JOINT COMMITTEE ON TAXATION
February 26, 2014
JCX-11-14

# TESTIMONY OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION BEFORE THE SENATE COMMITTEE ON FOREIGN RELATIONS HEARING ON THE PROPOSED TAX TREATIES WITH CHILE AND HUNGARY, THE PROPOSED TAX PROTOCOLS WITH LUXEMBOURG AND SWITZERLAND, AND THE PROPOSED PROTOCOL AMENDING THE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS[1]

**FEBRUARY 26, 2014**

My name is Thomas A. Barthold. I am Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation today concerning the proposed income tax treaties with Hungary and Chile, the proposed tax protocols with Luxembourg and Switzerland, and the proposed protocol amending the multilateral mutual administrative assistance treaty.

## Overview

As in the past, the Joint Committee staff has prepared pamphlets covering the proposed treaties and protocols.[2] The pamphlets provide detailed descriptions of the proposed treaties and protocols, including, in the case of the income tax treaties and protocols, comparisons with the

---

[1] This document may be cited as follows: Joint Committee on Taxation, *Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaties with Chile and Hungary, the Proposed Tax Protocols with Luxembourg and Switzerland, and the Proposed Protocol Amending the Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (JCX-11-14), February 26, 2014. This publication can also be found at http://www.jct.gov.

[2] Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty Between the United States and Hungary* (JCX-32-11), May 20, 2011; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Luxembourg* (JCX-30-11), May 20, 2011; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), May 20, 2011; Joint Committee on Taxation, *Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (JCX-9-14), February 21, 2014; Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty Between the United States and Chile* (JCX-10-14), February 24, 2014. The pamphlets describing the proposed treaty with Hungary and the proposed protocols with Luxembourg and Switzerland were prepared in connection with a Committee on Foreign Relations hearing held on June 7, 2011.

United States Model Income Tax Convention of November 15, 2006 ("U.S. Model treaty"), which reflects preferred U.S. tax treaty policy, and with other recent U.S. tax treaties. The pamphlets also provide detailed discussions of issues raised by the proposed treaties and protocols. We consulted with the Treasury Department and with the staff of your committee in analyzing the proposed treaties and protocols and in preparing the pamphlets.

The principal purposes of the proposed income tax treaties and protocols are to reduce or eliminate double taxation of income earned by residents of either country from sources within the other country and to prevent avoidance or evasion of the taxes of the two countries. The proposed income tax treaties and protocols also are intended to promote close economic cooperation between the treaty countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the treaty countries. As in other U.S. income tax treaties, these objectives principally are achieved through each country's agreement to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country.

The principal purpose of the multilateral mutual assistance treaty is to promote increased cooperation in tax administration and enforcement among the parties to the treaty.

The proposed treaty with Hungary would replace an existing income tax treaty signed in 1979. The proposed protocol with Luxembourg would amend an existing tax treaty that was signed in 1996. The proposed protocol with Switzerland would amend an existing tax treaty and previous protocol that were both signed in 1996. The proposed treaty with Chile is the first income tax treaty with that nation. The last proposed protocol under consideration by your committee amends the multilateral mutual administrative assistance in tax matters agreement that the United States ratified in 1991.

As a general matter, the U.S. Model treaty provides a framework for U.S. income tax treaty policy and a starting point for income tax treaty negotiations with our treaty partners. Income tax treaties that the United States has negotiated since 2006 in large part follow the U.S. Model treaty. The proposed income tax treaties and protocols that are the subject of this hearing are, accordingly, generally consistent with the provisions found in the U.S. Model treaty. There are, however, some key differences from the U.S. Model treaty that I will discuss.

My testimony today will highlight three issues related to the agreements being considered by your committee, the limitation-on-benefits provisions in the treaties with Chile and Hungary, exchange of information, and the expansion of the mutual administrative assistance agreement.

