

## 2 HISTORICAL DEVELOPMENT OF INFORMATION EXCHANGE

The most relevant legal basis for the international exchange of information can be found in Article 26 of the Model Convention of the Organization for Economic Cooperation and Development (OECD-MC). Throughout history, the content of this exchange of information clause has been subject to numerous modifications. Also, the implementation of the clause in the different Double Tax Agreements (DTAs) has developed over the last decades.

The following chapter will provide a historical overview of Article 26 of the OECD-MC and of other developments that have influenced the exchange of information for tax purposes. While the focus of DTAs was historically on the avoidance of double taxation, it has since shifted to a stronger emphasis on the elimination of tax evasion and harmful tax practices, as the historical overview in this chapter will demonstrate.

### 2.1 EXCHANGE OF INFORMATION FROM 1963 TO 1998

#### 2.1.1 The Income and Capital Model Convention of 1963

The history of the exchange of information clause goes back to the 1960s, at the time the Organisation for European Economic Co-operation was reconstituted to form the OECD. After the Organization for European Economic Cooperation had already proposed a series of Model Articles in the framework of their reports from 1958 to 1961, the first complete model convention was published in July 1963.<sup>2</sup>

The Income and Capital Model Convention of 1963 included a provision regarding the exchange of information between the Contracting States of the Convention in Article 26. The wording of the article is as follows:

(1) The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. 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.

(2) In no case shall the provisions of section 1 be construed so as to impose on one of the Contracting States the obligation:

- a) to carry out administrative measures at variance with the laws or the administrative practice of that or of the other Contracting State;
- b) to supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

2. [www.oecd.org](http://www.oecd.org).

- 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*).

To summarize the content of this exchange of information clause, the authorities of the two states that adopted this version of the Convention should exchange the information that was required for carrying out the Convention and the domestic laws as far as these provisions correspond to the taxation under the Convention.

Furthermore, the exchanged information was protected by a confidentiality clause. To assure the secrecy of the information, Article 26 indicated that the exchanged information should only be disclosed to the persons or authorities that are concerned with the specific taxation.

However, according to Article 26, paragraph 2, the exchange of information should not be unlimitedly granted. The states that implement the Convention should not be obliged to carry out special measures that are not part of the normal course of their administration to obtain the requested information. The obligation to exchange information was further limited by secrecy provisions: None of the Contracting States was obliged to exchange information that would disclose secrets. As far as the disclosure of this information would be contrary to public order, they were excluded from the exchange of information provision.

#### 2.1.2 Developments after the Income and Capital Model Convention of 1963

The states that concluded DTAs after 1963 either implemented a minor and/or a major exchange clause. The minor exchange clause determined the exchange of the information that was necessary for applying the convention. The major exchange clause contained the obligation of the Contracting States to exchange the information that was necessary for the application of domestic laws.<sup>3</sup> In general, it can be stated that the major exchange clause can only be found rarely as an exclusive exchange clause in the DTAs. The Contracting States will often choose to implement an exclusive minor exchange clause, or a major exchange clause in combination with a minor exchange clause in their DTA. As an example of Luxembourg's application of minor and major exchange clauses, Luxembourg agreed on a minor exchange clause in Article 22 of the DTA with France dated 1 April 1958. But according to the practice of the tax administration, though the article explicitly only applies to an exchange of necessary information for the application of the DTA, all the necessary information for carrying out the domestic laws will be exchanged by the administration.<sup>4</sup>

In the late sixties and early seventies Luxembourg has concluded and/or renegotiated a substantial number of DTAs with main trading partners, such as Germany, France and the United Kingdom, in order to reflect the recent

3. Vogel & Lehner, *DBA Kommentar* (5th edn, Munich, C.H. Beck, 2008), p. 1880.

4. Footnote to Art. 22 of the DTA Luxembourg-France dated April 1, 1958.

developments in international tax law. As a certain number of DTAs from that time remain valid today, it is important to stress that Luxembourg, contrary to certain other countries, seems to adopt rather a static approach to the interpretation of the provisions of the DTAs. Consequently, the content of a specific DTA needs to be interpreted on the basis of the commentaries available and authoritative at the time of the conclusion of a particular DTA.<sup>5</sup>

### 2.1.3 The OECD Model Convention of 1977

The OECD published a new version of the OECD-MC in the year 1977. Within the new Convention, the OECD also decided another slight adjustment to Article 26. From a broad point of view, it can be said that the Convention of 1977 almost maintained the wording of the original Convention of 1963. However, the modifications to Article 26 extended the scope of application beyond residents by making clear that the exchange of information exceeds the limits of application according to Article 1 of the Convention.<sup>6</sup> As a result, the exchange of information between the Contracting States was also possible when the DTA itself was not applicable in the specific case.

