provided it meets the standard of "foreseeable relevance".³⁷ However, there will be a fishing expedition where the request relates to a group of taxpayers not individually identified, the requesting state cannot point to an on-going investigation into the affairs of that particular group or provide a detailed description of the group and the specific facts and circumstances that have led to the request, and other detailed explanation such as the applicable law, why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law supported by a clear factual basis and that the requested information would assist in determining compliance by the taxpayers in the group.³⁸

In this context, it is questionable whether the agreement concluded on 19 August, 2009, between the Swiss Confederation and the United States of America (US) on a request for legal assistance by the US Internal Revenue Service concerning a bank (A) resident in Switzerland (the 09 Agreement)³⁹ fulfils the aforementioned meaning and limits of foreseeable relevance or whether it is a fishing expedition. According to the criteria set out in the annex to the agreement, requests of information by the US to Switzerland under the US-Switzerland tax treaty cover the following persons where there is

³⁵ See no.57 OECD MC comm. on Art. 26.

³⁶ T. Schenk-Geers, 'International Exchange of Information and the Protection of the Taxpayer' in: R. Seer & I. Gabert (eds.) *Mutual Assistance and Information Exchange*, 2010, at 81.

³⁷ No. 5.2. OECD MC Comm.

³⁸ No. 5.2. OECD MC; see also Nos. 6 and 8.1 OECD MC.

³⁹ Agreement between the United States of America and the Swiss Confederation 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, Done at Washington, DC 19 August 2009; See M.J. Michaels & M.-T. Yates, 'The Death of Information Exchange Agreements ? (Part Two)' *Journal of International Taxation* , 2009, at 56 et seq.

a reasonable suspicion of "tax fraud or the like": US-domiciled clients of A. (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 between 2001 and 2008; and US persons (irrespective of their domicile) who beneficially owned offshore company accounts established or maintained between 2001 and 2008.

The term "tax fraud or the like" is defined in detail in the agreement. It extends to fraudulent conduct (e.g. constructing a scheme of lies or submitting incorrect or false documents) that might result in the concealment of assets and the underreporting of income. The direct reason for concluding this agreement lay in the fact that the US tax authorities had a data pool of 100 identified US residents who maintained undisclosed financial accounts with A and sought identification of any others on the grounds that the data pool should be interpreted as meaning an "ascertainable group or category of persons" and that it would be applicable to the US-Switzerland tax treaty. Switzerland agreed to process the request for legal assistance on the basis of the tax treaty concluded with the US in 1996 and by means of four categories of situations as defined in the Annex to the 09 Agreement. The request concerned an estimated 4,500 current or closed accounts.

The Swiss Federal Administrative Court, applying the Vienna Convention on the Law of Treaties (VCLT), characterized the 09 Agreement as a "Memorandum of Understanding," which may neither alter nor amend the tax treaty with the US of 1996. Thus, legal assistance might only be granted if the actions falling in the categories set out in the Annex to the 09 Agreement were foreseen in the tax treaty itself and did not go beyond it.⁴⁰ Following this ruling, a protocol was signed between the US and the Swiss tax administration (approved by the Swiss Federal Council on 31 March 2010) and passed by the upper house of the Swiss parliament in December 2011 and by the lower house of the Swiss parliament in March 2012).⁴¹ The Swiss Federal Administrative Court then dismissed the appeal against the Federal Tax Administration to grant administrative assistance based on the Agreement of 19 August 2009 as amended by the mentioned Protocol and accepted that the request by the US authorities was not a fishing expedition.

It is contended here that the terms under the US-Swiss Protocol correspond to the example under the OECD MC Commentary 8.1. a), allowing for behavioural-pattern information and go beyond the OECD and the Global Forum standard on exchange of information on request. Its Protocol allows for behavioural-pattern information exchange requests. It therefore constitutes a fishing expedition according to that standard, since the identity of the account holders was unknown as well as the account number or similar identifying information or even the name of the financial instruments.

The issue is whether the forbidden fishing expeditions go beyond the standard or whether they violate the standard. If prohibition of fishing expeditions is aimed at protecting the requested tax administration, nothing prevents them going beyond the standard. This is the viewpoint of the OECD MC Commentaries: According to Commentary 6 introduced on 17 July 2012, "[i]n the examples mentioned in paragraph 8.1, and assuming no further information is provided, the contracting states are not obligated to provide information in response to a request for information".