## Limitation-on-benefits provisions in treaties with Chile and Hungary

### In general

Like the U.S. Model treaty, the proposed treaties with Chile and Hungary include extensive limitation-on-benefits rules (Chile, Article 24; Hungary, Article 22). Limitation-on-benefits provisions are intended to prevent third-country residents from benefitting inappropriately from a treaty that generally grants benefits only to residents of the two treaty countries. This practice is commonly referred to as "treaty shopping." A company may engage in treaty shopping by, for example, organizing a related treaty-country resident company that has

no substantial presence in the treaty country. The third-country company may arrange, among other transactions, to have the related treaty-country company remove, or strip, income from the treaty country in a manner that reduces the overall tax burden on that income. Limitation-on-benefits rules may prevent these and other transactions by requiring that an individual or a company seeking treaty benefits have significant connections to a treaty country as a condition of eligibility for benefits.

The present treaty between the United States and Hungary is one of only seven U.S. income tax treaties that do not include any limitation-on-benefits rules.[3] Two of those seven treaties, including the treaties with Hungary and Poland, include provisions providing for complete exemption from withholding on interest payments from one treaty country to the other treaty country that may present attractive opportunities for treaty shopping.[4] For example, a November 2007 report prepared by the Treasury Department at the request of the U.S. Congress suggests that the income tax treaty with Hungary has increasingly been used for treaty-shopping purposes as the United States adopted modern limitation-on-benefits provisions in its other treaties. In 2004, U.S. corporations that were at least 25-percent foreign owned made $1.2 billion in interest payments to related parties in Hungary, the seventh largest amount of interest paid to related parties in any single country.[5] With its inclusion of modern limitation-on-benefits rules, the proposed treaty with Hungary represents a significant opportunity to mitigate treaty shopping. Nevertheless, your committee may wish to inquire of the Treasury Department as to its plans to address the remaining U.S. income tax treaties that do not include limitation-on-benefits provisions.

Contrasts with the U.S. Model treaty

Although the limitation-on-benefits rules in the proposed treaties with Chile and Hungary are similar to the rules in other recent and proposed U.S. income tax treaties and protocols and in the U.S. Model treaty, they are not identical, and your committee may wish to inquire about certain differences. In particular, your committee may wish to examine the rules for publicly

[3] The other income tax treaties without limitation-on-benefits rules are the ones with Greece (1953), Pakistan (1959), the Philippines (1982), Poland (1976), Romania (1976), and the U.S.S.R (1976). The United States and Poland signed a new income tax treaty on February 13, 2013 that includes comprehensive limitation-on-benefits rules, but that treaty has not yet been transmitted to the Senate for consideration for ratification (and therefore has not yet taken effect). Following the dissolution of the U.S.S.R., the income tax treaty with the U.S.S.R. applies to the countries of Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikstan, Turkmenistan, and Uzbekistan.

[4] The income tax treaty with Greece also provides for complete exemption from withholding on interest, although it contains restrictions that limit the availability of the exemption, such that a Greek company receiving interest from a U.S. company does not qualify for the exemption if it controls, directly or indirectly, more than 50 percent of the U.S. company.

[5] Department of the Treasury, *Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties* (Nov. 28, 2007). The report states that, as of 2004, it does not appear that the U.S.-Poland income tax treaty has been extensively exploited by third-country residents. Although the report also focused on Iceland to the same extent as Hungary, a 2007 Income Tax Convention with Iceland that includes a modern limitation-on-benefits provision has since taken effect.

traded companies, derivative benefits, and certain triangular arrangements. Your committee also may wish to ask the Treasury Department about the special limitation-on-benefits rules applicable to headquarters companies.

Publicly traded companies

Under the proposed treaties with Chile and Hungary, a publicly traded company that is a resident of a treaty country is eligible for all the benefits of the proposed treaty if it satisfies a regular trading test, which requires that the company's principal class of shares is primarily traded on a recognized stock exchange, and also satisfies either a management and control test or a primary trading test.

