Tax Information Exchange Arrangements

Draft TJN Briefing Paper April 2009: comments welcome to markus@taxjustice.net

In March 2009, many states which had been identified as tax havens or secrecy jurisdictions[1] suddenly began making more commitments to exchanging information for tax purposes. This paper seeks to summarise and explain the nature of existing arrangements and standards, and to assess whether they can effectively address the pervasive problems that secrecy jurisdictions pose, to both rich and developing countries.

International provisions for tax information exchange

Exchange of information between the tax authorities of states can be done bilaterally or multilaterally. When done bilaterally, two main types of agreements are used[2]. The first is *Double Taxation Agreements* (DTAs, also known as income tax treaties). The second is *Tax Information Exchange Agreements* (TIEAS.)

Double Taxation Agreements (DTAs)

These are comprehensive agreements between two states to prevent income or profits from international economic activity being taxed twice. A major reason why countries enter such agreements is to foster foreign investment.

However, through "treaty shopping" by businesses and other actors these treaties can also be abused so that cross-border income is taxed lightly, or not at all. There are now over 2,000 such bilateral treaties between different states. The Organisation for Economic Cooperation and Development (OECD) plays an important role in shaping these treaties because it produces a Model Convention that is frequently updated and serves as a template for many bilateral treaties. However, this model remains contested in the developing world because it favours rich nations by emphasising the rights of the investor's resident state (usually a rich nation) to levy the taxes. A variant of this Model Convention has been produced by the UN Committee of Tax Experts, however, which is more amenable to developing countries'

---

[1] No common definition of the terms has been agreed. The Tax Justice Network uses the terms "tax haven" and "secrecy jurisdiction" interchangeably

[2] There is a third type of bilateral agreements, the Treaty for Mutual Legal Assistance in Criminal Matters (MLATs). Some of those MLATs cover criminal tax matters, but other MLATs specifically exclude tax matters. However, a MLAT only allows criminal law enforcement authorities to make use of the treaties and information requests may be hampered by delays, not least because judicial authorization might still be needed (OECD 2001: Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes, Paris, 65).

interests because it prioritises the taxing rights of the state where the economic activity is actually undertaken[3] - often a developing country.

The provision for exchange of information in the OECD Model Convention is Article 26. This Article has been considerably revised and extended in recent years; the current version was agreed in 2005. It now provides for exchange of information which is `forseeably relevant' for the `administration or enforcement of … taxes of every kind', and it now requires each party to use its powers to obtain and provide such information even if it is not needed for its own tax purposes (Art. 26 (4)). Another major improvement in 2005 was to override banking secrecy: bank secrecy may no longer serve as a reason for categorical refusal to exchange information (Art. 26 (5)). Earlier versions were much weaker, and were limited to the exchange of information necessary for the purposes of the treaty, which many states interpreted as meaning only to prevent double taxation, but not to prevent tax evasion and avoidance. Many existing DTAs still contain the older version of article 26.

Tax Information Exchange Agreements (TIEAs)

The second type of treaty is the **Tax Information Exchange Agreement (TIEA).** TIEAs are intended for use with countries for which a DTA is not considered appropriate, mainly because they have no, or low, taxes on income or profits. While TIEAs are much narrower in scope than DTAs, they are more detailed than DTAs on the subject of information exchange. They specify, over about 20-30 pages, the rules and procedures for how such information exchange is to occur. Today, TIEAs are based on an OECD Model Agreement which was published in 2002 by the Global Forum on Taxation, a loose institution formed in 2001 as a result of the OECD's Harmful Tax Practices Project. This Forum includes many tax havens and secrecy jurisdictions such as Bermuda, the Cayman Islands, Cyprus, the Isle of Man, Malta, Mauritius, and the Netherlands Antilles[4]. TIEAs have several fundamental flaws.

First Problem: Bilateralism vs. Multilateralism

Both, the OECD's and the UN's Model only provide a template for bilateral treaties – they have no force unless pairs of states conclude such agreements. The resulting bilateralism produces two related problems: first, it only involves a few links between many players; second, developing countries get left out.

The early 2009 announcements by tax havens, substantially triggered by threats of sanctions or blacklisting, boiled down to commitments to:

(a) accept the new Art. 26 provisions in new DTAs, and renegotiate their existing treaties to include this new version (e.g. Switzerland, Luxembourg, Austria, Singapore), or
(b) conclude a few TIEAs, at least enough to satisfy the international community (e.g. Jersey, Guernsey, Isle of Man).

