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OECD Convention on Mutual Administrative Assistance in Tax Matters

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American Bar Association Section of International Law and Practice Reports to the House of Delegates

I. OECD Convention on Mutual Administrative Assistance in Tax Matters*

RECOMMENDATION

BE IT RESOLVED, That the American Bar Association supports the ratification by the United States of the Council of Europe-Organisation for Economic Co-operation and Development (OECD) Convention on Mutual Administrative Assistance in Tax Matters, subject to reservations proposed by the United States Treasury Department—which would exclude the operation of portions of Convention's provisions concerning assistance in recovery of taxes and service of documents;

BE IT FURTHER RESOLVED, That the support of the American Bar Association is predicated upon the establishment by the United States Treasury Department of procedures which will adequately protect the rights of taxpayers to due process and, in particular, will ensure that any taxpayer who is a United States national or resident who is the subject of a tax investigation by a foreign government will receive, subject to certain exceptions, notice of a request under the Convention for information concerning the taxpayer, or of other actions taken under the Convention that will affect the taxpayer, and that such taxpayers will have a right to object to the information exchange, subject to certain exceptions.

REPORT

Introduction

On January 25, 1988, the Council of Europe and the Organisation for Economic Co-operation and Development finished work on the Convention on Mu-

*This Report was approved by the House of Delegates at the Honolulu meeting in August 1989. The Report emanated from the Section's Committee on International Taxation. Bruce Zagaris was principally responsible.

tual Administrative Assistance in Tax Matters ("Convention").¹ The Convention would provide, on a multilateral basis, for administrative assistance in respect of income, capital (wealth), social security, and other taxes. Administrative assistance would include the exchange of information, assistance in collection, and service of documents. The Convention also provides for simultaneous examinations whereby two or more contracting parties could examine the tax liabilities of a taxpayer.

Under the Convention, limitations are placed on the procedural rules. A contracting party would not be required to implement measures at variance with its own laws or public policy or to supply information which would disclose trade secrets or processes. Information obtained could be used only for tax enforcement purposes and would be treated as secret in the same manner as under the more restrictive secrecy laws of the two particular countries undertaking an exchange of information.

The Convention does not enter into force until at least five countries consent to be bound. Countries, through permissible reservations, can choose not to have the Convention apply to certain types of taxes (e.g., social security or local taxes), not to provide assistance in recovery, and not to allow for assistance in the service of tax documents. Already several potential signatory governments, including Malta,² the Federal Republic of Germany, and the United Kingdom³ have indicated they will not sign. The reason these governments have indicated that they do not want to join the Convention is that the existing assistance, e.g., under bilateral conventions, is sufficient, and that the potential for eroding the rights of taxpayers is not worth additional cooperative measures.

In November, 1988, Treasury had a meeting with persons in the U.S. Government and in the private sector concerned with tax treaty policy. Treasury indicated that it intends to submit the Convention to the Senate Foreign Relations Committee for ratification, but to reserve on the portions of the Convention relating to recovery of taxes and service of documents. The Treasury requested comments from responsible members of the bar and concerned persons on designing procedures to provide protection to taxpayers affected by actions taken under the Convention. The Treasury indicated that, in the past, support of proposed conventions, e.g., U.S.–Switzerland Mutual Legal Assistance Treaty, by the American Bar Association has been instrumental in the ratification process. In addition to the Convention, an Explanatory report and commentary

1. For the text and a brief discussion of the Convention, see 28 I.L.M. 1160 (1988); 5 RHOADES & LANGER, *INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS*, ch. 85.

2. For a discussion of the Malta Human Rights Objections to the Convention, see Zagaris, *Malta Raises Human Rights Law Issues to OECD Mutual Assistance Convention*, 3 INT'L ENFORCEMENT LAW RPTR. 406 (Dec. 1987).