### 2.1.4 The Convention on Mutual Administrative Assistance in Tax Matters

The Council of Europe and the OECD developed the Convention on Mutual Administrative Assistance in Tax Matters and opened the Convention for signature by the Member States of both organizations on 25 January 1988.

The Convention aims to advance the administrative Cooperation between states in the assessment and collection of taxes to combat tax avoidance and evasion. The Convention of 1988 should not only provide the exchange of information between the states but also the recovery of foreign tax claims.<sup>7</sup>

Luxembourg itself has not ratified the Convention on Mutual Administrative Assistance in Tax Matters.<sup>8</sup>

### 2.1.5 Council Directive 77/799/EEC of 19 December 1977

With the Council Directive 77/799/EEC dated 19 December 1977 ('the 1977 Directive') on mutual assistance by Member States in the field of direct taxation and taxation of insurance premiums, the European Union intended to combat international tax evasion and avoidance. The hereby improved collaboration between the tax authorities of the Member States should support the practice of

5. Bill No. 6072, p. 8, opinion of the Conseil d'Etat and the travaux parlementaires.

6. Debatin & Wassermeyer, *Doppelbesteuerung* (102nd Ergänzungslieferung, Munich, C.H. Beck, 2007), Art. 26 MA, para. 12.

7. www.oecd.org.

8. www.conventions.coe.int.

exchange of information in tax matters as well as the correct assessment of taxes on income and capital.<sup>9</sup>

The 1977 Directive contains different procedures of information exchange: the exchange of information on request, the automatic exchange of information and the spontaneous exchange of information. Nevertheless, the exchange of information is restricted by Article 8 of the 1977 Directive, according to which the directive does not impose the obligation to investigate or to disclose information if this procedure conflicts with the laws or administrative practice of a Member State. Furthermore, the directive includes a secrecy clause, according to which the information received under the directive shall be kept secret according to the secrecy provisions of the domestic laws of that Member State.

Luxembourg has implemented the 1977 Directive by Grand-Ducal Decree dated 15 March 1979. The provision of Article 3 of the 1977 Directive concerning the automatic information exchange has been modified by Article 5 of this Grand-Ducal Decree.

## 2.2 THE OECD REPORT ON HARMFUL TAX COMPETITION

With the Ministerial Communiqué of May 1996 and the G-7 Summits in 1996 and 1997, the OECD was commissioned to identify and report on harmful tax practices and to 'develop measures to counter the distorting effects of harmful tax competition'.<sup>10</sup>

The OECD report on Harmful Tax Competition that was published on 27–28 April 1998 contained some comments on the actual situation regarding the exchange of information. According to the OECD, 'the ability or willingness of a country to provide information to other countries is a key factor in deciding upon whether the effect of a regime operated by that country has the potential to cause harmful effects. A country may be constrained in exchanging information, (...) because of secrecy laws which prevent the tax authorities from obtaining information (...). Such laws, administrative policies, practices or lack of cooperation may suggest that the preferential tax regime constitutes harmful tax competition. The limited access that certain countries have to bank information for tax purposes (e.g., because of bank secrecy rules) is increasingly inadequate to detect and to prevent the abuse of harmful preferential tax regimes by taxpayers.'

After this report was presented in June 1998, the OECD received 19 recommendations to combat harmful tax competition. The absence of an effective exchange of information is one of the factors helping to identify countries that engage in harmful tax competition and/or having a privileged tax regime.

However, Luxembourg disagreed in the form of a general abstention in respect of the report and the recommendation of the Council and pointed out that as the report does not fulfil the 1996 mandate, having the effect that the report is

9. www.eur-lex.europa.eu.