For these commitments to become a reality two major steps are needed. First, countries that have not yet done so (such as Switzerland) must change their internal laws and administrative

[3] For more details about "Source" and "Residence" taxation, see here: http://taxjustice.blogspot.com/2008/11/source-and-residence-un-and-oecd.html; and here: http://faculty.law.wayne.edu/tad/Documents/Research/Figueroa_Argentina_Intl_Double_Taxation.pdf; 30.3.2009; or in Rixen, Thomas 2008: The Political Economy of International Tax Governance, Basingstoke, 101-104.

[4] Sheppard, Lee 2009: Don't Ask, Don't Tell, Part 4: Ineffectual Information Sharing, in: Tax Notes (23 March 2009), 1411-1418.

practices to allow them to obtain and exchange information for tax purposes. The changes to internal laws can be very significant and can depend on political approval which may, for example, require referendums. Second, they must renegotiate their existing treaties, or negotiate new treaties, with all interested states.

Furthermore, states may maintain or introduce other restrictions on the procedures for obtaining or supplying information. For example, some states consider that before any information is supplied, the person concerned must be notified of the request, and be given an opportunity to object. This could give tax evaders ample opportunity to cover their tracks.

Assuming that domestic legal barriers are removed, the negotiation of these treaties would require many resources and much time, even for rich countries. There are between 50 and 72 secrecy jurisdictions in the world and far more than a hundred countries with which they could negotiate information exchange agreements. Yet by March 2009, only 49 TIEAs have been signed between OECD countries and secrecy jurisdictions and only 18 TIEAs have entered into force. Thus, in almost a decade, the thirty most powerful and technically sophisticated states in the world have only negotiated a handful of such agreements each.

Even this figure is inflated by a number of treaties which are unlikely to be used. For example, recently the UK Crown Dependencies (Isle of Man, Jersey, Guernsey) have each concluded TIEAs with Greenland and the Faroe Islands (both "Crown Dependencies" of Denmark), territories with a combined population of little over 100,000 people[5]. While it is theoretically possible that Greenland and the Faroe Islands might need to investigate their citizens' use of secrecy jurisdictions for tax evasion and avoidance, it is far more likely that these treaties will hardly be used, and are merely concluded to bulk up the number of TIEAs signed.

TIEAs do not work for developing countries. It is very unlikely that even a medium-sized developing country like Chile, India or South Africa would have sufficient leverage to strike a deal with, for instance, Switzerland, on similar terms to those struck by the US and Germany. Worse, if these powerful countries pursue bilateral TIEAs with tax havens, developing countries will not benefit at all and their collective negotiating position will be weakened *vis-à-vis* the tax havens.

Box 1: OECD's false multilateralism

The OECD's Model TIEA, entitled "*Agreement on Exchange of Information on Tax Matters*", in fact presents two models: a multilateral version and a bilateral version, which largely share the same text. However, the multilateral instrument is not a "multilateral" agreement in the traditional sense. Instead, it provides the basis for an integrated bundle of bilateral treaties. A party to the multilateral Agreement would only be bound by the Agreement vis- à-vis the specific parties with which it agrees to be bound." (p. 2). So each treaty partner would continue to negotiate individually with every other single treaty partner about whether or not to exchange information. Furthermore, this Model TIEA currently does not include automatic information exchange.

NB: This "multilateral instrument" bears no resemblance to the multilateral Council of Europe/OECD Convention of 1988, referred to below.

[5] CIA World Factbook. https://www.cia.gov/library/publications/the-world-factbook/; 1.4.2009.

Second problem: No automatic information exchange

Both of the bilateral treaty provisions, the DTAs but especially the TIEAs, require only the provision of information exchange 'upon request'. The TIEA includes strict conditions about the form of such requests. These are designed to prevent so-called `fishing expeditions'. So a request does not mean a brief email containing the name and identifying information of the individual concerned. Instead, a detailed case must be made, with the criteria set out in a lengthy legal document. In effect, this means that the authorities requesting the information must already have a strong case even before they request the information. So it is not possible to follow up a suspicion without already having significant evidence. This sets the bar very high indeed for tax authorities wanting to make a request.

The legal technicalities provide ample opportunities to hinder and block requests for information. Well-resourced law and accountancy firms proliferate in secrecy jurisdictions, ready to take full advantage of every legal technicality. They can also use their good connections with the local officials, since there is little incentive for secrecy jurisdictions to stick properly will to their obligations under TIEAs. The evidence so far is that TIEAs have produced little more than a trickle of information. For instance, the TIEA between the US and Jersey – two of the biggest players in the offshore system - was used only four times in 2008[6].

Third problem: there may be no information to exchange, or problems collecting it

Finally, the procedure entirely depends on the availability of the relevant information, which in turn depends on the legal requirements and administrative measures laid down in the secrecy jurisdiction. Quite often, the information simply does not exist in the jurisdiction concerned, and this is deliberate.