3. For a discussion of the decision of the United Kingdom Government not to sign the Convention, see *Exchange of Information: Government Decides Not to Sign*, THE TAX JOURNAL 2 (January 12, 1989).

dated May 27, 1986 (62 pp.), is helpful in understanding the intent of the Convention. On September 28, Irwin L. Treiger, Chair, Section of Taxation, sent to Lawrence B. Gibbs, Commissioner, Internal Revenue Service, comments on the Convention that were prepared by members of the Section's Committee on U.S. Activities of Foreigners and Tax Treaties. The Treasury has found many of the comments useful, although it does not agree with all of them (i.e., an appellate process for taxpayers aggrieved by an IRS/Treasury decision to take action on a request for information). The resolution and comments endorse many, but not all, of the recommendations of the Section of Taxation.

Summary of and Reasons for Supporting Ratification of the Convention

Many of the provisions of the Convention are already contained in double tax conventions of the U.S., tax information exchange agreements, and in multilateral conventions among other countries of the world, such as the Nordic Convention of Mutual Assistance in Tax Matters. The Convention would update and strengthen many existing bilateral procedures and extend them to a number of countries which currently do not give administrative assistance or with which the U.S. does not now have such procedures, or with which the U.S. has weak procedures, especially because many of the U.S. treaties have not been updated to provide for the latest techniques of cooperation. A multilateral convention with standardized procedures would result in greater cooperation than is currently the case, as well as exchanges of information and other assistance on a much wider basis than exists under the existing bilateral treaties.

The preamble of the Convention states that the Convention's goals are to combat tax avoidance and evasion, to protect against discrimination and double taxation, and to protect privacy and flows of personal data. Chapter I contains Articles 1 and 2. Article 1 states that the Convention is to provide administrative assistance, including exchange of information; recovery assistance; and service of documents. Article 2 states that the Convention applies to all taxes imposed by a Party or its political subdivision, except personal property taxes on motor vehicles. A detailed list of the taxes covered is contained in Annex A. Article 3 contains certain definitions.

Chapter III provides for the Forms of Assistance. Article 4 states that information provided by the Convention must be related to assessment, collection, recovery, enforcement, or prosecution. The requested State may give prior notice of the information transmittal to its resident or national taxpayer. Under Article 5, the requested State must obtain and provide information to the requesting State. Article 6 sets forth the obligation of Parties to exchange information automatically according to procedures mutually agreed upon. Article 7 provides for spontaneous exchange of information and lists circumstances in which a Party, having certain direct or circumstantial information, must inform the affected Party of such information, even though the affected Party has not re-

requested the information. Article 8, simultaneous tax examinations, requires a requested State to coordinate examination of its records with the requesting State concerning the tax affairs of persons of common interest. Under Article 9, a requesting State may be present at the requested State's tax examination. Article 10 states that, upon receipt of conflicting information from a requested State, the requesting State shall inform the requested State of the conflicting information in its possession.

Section II provides for assistance in recovery. Article 11 states that a requested State must assist in the recovery of enforceable, uncontested tax claims. Tax claims against non-residents must be noncontestable. Limitations are imposed on assistance in the recovery of estate tax claims. Under Article 12, a requested State must take measures of conservancy, whether or not a tax claim is contested. Article 13 provides for the documents that must accompany the requests. Article 14 sets forth time limits on assistance in recovery and Article 15 states that tax claims of an applicant State do not have priority over tax claims in the requested State. Article 16 provides for deferral of payment or installment payments which a requested State may allow.

In Section III, Article 17 provides for the procedures by which the requested State shall allow for service of documents.

Chapter IV contains provisions relating to all forms of assistance. Article 18 provides for the information that a request for assistance shall contain. Article 19 provides that, if a requesting State has not taken comparable available action in its own territory, a requested State can decline a request. Article 20 obligates a requested State to inform the requesting State of the actions it has taken and the reasons for any action not taken. It obligates a requested State to respond in the manner requested. Article 21 provides that the Convention will not be construed so that a requested State must take assistance measures that violate its own laws. The Convention also provides that a requested State need not assist for the other reasons mentioned later in this Report under "Exchanges of Information Generally—Notice and Opportunity to Object." Under Article 22, the requesting State must limit the disclosure of the information obtained to purposes contained in Article 1 of the Convention. It can disclose information in public proceedings or in judicial decisions relating to such taxes, subject to prior authorization by the competent authority of the supplying Party. Any two or more Parties may mutually agree to waive the condition of prior authorization. Article 23 details proceedings relating to measures taken under the Convention brought by the requested State.