However, if the standard (i.e. the prohibition of fishing expeditions) aims at protecting taxpayers' rights, there are good reasons to fear that such actions violate the standard, unless those rights are duly safeguarded. Under the US-Swiss Protocol, the individuals concerned will arguably be allowed to inspect their files upon request, and will also be granted the opportunity to state their case. The rights

⁴⁰ Swiss Bundesverwaltungsgericht of 21 January 2010, at m.nos 4.1.1., 4.1.3., 4.2.2.-4.2.4., 4.3, 5-6.

⁴¹ On 5 March 2012 the lower house of the Swiss parliament amended the resolution ratifying the 2009 protocol to the Switzerland-US income tax treaty to simplify the identification of potential tax evaders holding secret Swiss bank accounts. The amendment passed 110 to 56, confirming Swiss lawmakers' initial support in a procedural vote taken on 29 February. See also Tax Analysts Doc 2012-4271 or 2012 WTD 41-1. The parliament's upper house had already passed the amendment in December 2011.

of these individuals are therefore safeguarded in full. The Swiss Federal Tax Administration will decide whether or not assistance will be provided, and will issue a final decision. Upon receipt of this decision, the individuals concerned have 30 days in which to lodge an appeal with the Federal Administrative Court, which will issue a judicial final decision.⁴²

Where parties bilaterally go beyond the OECD standard and engage in fishing expeditions, it is contended here that in such cases exchange of information upon request is moving in the direction of automatic exchange of information, risk analysis techniques or tax avoidance or evasion schemes (exchange of sensitive information not limited to taxpayer-specific information)⁴³, even though in the latter case it is exclusively for the requesting State to assess the data.

This trend can hardly be part of a valid international standard, taking into account that taxpayers' fundamental rights vary greatly among the Members of the Global Forum. There is no guarantee that taxpayers' rights are duly safeguarded, namely that the individuals concerned by a fishing expedition, that has been accepted as valid by a requested state, will be allowed to inspect their files upon request and granted the opportunity to state their case.

6.3. Assessment of Validity by a Requested Contracting State

The risk of violation of taxpayers' rights in an exchange of information procedure can be also illustrated by reference to some relevant case law, according to which it is irrelevant whether or not the domestic legislation of the requesting states complies with those rights. For example, information requested by a contracting state to the US tax revenue will be granted if the US Powell criteria are met, and the US Internal Revenue and courts will not verify *how* the information will be used in the Requesting State: 'To obtain enforcement of an administrative summons, the US IRS must demonstrate that it issued the summons in good faith – i.e., that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry will be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed – in particular, that the [IRS], after investigation, has determined the further examination to be necessary and has notified the taxpayer in writing to that effect'.⁴⁴

It results from Powell that a legitimate purpose does not correspond to the merits of the investigation, but to the purpose of determining the party's tax liability.⁴⁵ It also results from Powell, that the legitimacy and good faith of the request should be focused on the requested country: on the authority seeking to comply with the request. In the *Mazurek* case, "Mazurek asserted that under French law the [French Tax Authorities] could not continue its investigation until a final decision on his residency status is made, arguing that it would therefore be improper for the IRS to provide his financial information to the FTA at this time". The US Court of Appeals for Fifth Circuit did not find this argument relevant.⁴⁶ The Powell criteria exclude an assessment on the legitimacy of the request

⁴² S.S. Johnston, Swiss Parliament Amends Protocol to Treaty With U.S., *Tax Analysts*, 7 March 2012.

⁴³ See No. 5.1. OECD MC Comm. on Art.26.

⁴⁴ U.S. Supreme Court of 23 November 1964, *United States v. Powell*, 379 U.S. 48, 57-58, 14 AFTR2d 5942 (1964); US District Court for District of Hawaii of 21 May 1997, Docket n.° 86-1135, *Alliance Acceptance Corp Inc v. US*; US District Court for Northern District of California of 28 April 1997, Docket n.° C-97-0029 TEH, 79 AFTR 2d 97-2702, *William J. Fitzmaurice v. Commissioner of Internal Revenue*; US District Court for Central District of California of 5 February 1999; US District Court for Central District of California of 13 November 2000, Docket n.° CV 00-06975 (BQRx), *Yeong Yae Yun v. U.S.*; US Court of Appeals for Fifth Circuit of 7 November 2001; US District Court for Western District of Texas of 5 January 2007, Docket n.° 3:06-cv-00411, *Bull D S.A. de C.V. v. U.S.*