The primary trading test in the proposed treaty with Hungary requires that a company's principal class of shares be primarily traded on a recognized stock exchange located in the treaty country of which the company is a resident or, in the case of a Hungarian company, on a recognized stock exchange in another European Union ("EU") or European Free Trade Association ("EFTA") country, or in the case of a U.S. company, in another North American Free Trade Agreement country. A similar primary trading test was included in the recent protocols with France and New Zealand.

The primary trading test in the proposed treaty with Chile follows the U.S. Model treaty, requiring the trading to occur on a stock exchange in the treaty country of which the relevant company is a resident; trading on a stock exchange in another country may not be used to satisfy the test.

As in the U.S. Model treaty, in both the proposed Chile treaty and the proposed Hungary treaty a recognized stock exchange includes certain exchanges specified in the treaty as well as any other stock exchange agreed upon by the competent authorities of the treaty countries. Your committee may wish to explore the rationale underlying the identification of recognized stock exchanges for purposes of limitations of benefits, and the criteria the Treasury Department considers when negotiating over the definition of a recognized stock exchange.

Derivative benefits

Like other recent treaties, the proposed treaty with Hungary includes derivative benefits rules that are generally intended to allow a treaty-country company to receive treaty benefits for an item of income if the company's owners (referred to in the proposed treaty as equivalent beneficiaries) reside in a country that is in the same trading bloc as the treaty country and would have been entitled to the same benefits for the income had those owners derived the income directly. The derivative benefits rules may grant treaty benefits to a treaty-country resident company in circumstances in which the company would not qualify for treaty benefits under any of the other limitation-on-benefits provisions. The Chile treaty, like the U.S. Model treaty does not include derivative benefits rules.

Triangular arrangements

The proposed treaties with Chile and Hungary include special anti-abuse rules intended to deny treaty benefits in certain circumstances in which a Chilean or Hungarian resident company

earns U.S.-source income attributable to a third-country permanent establishment and is subject to little or no tax in the third jurisdiction and (as applicable) Chile or Hungary. A rule on triangular arrangements is not included in the U.S. Model treaty, but similar anti-abuse rules are included in other recent treaties and protocols.

Headquarters companies

The proposed treaties with Chile and Hungary include special rules intended to allow treaty country benefits for a resident of a treaty country that functions as a headquarters company and that satisfies certain requirements intended to ensure that the headquarters company performs substantial supervisory and administrative functions for a group of companies: among other requirements, (1) that the group of companies is genuinely multinational; (2) that the headquarters company is subject to the same income tax rules in its country of residence as would apply to a company engaged in the active conduct of a trade or business in that country; and (3) that the headquarters company has independent authority in carrying out its supervisory and administrative functions.

While U.S. income tax treaties in force with Austria, Australia, Belgium, the Netherlands, and Switzerland include similar rules for headquarters companies, the U.S. Model treaty does not include these rules.

## Exchange of information

Tax treaties establish the scope of information that can be exchanged between treaty countries. Exchange of information provisions first appeared in the late 1930s,[6] and are now included in all double tax conventions to which the United States is a party. A broad international consensus has coalesced around the issue of bank transparency for tax purposes and strengthened in recent years, in part due to events involving one of Switzerland's largest banks, UBS AG, the global financial crisis, and the general increase in globalization. Greater attention to all means of restoring integrity and stability to financial institutions has led to greater efforts to reconcile the conflicts between jurisdictions, particularly between jurisdictions with strict bank secrecy and those seeking information to enforce their own tax laws.[7] As a result, the Committee may wish to inquire as to whether the U.S. Model treaty published in 2006 remains the appropriate standard by which to measure an effective exchange of information program.

Although the United States has long had bilateral income tax treaties in force with Hungary, Luxembourg, and Switzerland, the United States has engaged in relatively limited exchange of information under these tax treaties. With Luxembourg and Switzerland, the limitations stem from strict bank secrecy rules in those jurisdictions. The proposed protocols

[6] Article XV of the U.S.-Sweden Double Tax Convention, signed on March 23, 1939.