Chapter V contains special provisions. Article 24 provides that under the aegis of the OECD, a coordinating body will monitor implementation of the Convention and make recommendations. Article 25 provides that requests for assistance shall be in an official OECD language or other language mutually agreed upon. Under Article 26, the requested State must bear ordinary costs with the requesting State paying extraordinary costs.

Chapter VI contains the final provisions. According to Article 27, the possibilities of assistance provided by the Convention do not limit other arrangements in existing or future international agreements. Article 28 provides for signature and entry into force of the Convention while Article 29 delimits the territorial application of the Convention. Article 30 concerns allowable reservations. Article 31 concerns denunciation after three months notice, and Article 32 concerns depositories and their functions.

The Convention contains three annexes. Annex A sets forth the taxes to which the Convention would apply; Annex B contains competent authorities; and Annex C sets forth the definition of the word "national" for the purpose of the Convention.

Establishment of Procedures for Taxpayer Notice and Participation

The Department of Treasury should establish an administrative procedure whereby the taxpayer, upon receiving notice, could, without unnecessary delay, have the right to show that a request for information under the Convention should not be granted or that it should be only partly granted.

Exchange of Information for Use in a Criminal Court

Article 4, Paragraph 2 of the Convention provides that:

A party may use information obtained under this Convention as evidence before a criminal court only if prior authorization has been given by the Party which has supplied the information. However, any two or more Parties may mutually agree to waive the condition of prior authorization.

This provision could result in a criminal charge for a taxpayer when the latter is not even aware that a criminal investigation is pending. Subject to certain exceptions as noted below, the IRS should notify the taxpayer concerned of a request by a party to use information in a criminal court, before authorization is given by the U.S. as the requested country. The taxpayer may have knowledge of facts or legal arguments (i.e., under Article 4, para. 2) which, if known by the U.S. as the requested country, would result in refusal of the requested authorization. Only if the taxpayer has ample opportunity to present reasons for not complying with the requested authorization will an improper, and/or inadvertent, authorization be foreclosed. The notice should advise the taxpayer that the information may be used in any proceeding of the requesting party. The U.S. should seek bilateral waivers so that any information transmitted by a requested country may be used in a requesting country in a criminal proceeding without prior authorization by the requested country.

Exchanges of Information Generally— Notice and Opportunity to Object

If the United States receives a request for information on a taxpayer, the Convention gives many reasons for a requested country to refuse to grant a request. They include:

1. The information requested is not foreseeably relevant to the assessment and collection of tax, the recovery and enforcement of tax claims, or a related prosecution before an administrative or judicial body. (Art. 4, para. 1)

2. The requesting country has not pursued all means available in its own territory, except where recourse to such means would give rise to disproportionate difficulty. (Art. 19)

3. The request would affect the rights and safeguards guaranteed to persons by the laws or administrative practice of the requested state. (Art. 21, para. 1)

4. The measures requested would be at variance with the laws or administrative practice of either the requested or requesting state. (Art. 21, para. 2)

5. The measures would be contrary to public policy or the essential interests of the requested State. (Art. 21, para. 2)

6. The information requested is not obtainable under the laws or administrative practice of either State. (Art. 21, para. 2)

7. The requested information would disclose a trade, business, industrial, commercial or professional secret, or trade process, or information the disclosure of which would be contrary to public policy or to the requested State's essential interests. (Art. 21, para. 2)

8. The taxation in the requesting state is considered contrary to generally accepted taxation principles or to any treaty. (Art. 21, para. 2)

9. Discrimination would result between a national of the requested state and nationals of the requesting state in the same circumstances. (Art. 21, para. 2)

The convention specifically allows a contracting party to inform its residents or nationals before transmitting information concerning the taxpayer concerned. There may be many cases where the United States as the requested state may not be aware of the above-mentioned nine factors unless the taxpayer has a notice and opportunity to participate.