⁴⁵ US District Court for Southern District of New York 29 November 1995, *Fernandez-Marinelli v. U.S.*

⁴⁶ US courts 'determine whether the government has demonstrated a prima facie case by fulfilling the four factors delineated in Powell. The burden on the government to produce a prima facie case is "slight" or "minimal". Next, if the government meets its burden [the courts] assess whether the opponent of the summons fulfils his "heavy burden" of

by the requesting state and it is therefore disputable whether this interpretation fulfils the meaning of foreseeable relevance and corresponding taxpayers' rights.⁴⁷

In another US case, the US District Court for District of Arizona “[t]he US District Court stated that the inquiry was not whether the Mexican tax authorities were acting in good faith but whether the conditions stipulated by the US Supreme Court in the case of *United States v. Stuart*, 489 U.S. 353 (1989) had been met”⁴⁸: in this case the taxpayer objected to the tax investigation in Mexico on the basis that it was time-barred by the statute of limitations and the Mexican court agreed with the taxpayer and issued a permanent injunction on 16 August 2000 suspending the tax audit and prohibiting the Mexican tax authorities from taking any further action. Subsequently, the taxpayer filed a motion in the US District Court for the District of Arizona to have the IRS summons quashed but the US court did not apply the Powell criteria to the requesting state and considered they were fulfilled in the US.

It is therefore herein assumed that information will be often granted by a requested state without verifying how it will be used by the requesting state. Once the information is granted, disclosure limited to certain persons and entities described in Article 26 para. 2 OECD MC, and confidentiality according to a non-discrimination principle under the same para. 2, constitute the only limits to the use of that information by the requesting state. It is for the taxpayer to use any other international tools, e.g. the European Convention on Human Rights, in order to argue infringement of the rule of law, such as the privilege against self-incrimination or in the case of confiscatory taxes.⁴⁹

The privilege against self-incrimination will only protect the taxpayer in the requesting state, once this state obtains the relevant information. That privilege will not apply to the vast majority of the information requests seeking to obtain information from third parties such as banks, intermediaries or other contracting parties and not from the individual under investigation. And even if the requesting state may consider banks as accomplices to the crimes involved in the tax evasion, it has to be checked whether the privilege only protects natural persons or also juridical persons.⁵⁰

The requested state can deny provision of information if the reasons for requesting it infringe the rule of law and this has been done previously. The Swiss federal court rejected a request for exchange

(Contd.) _____

rebutting the proponent's case either by undermining the proponent's contentions regarding any of the Powell factors or by demonstrating that enforcement of the summons would result in an “abuse” of the court's process’. The summons would constitute an abuse of the judicial process if it were ‘used to harass, to gain leverage, or pretextually to develop a criminal investigation’: US Court of Appeals for Fifth Circuit, of 7 November 2001, *Zbigniew Emilian Mazurek v. U.S.*; see also a U.S. case involving an exempted taxpayer (charitable private Foundation): according to the U.S. court, “in order to enforce the summonses...this Court is not required to find that Banyan Tree Foundation is liable for income tax liability under the Income Tax Act of Canada”: US District Court for Southern District California, of 2 October 2007, *Paul N. Hiley Pnh Financial Inc.*

⁴⁷ See US District Court for District of Arizona, of 5 December 2000, Docket n.º CIV 00-381, 86 AFTR 2d 2000-7356, *Francisco Alatorre Urtuzuastegui v. U.S.*: ‘The taxpayer objected to the tax investigation in Mexico on the basis that it was time-barred by the statute of limitations. A Mexican court agreed with the taxpayer and issued a permanent injunction on 16 August 2000 suspending the tax audit and prohibiting the Mexican tax authorities from taking any further action. The taxpayer filed a motion in the US District Court for the District of Arizona to have the IRS summons quashed...The US District Court stated that the inquiry was not whether the Mexican tax authorities were acting in good faith but whether the conditions stipulated by the US Supreme Court in the case of *United States v. Stuart*, 489 U.S. 353, 1989, had been met. The case was confirmed: US District Court for District of Arizona, of 9 January 2001, Docket n.º CIV 00-381, 87 AFTR2 d (RIA) 2001-489, *Francisco Alatorre Urtuzuastegui v. U.S.*