[7] See, Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal; Part Three: Provisions Related to the Taxation of Cross-Border Income and Investment* (JCS-4-09), September 2009. Section VI of that pamphlet provides an overview of the international efforts to address these issues.

with Luxembourg and Switzerland are a response to that history as well as part of the international trend in exchange of information.

The pamphlets prepared by the Joint Committee staff provide detailed overviews of the information exchange articles of the proposed income tax treaties with Chile and Hungary and the proposed protocols with Luxembourg and Switzerland. They also describe the extent to which those articles differ from the U.S. Model treaty's rules on information exchange. I note that since we published our May 20, 2011 pamphlets describing the agreements with Hungary, Luxembourg, and Switzerland, additional information about exchange of information involving those countries has become available, and similar analysis is available about information exchange with Chile.

In June 2011, the Organisation for Economic Co-operation and Development ("OECD") published reports of Phase I Peer Reviews of Hungary and Switzerland, as well as a report on its Combined Phase I and Phase II Peer Review of the United States.[8] The OECD published a report of its Phase I Peer Review of Chile in April 2012. The OECD published a report of its Phase I Peer Review of Luxembourg in September 2011 and a report of its Phase II Peer Review in July 2013. Table 3 of the appendix of the recently published Joint Committee explanation of the proposed protocol amending the mutual administrative assistance agreement provides a summary of the status and outcomes of the OECD peer reviews as of February 6, 2014.[9]

Here I wish to highlight first those issues related to the effectiveness of information exchange under income tax treaties that are common to both the proposed treaties and proposed protocols under consideration today, and second, issues specific to the proposed protocols with Luxembourg and Switzerland.

Effectiveness of U.S. information exchange agreements in general

The Joint Committee staff's pamphlets describe in detail several practical issues related to information exchange under income tax treaties. I will briefly note three issues: the usefulness of automatic exchange of information, the ability of the United States to provide information about beneficial ownership of foreign-owned entities, and, finally, the limitations on specific requests for information.

Automatic exchange of information

The OECD standards do not require exchange other than upon specific requests for information, although the language permits the treaty countries to agree to provide for other exchange mechanisms. The OECD, in its commentary to the exchange of information provisions in the OECD Model treaty, specifies that the treaty "allows" the competent authorities to

[8] Phase I reviews evaluate the quality of a country's legal and regulatory framework for information exchange, and Phase II reviews assess the practical implementation of that framework.

[9] See Joint Committee on Taxation, *Explanation of Proposed Protocol to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (JCX-9-14), February 21, 2014, p. 32.

exchange information in any of three ways that treaty countries have traditionally operated[10] – routine, spontaneous,[11] or specific exchanges.[12]

The Committee may wish to explore issues related to "routine exchange of information." In this type of exchange, also referred to as "automatic exchange of information." the treaty countries identify categories of information that are consistently relevant to the tax administration of the receiving treaty country and agree to share such information on an ongoing basis, without the need for a specific request. The type of information, when it will be provided, and how frequently it will be provided are determined by the respective Competent Authorities after consultation. Once an agreement is reached, the information is automatically provided. The United States, for example, annual provides over 2.5 million items of information about U.S.-source income received by residents of treaty countries to those treaty partners.

The Committee may wish to inquire about the (1) the extent to which the United States presently engages in automatic exchange of taxpayer-specific information, (2) practical hurdles to greater use of automatic exchange, and (3) whether it anticipates significant changes in that practice with the ratification of the documents presently before the Committee.