Furthermore, TIEAs do not specify what is to be done if there are no appropriate domestic legal provisions to collect the information. Instead, they oblige the requested party to "use all relevant information gathering measures to provide the applicant Party with the information requested,…" (Art. 5 (2)). When looking at how the OECD model defines information gathering measures, the TIEA model refers to "laws and administrative or judicial procedures that enable a Contracting Party to obtain and provide the requested information;" (Art. 4 (1), sub (l)). The underlying presumption is that sufficient information gathering powers are in place for domestic purposes. There is no obligation to create new or quicker mechanisms to access information contained in the TIEA model. This explains a seeming paradox that Switzerland announced both: that it would accept OECD standards, but that its banking secrecy would not be affected[7].

Box 2: Expert Opinion
Lee A. Sheppard, a leading expert writing in the specialist tax publication *Tax Notes*[8]: "The standard OECD information exchange agreement is nearly worthless. Information exchange under the standard agreement is sporadic, difficult, and unwieldy for tax administrators even under the best of circumstances. When a banking haven is the requested party, information exchange is nearly impossible. The information exchange article in the OECD model tax convention suffers from the same limitations."

[6] http://www.jerseyfunds.org/bfiles/Privacyfactsheet111108.pdf; 1.4.2009.
[7] http://news.bbc.co.uk/1/hi/business/7941717.stm; 1.4.2009.
[8] Sheppard, Lee 2009: Don't Ask, Don't Tell, Part 4: Ineffectual Information Sharing, in: Tax Notes (23 March 2009), 1411-1418.

The solution: multilateral automatic information exchange

There is a solution that can overcome the problems set out in this paper: automatic information exchange on a multilateral basis. This would cover all states, not just those with the political muscle to negotiate bilateral agreements[9].

Precedents for automatic multilateral information exchange exist. The best known is the European Union's Savings Directive (STD), which has since 2005 put in place a working system for multilateral, automatic information exchange. The Directive has many flaws (see below), but in an improved form it could be used to inspire or serve as a template for a global standard. With the EU STD, tax haven governments and courts no longer have a choice over how to interpret the treaties; instead, the format of the information, its collection and its transmission are automated, with no room for discretion.

A TJN briefing paper sets out the current limitations of the EU STD. Essentially, it only covers interest from bank accounts paid to individuals (natural persons), so it can easily be avoided by using a company or trust to control the account. It also allows some jurisdictions currently Austria, Belgium, Luxembourg and in all the non-EU jurisdictions like Jersey that participate, to let taxpayers opt out of information exchange and instead submit to withholding taxes, thus preserving secrecy. Proposals were put forward in November 2008 to revise and improve the Directive to cover artificial legal persons and a wider range of assets, and these hold promise for improvement.

However, a second, largely untested precedent exists in the form of a comprehensive multilateral Convention drawn up in 1988 by the Council of Europe and the OECD. This is a deeper and more comprehensive arrangement than the EU STD and consequently would make a better, stronger template.

It emerged following concern at the explosion of tax avoidance and evasion in the 1970s and 1980s, and unlike the EU STD it covers all information needed for both assessing and collecting all taxes from all taxpayers, both companies and individuals. Even this treaty is far from perfect, but it allows[10] information to be provided automatically, as well as on request, and spontaneously (that is, where specific information is provided to another tax authority even if the information has not been requested). It is also a comprehensive multilateral agreement, unlike the EU's STD which is a directive, not a multilateral treaty.

Unfortunately, while appropriate technical arrangements are available, these are currently not yet used by the member states and thus remain largely untested. Furthermore, even the OECD states have been slow to join: it is in force for only 14 states, and the UK joined only in 2008, while Germany has signed but not yet applied it. While this approach has the advantage of representing a stronger and deeper form of information exchange, the fact that it is very comprehensive may also make it harder for some jurisdictions to sign up.

Obviously, such arrangements should not be limited to the rich Council of Europe and OECD

[9] In fact, such a convention was put forward when the very first proposals were made by the League of Nations in 1928, which produced draft treaties both to prevent double taxation and for administrative assistance in assessment and collection of taxes. The latter were largely ignored, except for the heavily watered-down provision for information exchange, which became Article 26 of the Model treaty.
[10] Spencer, David 1991: Mutual Assistance Convention Has its Limitations, in: Journal of International Taxation (January / February 1991).

countries, but must be extended to poor and rich countries alike. Lack of current capacity in developing countries should not be used as a reason to lock developing countries out of participating in the system. Instead these states should if necessary be empowered with technical assistance to enable them to participate as fully as possible.

This briefing paper is based on a manuscript written by Markus Meinzer, with substantial input by Martin Hearson, Sol Picciotto, Nicholas Shaxson, and David Spencer.