⁴⁸ See US District Court for District of Arizona, of 5 December 2000, Docket n.º CIV 00-381, 86 AFTR 2d 2000-7356, *Francisco Alatorre Urtuzuastegui v. U.S.*; The case was confirmed: US District Court for District of Arizona, of 9 January 2001, Docket n.º CIV 00-381, 87 AFTR2 d (RIA) 2001-489, *Francisco Alatorre Urtuzuastegui v. U.S.*

⁴⁹ See ECtHR, judgment of 31 May 2011, case of *Khodorkovskiy v. Russia* (Application No. 5829/04); ECtHR, pending Application No. 11082/06 by *Mikhail Borisovich Khodorkovskiy* against Russia, lodged on 16 March 2006; See the comments on these cases and on the *Yukos* case in: P. Malherbe P. & M. Beynsberger, cit., at 126.

⁵⁰ No 74 of the Commentary on Art. 7(1) Model Agreement; on this topic, see P. Malherbe & M. Beynsberger, cit., at 132.

of information for criminal purposes in the *Yukos* case on the basis that the information would be used for political persecution: ‘The totality of these elements bears out the suspicion that the penal procedure was therefore used for the purposes of the established power, in order to go after the class of rich ‘oligarchs’ and to push aside potential or declared political adversaries. It follows that Mutual Assistance cannot be granted ...’⁵¹. However, the interpretation adopted by the Swiss federal court is not required by the current international standard.

Procedural rights and safeguards for taxpayers are not guaranteed by the international standard either, even if some contracting states include them in their domestic laws, for example, where the taxpayers’ rights and safeguards are affected by tax investigation procedures, audits, information-gathering measures or information exchange. Such rights and safeguards usually include notification rules, consultation rights and intervention rights. The latter may include a right to challenge the exchange of information following notification or rights to challenge information-gathering measures taken by the requested party.⁵² In case there is a suspicion of tax fraud or a serious risk that notification will affect the collection of taxes due in the requesting state, the latter should indicate those suspicions to the requested State.

The OECD Manual recommends that contracting parties inform each other of their legislation or administrative practice concerning notification (paras. 54-55), but there is no obligation to do so. In the European Union, notification rights no longer apply in VAT cases of exchange between Member States of the European Union, but the context is different from the worldwide context and bilateral relations between states that do not share harmonized legislation and common institutions. In any case, even within the European Union, the legal protection of the taxpayer can be jeopardized: in respect of direct taxes, incoming requests are higher than when a EU Member State wants to make a request. In fact, few EU Member States provide for a notification right in case they intend to make a request and the taxpayer has nearly no rights to bar those requests.⁵³

6.4. Confidentiality

Disclosure of information by one contracting state to another contracting state implies that the latter treats the information received as secret (Article 26 para. 2 OECD MC and Article 8 Model Agreement on Exchange of Information). However, the confidentiality limit in the OECD MC does not grant the necessary protection to the taxpayer either, because the current standard (dating back to the OECD MC of 1977) cross-refers to domestic law and therefore only assures a non-discrimination or equivalence principle: the contracting state must treat the information obtained by the other contracting state in the same manner as it treats it domestically. The equivalence principle implies that different procedural rules and different levels of protection will be applicable in the various contracting states, within the framework of the MC limits.⁵⁴

Under the OECD MC 1963 secrecy was a treaty obligation to be interpreted autonomously from domestic law, and requiring an absolute protection.⁵⁵ According to the 1963 version of Article 26 para.

⁵¹ Tribunal Fédéral of 13 August 2007, 1A.15/2007 /col.: See also P. Malherbe & M. Beysberger, cit., at 126.

⁵² In Luxembourg, the tax authorities notify the holder of the information of their decision to ask for the relevant information, and both the holder (e.g. a bank) or the taxpayer can object to the information exchange within a month. If the holder is a bank, the latter will decide whether to inform its client, i.e. the taxpayer, and will most likely do it. Although the matter will be decided by the administrative courts under the summary proceedings rules, the whole procedure reduces the efficacy of information exchange: A. Steichen, cit., at 28; Braum & Covolo, cit., at 50.

⁵³ See R. Seer & I. Gabert, ‘General Report’ in: Seer R. & Gabert I., *Mutual Assistance and Information Exchange*, 2010, at 46-50.