The Committee may also wish to inquire about regulations finalized in 2012 that expand information reporting by U.S. financial institutions on interest paid to nonresident aliens. In support of those regulations, the Preamble states "requiring routine reporting to the IRS of all U.S. bank deposit interest paid to any nonresidential alien individual will further strengthen the United States exchange of information program consistent with adequate provisions for reciprocity, usability and confidentiality in respect of this information."[13] Such reporting was not previously required, except with respect to payments to residents of Canada.[14] The IRS has published a list of the countries whose residents are subject to the reporting requirements, and a list of countries with respect to which the reported information will be automatically exchanged. The first list includes 78 countries. The second list includes only one, Canada.[15]

---

[10] OECD, Commentary on the Model Treaty Article 26, par. 9 as revised in OECD, *Update to Article 26 of the OECD Model Tax Convention and Its Commentary,* (July 12, 2012), available at http://www.oecd.org/ctp/exchange-of-tax-information/120718_Article%2026-ENG_no%20cover%20%282%29.pdf

[11] A "spontaneous exchange of information" occurs when one treaty country who is in possession of an item of information that it determines may interest the other treaty country for purposes of its tax administration spontaneously transmits the information to its treaty country through their respective competent authorities.

[12] A "specific exchange" is a formal request by one contracting state for information that is relevant to an ongoing investigation of a particular tax matter. These cases are generally taxpayer specific. Those familiar with the case prepare a request that explains the background of the tax case and the need for the information and submit it to the Competent Authority in their country. If he determines that it is an appropriate use of the treaty authority, he forwards it to his counterpart.

[13] Preamble to Treas. Reg. sec. 1.6049-4(b)(5). T.D. 9584, April 12, 2012.

[14] Treas. Reg. sec. 1.6049-4(b)(5).

[15] Rev. Proc. 2012-24 2012 I.R.B. Lexis 242 (April 17, 2012).

In the past, there have been concerns that information received pursuant to automatic exchanges under bilateral and multilateral agreements was not in a usable form. The OECD has developed standards for the electronic format of such exchanges, to enhance their utility to tax administration.[16] Despite these efforts to standardize the information exchanged and improve its usefulness, there remain numerous shortcomings, both practical and legal, in the routine exchange of information. Chief among them is the lack of taxpayer identification numbers ("TINs") in the information provided under the exchange, despite the recommendation of the OECD that member States provide such information.[17] The Committee may wish in inquire about the United State's experience, impediments to greater use of automatic exchanges, and preferences for improving such exchanges.

Ability of United States to provide beneficial ownership information

The United States has come under increasing pressure to eliminate policies that provide foreign persons with the ability to shelter income. The criticism has focused on disparities between the U.S. standards and foreign standards governing "know-your-customer" rules for financial institutions and the maintenance of information on beneficial ownership. With respect to the latter, U.S. norms have been criticized in recent years.[18] The Committee may wish to explore the extent to which either the existing U.S. know-your-customer rules or the corporate formation and ownership standards prevent the United States from providing information about beneficial ownership on a reciprocal basis with its treaty countries. The Committee may also consider whether there are steps to take that would help refute the perception that the United States permits states to operate as tax havens and that would help the United States better respond to information requests from treaty countries who suspect that their own citizens and residents may be engaging in illegal activities through U.S. corporations and limited liability companies.[19]

---

[16] *See* OECD, Committee on Fiscal Affairs, *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes*, Module 3 (January 23, 2006) ("OECD Exchange Manual").

[17] OECD Exchange Manual refers to a recommendation dating to 1997, "Recommendation on the use of Tax Identification Numbers in an International Context" C(97)29/FINAL (1997).

[18] Financial Action Task Force, IMF, *Summary of the Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism United States of America,* pp. 10-11 (June 23, 2006); Government Accountability Office, *Company Formations: Minimal Ownership Information Is Collected and Available,* a report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate GAO-06-376 (April 2006); Government Accountability Office*, Suspicious Banking Activities: Possible Money Laundering by US Corporations Formed for Russian Entities*, GAO-01-120 (October 31, 2006).

[19] E.g., the "Incorporation Transparency and Law Enforcement Assistance Act," S. 569, 111th Congress (2009), would require States to obtain and periodically update beneficial ownership information from persons who seek to form a corporation or limited liability company.

Specific requests for information

The Committee may wish to inquire as to the extent to which a request that a treaty country provide information in response to a John Doe summons[20] is a specific request within the meaning of the Article 26, and whether protracted litigation similar to that which occurred in the UBS litigation[21] can be avoided or shortened.