At least taxpayers concerned should have an opportunity administratively to persuade the Treasury not to heed a request. An open question is whether further appeal to a court is required in order to provide due process. The U.S. would notify the parties to the Convention that a taxpayer must be notified of a party's request for information from the U.S. under Article 5 of the Convention (a "Request") or a determination by the U.S. to transmit information spontaneously under Article 7 (a "Determination"). These procedures should be used in the event of a request for authorization to use information in a criminal court, a request for simultaneous examinations, or a request to have representatives present at another country's examination.

The U.S. would not have to provide notice under certain circumstances as set forth in Section 7609(g) of the Internal Revenue Code.⁴

4. Some members of the Subcommittee recommend that, in lieu of the procedures of Section 7609 of the Internal Revenue Code, the following procedures be adopted:

Simultaneous Tax Examinations

Under Article 8, two or more treaty countries will consult together to determine cases and procedures for simultaneous tax examinations, with a view to exchanging any relevant information they may obtain. The IRS should be notified of a request for a simultaneous tax examination involving the taxpayer and have an opportunity to inform either of the parties why it should not participate in a simultaneous tax examination.

Presence of a Competent Authority Representative in a Tax Examination Abroad

Under Article 9, para. 1, at the request of the competent authority of the requesting state, the requested state may permit representatives from that other state to be present at the appropriate part of a tax examination. The requested state is not required to allow representatives of another state to be present and may require "procedures and conditions" and will make all decisions on the conduct of the tax examination.

In order to prevent inappropriate disclosures to the requesting country in a tax examination, the taxpayer should receive notice of a request to have a representative from the requesting country participate in such examination. The taxpayer should have the opportunity to submit information that supports the exclusion of a requesting state from the examination or the imposition of appropriate limitations during such examination.

Reservation on Portions of the Convention

The United States Government has publicly announced that it will exercise its right to enter a reservation with respect to the portions of the Convention on assistance in recovery of tax claims and on service of documents [Sections II (Arts. 11–16) and III (Art. 17) of Chapter III of the Convention]. The American Bar Association supports this position. These portions of the Convention are attached as an Appendix.

Special Exception to Notice Requirement

Upon application of the Government authority, the notice requirement shall not apply if it is determined, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may result in:

- (a) endangering the life or physical safety of any person;
- (b) flight from prosecution;
- (c) attempts to conceal, destroy, or alter, records relevant to the examination; or to prevent the production of records relevant to the examination;
- (d) attempts to prevent the communication of information from other persons through intimidation, bribery, or collusion; or
- (e) otherwise seriously jeopardizing an investigation or official proceeding or unduly delaying a trial or ongoing official proceeding.

Except for the provisions of (e), the notice procedure, which parallels the notice provision of the Right to Financial Privacy, 12 U.S.C. § 3409 follows essentially § 7609 of the I.R.C.

Recovery of Tax Claims—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 in general must be uncontested. In the case of a taxpayer who is not resident in the applicant State, such claims must be 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. However, collection is not required more than 15 years from the date of the instrument to be enforced.

In the past Treasury has expressed concerns that may arise in the enforcement of foreign tax judgments and has indicated that it will reserve on this Article. The effect of the reservation is that the provisions of Articles 11–16 on recovery of taxes will not apply to the U.S.

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. The U.S. has announced that it intends to agree to the portion of the Convention that allows for service by post and to reserve on the rest of this Article. The reason is that, since service by post is adequate under U.S. law, the U.S. prefers not to assume a larger obligation than is necessary. The effect of the reservation is that service of documents under the Convention may be made directly through the post on a person within the territory of another country. The U.S. is not bound to effect service by the other methods provided in Article 17.

Support Contingent on Adequate Due Process Procedures

The Section of International Law and Practice makes support contingent on the adoption by the U.S. of measures adequate to provide due process to taxpayers, including the right of notice and the right to object to the information exchange. The Section of International Law does not anticipate any problems in Treasury's establishment of adequate procedures to provide taxpayers with due process. If problems arise, it will inform the United States Executive and Congress of such problems.

Respectfully submitted,
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Law and Practice

June, 1989