⁵⁴ A. Rust ‘Data Protection as a Fundamental Right’ in: Rust A. & Fort E. (eds.), *Exchange of Information and Bank Secrecy*, 2012, at 180-181.

⁵⁵ M. Engelschalk, cit., at mnos. 78 and 87.

2: ‘Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment or collection of the taxes which are the subject of the Convention’.

The current cross-reference to domestic law is not complete, since the MC includes parameters of secrecy, namely those regarding the persons to whom information may be disclosed and the purposes for which it may be used: the information can only be disclosed to a certain group of persons and used for purposes of assessment or collection of taxes under para.1, and for the enforcement or prosecution or the determination of appeals regarding the mentioned taxes (the purpose limitation principle).⁵⁶

The 2012 amendment to paragraph 2 allows the contracting states to share information received for purposes in addition to tax purposes, provided two conditions are met: first, the information may be used for other purposes under the laws of both states (e.g. in case of a non-fiscal crime, a treaty concerning judicial assistance); and, second, the competent authority of the supplying state authorizes such use (see commentary 12.3). If the supply of information does not respect the confidentiality limits, the requested state can refuse to supply that information and in that manner it is protecting the interests of the taxpayer. The supplying state therefore has a duty of care to protect the taxpayer’s interest. However that decision is discretionary and there is no guarantee that the requested state will refuse that supply. The taxpayer’s position under this duty of secrecy by the requesting state is not sufficiently protected.⁵⁷

On the contrary, under Article 8 Model Agreement on Exchange of Information, confidentiality is a treaty obligation to be interpreted autonomously from domestic law, and requiring an absolute protection⁵⁸, and if any breach of confidentiality is a treaty breach, it is not clear what the consequences or sanctions will be in the case of breach.

Some treaties or protocols clarify this topic and are best practices to be followed by other contracting states.

For example, protocols to TIEAs signed by Germany, namely the Protocol to the Agreement between Germany and Jersey, ensure the protection of personal data at a level that is equivalent to that of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data. Another example is the second Protocol to the Austria-Canada tax treaty, which includes a paragraph on this issue and provides that unauthorized disclosure of information received from a contracting party is a criminal offence in the recipient State: “Where information is exchanged is subject to strict confidentiality rules. It is expressly provided in Article 26 that information communicated shall be treated as secret. It can only be used for the purposes provided for in the convention. Sanctions for the violation of such secrecy are governed by administrative and penal laws

⁵⁶ See, however, the views of the US Senate on the *USA-Norway* Income Tax Treaty and the *USA-Germany* Treaty on Inheritance Tax, according to which information received should also be made available to “the appropriate Congressional committees and to the US General Accounting Office”, 22 *ET*, 1982, at 35.

⁵⁷ T. Schenk-Geers, cit., at 107-108; P.G. Végh, ‘Towards a Better Exchange of Information’, *ET* September, 2002, at 391, 399 et seq.; X. Oberson, *Bulletin for the International Fiscal Documentation*, 14 (17) 2003; J.M. Calderón ‘Taxpayer Protection within the Exchange of Information Procedure Between State Tax Administrations’, 28 *Intertax*, 2000, at 462; F.A. García Prats, ‘Exchange of Information under Article 26 of the UN Model Tax Convention’, 1999, *Bulletin – Tax Treaty Monitor*, 1999, at 541-547; P. Malherbe & M. Beysberger, cit., at 132-133.

⁵⁸ “Any information received by a Contracting Party under this Agreement shall be treated as confidential and may be disclosed only to persons or authorities (including courts and administrative bodies) in the jurisdiction of the Contracting Party concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by this Agreement. Such persons or authorities shall use such information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. The information may not be disclosed to any other person or entity or authority or any other jurisdiction without the express written consent of the competent authority of the requested Party”.

in all states. Typically, unauthorized disclosure of tax related information received from another country is a criminal offence punishable by a jail sentence”.