"Specific" exchange, is an exchange which occurs when one treaty country provides information to the other treaty country in response to a specific request by the latter country for information that is relevant to an ongoing investigation of a particular tax matter. One problem with specific exchange has been that some treaty countries have declined to exchange information in response to specific requests intended to identify limited classes of persons.[22] Your committee may wish to seek assurances that, under the proposed treaties with Hungary and Chile and the proposed protocols with Luxembourg and Switzerland, treaty countries are required to exchange information in response to specific requests that are comparable to John Doe summonses under domestic law.[23] As discussed below, this has been a recurring issue with exchanges with Switzerland.

To the extent that there were perceived deficiencies in the former information exchange relationships with Luxembourg and Switzerland, to the extent that the United States may have little recent practical experience in cooperating with Chile or Hungary on tax matters, and to the extent that OECD peer reviews have concluded that impediments to effective information

---

[20] When the existence of a possibly noncompliant taxpayer is known but not his identity, as in the case of holders of offshore bank accounts or investors in particular abusive transactions, the IRS is able to issue a summons to learn the identity of the taxpayer, but must first meet greater statutory requirements, to guard against fishing expeditions. Prior to issuance of the summons intended to learn the identity of unnamed "John Does," the United States must seek judicial review in an *ex parte* proceeding. In its application and supporting documents, the United States must establish that the information sought pertains to an ascertainable group of persons, that there is a reasonable basis to believe that taxes have been avoided, and that the information is not otherwise available.

[21] See, *United States v. UBS AG*, Civil No. 09-20423 (S.D. Fla.), enforcing a "John Doe summons" which requested the identities of U.S. persons believed to have accounts at UBS in Switzerland. On August 19, 2009, the United States and UBS announced an agreement (approved by the Swiss Parliament on June 17, 2010) under which UBS provided the requested information.

[22] For example, a petition to enforce a John Doe summons served by the United States on UBS, AG was filed on February 21, 2009, accompanied by an affidavit of Barry B. Shott, the U.S. competent authority for the United States-Switzerland income tax treaty. Paragraph 16 of that affidavit notes that Switzerland had traditionally taken the position that a specific request must identify the taxpayer. See *United States v. UBS AG*, Civil No. 09-20423 (S.D. Fla.). On August 19, 2009, after extensive negotiations between the Swiss and U.S. governments, the United States and UBS announced that UBS had agreed to provide information on over 4,000 U.S. persons with accounts at UBS.

[23] Under a John Doe summons, the U.S. Internal Revenue Service ("IRS") asks for information to identify unnamed "John Doe" taxpayers. The IRS may issue a John Doe summons only with judicial approval, and judicial approval is given only if there is a reasonable basis to believe that taxes have been avoided and that the information sought pertains to an ascertainable group of taxpayers and is not otherwise available.

exchange exist in Chile, Hungary, Luxembourg, or Switzerland, your committee may wish to seek reassurances that any obstacles to effective information exchange have been eliminated.[24]

Information exchange with Luxembourg and Switzerland

Switzerland

The exchange of information article in the 1951 U.S.-Swiss treaty was limited to "prevention of fraud or the like." Under the treaty, Switzerland applied a principle of dual criminality, requiring that the purpose for which the information was sought also be a valid purpose under local law. Because "fraud or the like" was limited to nontax crimes in Switzerland, information on civil or criminal tax cases was not available. The provision was substantially revised for the present treaty, signed in 1996, and accompanied by a contemporaneous protocol that elaborated on the terms used in the exchange of information article. That 1996 Protocol was intended to broaden the circumstances under which tax authorities could exchange information to include tax fraud or fraudulent conduct, both civil and criminal. It provided a definition at paragraph 10 of "tax fraud" to mean "fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of tax paid to a contracting state." In practice, exchange apparently remained limited, leading the competent authorities to negotiate a subsequent memorandum of understanding that included numerous examples of the facts upon which a treaty country may base its suspicions of fraud to support a request to exchange information.[25]