10. OECD, Harmful Tax Competition – An Emerging Global Issue (1998), p. 7 para. 1.

Since the 2009 decision of the Federal Council, Switzerland has initiated more than 30 new or amended DTAs with a clause on the exchange of information in accordance with Article 26 of the 2008 OECD Model Tax Convention. Twenty of these Agreements have been signed and 10 Agreements have been approved by the Swiss Parliament and are ready to be ratified. The ratification process of most of these approved DTAs should be concluded within the next couple of days, so that the widened exchange of information clauses may enter into force. According to the Swiss Federal Council, the process of amending the existing DTAs will continue until all Swiss double taxation agreements have a clause on the exchange of information in accordance with Article 26 of the OECD Model Tax Convention.

TIEAs have, until now, not been concluded by Switzerland.

As mentioned before, more than 30 concluded exchange-of-information clauses are in accordance with the 2008 OECD standard. The following particularities are of interest:

- In paragraph 1, most agreements limit the scope of the information exchange to taxes covered by the OECD Model Tax Convention. No such limitations are contained in the clauses with France, the United Kingdom, Japan, Germany, the Netherlands, Poland and Sweden.
- In paragraph 2, the vast majority of clauses include the provision that 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 authorizes such use. This extension of the use of exchanged information shall be included in a new version of the OECD Model Tax Convention. Another limitation of the Swiss clauses concerns authorities responsible for overseeing tax administrations. In most Swiss DTAs these authorities are not allowed to have access to the transmitted information.
- In paragraph 5 all concluded Agreements provide for a special provision on bank secrecy. For residents of Switzerland the Swiss tax authorities are only allowed to have access to bank information in cases of tax fraud or severe tax evasion. The OECD standard does not require a tax evasion. Therefore, Switzerland has to implement in its exchange of information clauses of the DTAs a provision, which allows the Swiss Federal Tax Administration as the competent authority to obtain such information.

Another particularity is that all Swiss DTAs with a clause on the exchange of information in accordance with Article 26 of the OECD Model Tax Convention have a protocol provision which provides further explanations of the common understanding of the clause. In general, these protocol provisions state that an exchange of information will only be requested once the requesting State has exhausted its normal procedures under domestic law to obtain the information. An information request to another country is therefore a subsidiary information gathering instrument. They contain an explanation of the standard of 'foreseeable relevance'. This standard is intended to provide for exchange of information in tax

matters to the widest possible extent and, at the same time, to clarify that the Contracting States are not at liberty to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. Furthermore, the Protocols contain a list of information the requested State has to provide when making a request. According to the vast majority of DTAs the following information has to be provided:

- the name and address of the taxpayer under examination or investigation;
- the name and address of the information holder;
- the period of time for which the information is requested;
- the tax purpose for which the information is sought;
- the form in which the requesting State wishes to receive the information.

Some DTAs do not require that the name and address of the taxpayer under examination or investigation has to be provided (USA, the Netherlands, and Germany). However, these DTAs insist on a clear identification of the taxpayer by other means.

With respect to the identification of the information holder, all but one DTA require the name and most of them also require the address of the holder of the information. The treaty with France only requires the name and the address to the extent known. However, in the absence of such identifying information, the requested State would not know where to obtain the information requested.

Furthermore, the protocols state that the provision on the exchange of information does not require the Contracting States to exchange information on an automatic or a spontaneous basis.

Finally, the protocols guarantee that the taxpayers' rights provided for in the requested Contracting State (e.g., the right to be notified, the right of appeal) remain applicable before the information is transmitted to the requesting Contracting State.

With respect to the procedural rules governing the exchange of information, Switzerland has implemented an ordinance of the Swiss Federal Council. On 1 October 2010 the ordinance on Administrative Assistance for Double Taxation Agreements entered into force. This ordinance provides domestic law for the application of the new DTAs with a clause on the exchange of information. According to this ordinance, decisions of the Swiss Federal Tax Administration on the exchange of information can be appealed to a court of first instance. Such an appeal can be made by the taxpayer, by an affected third person and, if affected in its own interests, even by the holder of the information. An appeal to a higher court is not possible. Regarding the information gathering methods, the ordinance refers to the domestic law. The Federal Tax Administration will use the same procedural instruments as foreseen under domestic law to obtain the information. Regarding tax information as described in paragraph 5 of Article 26 of the OECD Model Tax Convention (bank information ownership information) the information gathering methods go even further than those relating to domestic law.