If the requested state has grounds to suspect that the requesting state will not respect confidentiality of the information provided, namely because in previous exchange of information situations it has not respected confidentiality or because its domestic legislation does not respect it, sanctions can be applicable in the requested state that provided the information, but this is not guaranteed: See the *Aloe Vera of America* case.⁵⁹

6.5. Other Limits

A right to refuse a request for information beyond the conditions and limits laid down in Article 26 results from the general principles of international public law (Article 60 VCLT), in particular, in cases where there are grounds to believe that secrecy of the information as required under para. 2 will not be respected or that the information will be misused.⁶⁰ Moreover, if one of the conditions in Article 26 (3) is satisfied, there is no obligation to supply information and hence no obligation to make investigations under the tax treaty.⁶¹

If all conditions for exchanging information are fulfilled, the requested State has to provide the information to the requesting State.” Information obtainable” by the requested tax administration is the information that is in the possession of the authorities or that can be obtained by any investigative procedures as foreseen in its domestic law (OECD MC Commentary 16). The contracting state is not obliged under treaty law to obtain information illegally but it is disputable whether it can use information obtained in that way. Moreover, it is debatable whether information obtained illicitly can be validly used. Article 26 OECD MC does not contain any prohibition in this respect, as long as the confidentiality limits are respected, and a prohibition of use being made of such evidence in the requesting contracting state depends on the latter state’s domestic law⁶².

7. Concluding Remarks: a Step-by-step Approach and Transitional Regimes

It results from the previous pages that validity of an international standard implies that the taxpayers’ fundamental rights are respected in the legal systems using the standard. The examples analysed in this paper correspond to some of the conditions that should be verified in an exchange of information procedure complying with the rule of law: the existence of foreseeable relevance of the request and corresponding prohibition of fishing expeditions; compliance with the statute of limitations; confidentiality; non-use of illicitly obtained data. But these conditions are either not required by the standard or can be easily misapplied. Moreover, the contracting States have their own judicial

⁵⁹ US District Court of Arizona of 2 February 2007, Case n.º 99-1794-PHX-JAT, 99 AFTR 2d 2007-895, *Aloe Vera of America Inc. et al. V. U.S.*; See also FG Köln, Beschluss vom 20. 8. 2008 - 2 V 1948/08 (rkr.).

⁶⁰ See ECtHR, pending Application No. 11082/06; and the comments on these cases and on the Yukos case in: P. Malherbe & M. Beynsberger, cit., at 126.

⁶¹ According to Article 26 (3) OECD MC: “ In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

- a. To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
- b. To supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
- c. 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 (ordre public).”

⁶² Concurring, M. Engelschalk, fn. 21 at m.no 98. A somewhat more cautious approach: *Tax Court*, Midwest Generator Co. v. Comm., 55 TCM 90, 1988.

instances and there is no binding supranational case law enacted by a supranational independent court that will interpret the standard according to the rule of law and in a uniform manner.

Exchange of information on request as an international standard still has serious fragilities and therefore can hardly be validly proposed as a universal standard. It should instead take into account the legal system and the taxpayers' rights of each and every Member of the Global Forum and consequently be adapted if necessary (it should require that the conditions related to the rule of law are effectively foreseen, respected and subject to peer review) or replaced by another mechanism fulfilling the same purpose (preventing and combating tax evasion). The virtues of exchange of information in combating tax evasion were discussed at the European Union level, in the late nineties, in respect of taxation of interest from savings. The first version of the proposal provided the Member States an option between (automatic) exchange of information and a withholding tax at source. In June 2000, exchange of information became the rule and the withholding tax could only be adopted exceptionally by those Member States with bank secrecy, specially authorized in the Directive, and during a transitional period.⁶³ Even if exchange of information is a best practice, compliant with the virtues of transparency, it is herein contended that the Global Forum could instead adopt a step-by-step approach, and for example require withholding taxes at source in respect of passive income by those Member States that do not fulfil the aforementioned conditions of a rule-of-law state, including taxpayers' fundamental rights combined with specific anti abuse provisions applied by the residence countries, such as those suggested in the OECD Report of 1998. Transition to exchange of information would then be achieved progressively and by a peer-review process.

⁶³ Ana Paula Dourado, "The EC draft directive on interest from savings from a perspective of international tax law", *EC Tax Review*, 2000, n. 3, at. 144-52.

Author contacts:

Ana Paula Dourado

Faculdade de Direito da Universidade de Lisboa att. IDEFF Alameda da Universidade

Cidade Universitária

1649-014

Lisboa

PORTUGAL

Email: Ana Paula do Valle Frias Madureira Dourado <anadourado@fd.ul.pt>