In March 2009, the Swiss Federal Council withdrew its reservation regarding Article 26 (Exchange of Information) of the OECD Model treaty, thus apparently adopting the OECD standards on administrative assistance in tax matters.[26] It simultaneously announced key elements that it would require as conditions to be met in any new agreements. The Swiss conditions established by the Federal Council limited administrative assistance to individual cases and only in response to a specific and justified request. Although Switzerland is considered by the OECD to be a jurisdiction that has fully committed to the transparency standards of the OECD, the OECD report on Phase I of its peer review of Switzerland states that the Swiss authorities' initial insistence on imposing identification requirements as a predicate for exchange of information were inconsistent with the international standards and that additional

---

[24] Certain OECD conclusions about information exchange with Luxembourg and Switzerland are noted below. The OECD peer reviews of Chile and Hungary found that although those jurisdictions generally are compliant with OECD standards, each country had certain deficiencies preventing fully effective information exchange.

[25] "Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Tax Convention of October 2, 1996," reprinted at paragraph 9106, *Tax Treaties*, (CCH 2005).

[26] See "Switzerland to adopt OECD standard on administrative assistance in fiscal matters," Federal Department of Finance, FDF (March 13, 2009), available at http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=25863 (last accessed March 1, 2011).

actions would be needed to permit the review process to proceed to Phase II. Those actions include bringing a significant number of its agreements into line with the standard and taking action to confirm that all new agreements are interpreted in line with the standard.

The proposed protocol, by replacing Article 26 (Exchange of Information and Administrative Assistance) of the present treaty and amending paragraph 10 of the 1996 Protocol, closely adheres to the principles announced by Switzerland. It also conforms to the standards, if not the language, of the exchange of information provisions in the U.S. Model treaty in many respects. As a result, the proposed protocol may facilitate greater exchange of information than has occurred in the past, chiefly by eliminating the present treaty requirement that the requesting treaty country establish tax fraud or fraudulent conduct or the like as a basis for exchange of information and providing that domestic bank secrecy laws and lack of a domestic interest in the requested information are not possible grounds for refusing to provide requested information. Lack of proof of fraud, lack of a domestic interest in the information requested, and Swiss bank secrecy laws were cited by Swiss authorities in declining to exchange information. The proposed protocol attempts to ensure that subsequent changes in domestic law cannot be relied upon to prevent access to the information by including in the proposed protocol a self-executing statement that the competent authorities are empowered to obtain access to the information notwithstanding any domestic legislation to the contrary.

Nevertheless, there are several areas in which questions about the extent to which the exchange of information article in the proposed protocol may prove effective are warranted. The proposed revisions to paragraph 10 of the 1996 Protocol reflect complete adoption of the first element listed above in the Swiss negotiating position, "limitation of administrative assistance to individual cases and thus no fishing expeditions." The limitation poses issues regarding (1) the extent to which the Swiss will continue to reject requests that do not name the taxpayer as a result of the requirement that a taxpayer be "typically" identified by name, and (2) the standard of relevance to be applied to requests for information, in light of the caveat against "fishing expeditions." In addition, the appropriate interpretation of the scope of purposes for which exchanged information may be used may be unnecessarily limited by comments in the Technical Explanation. In particular, although paragraph 2 of Article 26 (Exchange of Information), as modified by the proposed protocol, generally prohibits persons who receive information exchanged under the article from using the information for purposes other than those related to the administration, assessment, or collection of taxes covered by the treaty, the paragraph also allows the information to be used for other purposes so long as the laws of both the United States and Switzerland permit that use and the competent authority of the requested country consents to that use. The Technical Explanation, however, states that one treaty country (for example, the United States) will seek the other treaty country's (for example, Switzerland's) consent under this expanded use provision only to the extent that use is allowed under the provisions of the U.S.-Switzerland Mutual Legal Assistance Treaty that entered into force in 1977.