## 2 MEANING OF THE TERM 'FISHING EXPEDITION'

The OECD commentary to Article 5 states in paragraph 5 sentence 3 that:

[t]he standard of 'foreseeable relevance' is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Contracting States are not at liberty to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. It does not define the meaning of the term 'fishing expedition'.

According to the Swiss view, an information is foreseeably relevant if it will presumably be needed for the correct taxation of the taxpayer under examination or investigation by the requesting State. Switzerland thinks that the best way to avoid fishing expeditions is that the requesting State will provide specific information. This information includes the name of the taxpayer as well as the name of the holder of the information. In Switzerland about hundred banks are established. Without such detailed information fishing expeditions are very likely to occur. Switzerland will decline a request if the collection of information is particularly burdensome; e.g., where a request asks for all accounts at all banks. In general a resident of one State will not have an account with all banks of the other State but with one bank or with a small number of banks, probably not more than 5. If the requested State would be obliged to contact all domestic banks, and possibly to take coercive measures against a large number of these banks, in order to be able to certify that the taxpayer does not have an account with most of them, the request would be regarded as excessively burdensome. That means that a request by a Contracting State which provides the name of the taxpayer would not be qualified as a fishing expedition. The supply of information would nevertheless be refused if it focuses on accounts with all banks. Such a request would be overly burdensome and not in line with the principle of proportionality.

A high probability that some unspecified residents of a Contracting State have evaded taxes is not sufficient for an exchange of information request. If, e.g. the tax administration of a Contracting State has found out that some specific taxpayers have undeclared accounts with a Swiss bank it is not unreasonable to believe that other taxpayer have followed this example. Concerning the specific taxpayers the request would be legitimate. Asking the Swiss Tax Administration to search for other account holders resident in the other Contracting State would constitute a Fishing Expedition and the request would insofar be refused. The same holds true if a Contracting State would ask Switzerland to investigate whether the 10,000 richest person living in the other Contracting State have undeclared bank accounts. Such a request has no relation to an ongoing examination of a particular taxpayer. It is, therefore, a Fishing Expedition.

## 3 SPECIFIC BILATERAL TAX TREATIES

Some tax treaties concluded by Switzerland do not yet contain a provision equivalent to Article 26(5) OECD-MC. According to these particular treaties

exchange of information is only provided in cases of tax fraud or the like. If the requesting State establishes that the taxpayer has committed a tax fraud, bank secrecy will not stop Switzerland exchanging information. If, however, the threshold of tax fraud is not reached, Switzerland will not exchange information. Tax fraud means that the taxpayer either uses forged or falsified documents or adopts fraudulent conduct to deceive the tax administration. Fraudulent behaviour of the taxpayer is often described as a so-called 'scheme of lies'.

In the year 2006 Spain and Switzerland concluded a tax treaty which contained the following most-favoured-nation clause:

Should Switzerland conclude with a Member State of the European Union, in relation to exchange of information, any Agreement of whatever kind and nature or any provision in a Double Taxation Agreement, related to taxes covered by this Convention, Switzerland shall give to Spain the same level of co-operation as in such Agreement or provision or the part of them and Spain will act accordingly.'

At the time of the negotiation this clause was definitely desirable for Spain. From the Swiss perspective, nowadays the clause does not make sense any longer. It is better to conclude with Switzerland a clause on the exchange of information in line with the OECD standard.

## 4 ENTRY INTO FORCE OF THE NEW INFORMATION EXCHANGE OBLIGATION

Information can only be requested after the concluded agreement has been approved by both States, ratified, and entered into force. The vast majority of DTAs concluded by Switzerland allow an exchange of information that relates to taxable periods beginning on or after the first January of the year next following the entry into force of the DTA or an amending protocol. The agreements with the United States, Germany, France, and the Netherlands provide for exemptions.

## 5 INFORMATION OF THE TAXPAYER AND LEGAL REMEDIES

In Switzerland the tax administration is obliged to inform the taxpayer. The taxpayer has the right to appeal against a decision of the Swiss Federal Tax Administration to transmit information. If the requesting State explicitly asks the tax administration of the requested State not to inform the taxpayer about the request in order not to deteriorate the ongoing investigation such a request would not be regarded as permissible in Switzerland. The taxpayer always has the right to make an appeal against a decision of the Federal Tax Administration to exchange information. This does not mean that he/she has the right to have sight of the whole request. Parts of the request may be covered.