Luxembourg

The proposed protocol with Luxembourg, by replacing Article 28 (Exchange of Information and Administrative Assistance) of the 1996 treaty, is consistent with both the OECD and U.S. Model treaties. There are several areas in which questions are warranted about the extent to which the new article as revised in the proposed protocol may prove effective. These

questions arise not from the language in the proposed protocol itself but from the mutual understandings reflected in diplomatic notes exchanged at the time the protocol was signed. Potential areas of concern are found in statements in the diplomatic notes concerning (1) the obligation to ensure tax authority access to information about beneficial ownership of juridical entities and financial institutions, other than publicly traded entities, to the extent that such information is of a type that is within the possession or control of someone within the territorial jurisdiction, (2) the requirement that all requests must provide the identity of the person under investigation, (3) the standard of relevance to be applied in stating a purpose for which the information is sought, and (4) the requirement that requests include a representation that all other means of obtaining the information have been attempted, except to the extent that to do so would cause disproportionate difficulties.

Moreover, the OECD's Phase II peer review of Luxembourg's implementation of transparency and information exchange standards concluded that Luxembourg is non-compliant with OECD standards. Your committee may wish to inquire into the effect that Luxembourg's failure to comply with OECD standards in implementing exchange of information may have on its exchange relationship with the United States.

**Expansion of mutual administrative assistance agreement**

One of the most significant changes to the multilateral convention made by the proposed protocol is the opening of membership in the convention to states that are neither OECD nor Council of Europe members. In the most recently available list of signatories, dated December 23, 2013, there are a number of countries who are not members of G-20,[27] the OECD or the Council of Europe: Colombia, Costa Rica, Ghana, Guatemala, and Tunisia. All members of G-20 are among the signatories. Those members of G-20 who are not also members of either the OECD or Council of Europe include Argentina, Brazil, India, Indonesia, Saudi Arabia and South Africa. Thus, on the one hand, the inclusive standard for permitting nations to participate has opened the multilateral convention to a number of significant trade partners of the United States. On the other hand, it requires the United States to initiate an exchange of information program with jurisdictions with which it has not previously entered into a bilateral relationship. Among the signatories that have neither a tax treaty nor a TIEA with the United States are Albania, Andorra, Croatia, Ghana, Nigeria, Saudi Arabia, and Singapore.

The extent to which any of those states are jurisdictions with which the United States has previously participated in an exchange of information program and whether the program has operated satisfactorily are areas in which the Committee may wish to inquire. To the extent that they are jurisdictions with whom the United States has no exchange of information program under a bilateral agreement, the Committee may wish to inquire about the extent to which the United States has been able to satisfy itself that each jurisdiction is an appropriate partner for

---

[27] G-20, or the Group of Twenty, is a forum for international economic cooperation among the member countries and the European Union. The leaders of the members meet annually, while finance and banking regulators meet more frequently throughout the year. They work closely with a number of international organizations, including the OECD.

exchange of information. The Committee may also wish to inquire whether the expanded exchange of information requirements will be manageable.

The Committee may also wish to inquire about the circumstances under which the United States would object to accession by a non-member state, as contemplated under the procedures for securing the unanimous consent of the governing body of the treaty before the agreement may enter into effect with respect to that non-member state. For example, in explaining its general standards for considering entry into a bilateral agreement with a jurisdiction, Treasury has stated, "… prior to entering into an information exchange agreement with another jurisdiction, the Treasury Department and the IRS closely review the foreign jurisdiction's legal framework for maintaining the confidentiality of taxpayer information. In order to conclude an information exchange agreement with another country, the Treasury Department and the IRS must be satisfied that the foreign jurisdiction has the necessary legal safeguards in place to protect exchanged information and that adequate penalties apply to any breach of that confidentiality."[28]

## Conclusion

The matters that I have described in this testimony are addressed in more detail in the Joint Committee staff pamphlets on the proposed treaties and protocols. I am happy to answer any questions that your committee may have at this time or in the future.

[28] Preamble to Treas. Reg. 1.6049-4(b)(5). T.D. 9584, April 12, 2012.