112TH CONGRESS, 1st Session } SENATE { EXEC. REPT. 112–1

PROTOCOL AMENDING TAX CONVENTION WITH SWITZERLAND

AUGUST 30 (legislative day, AUGUST 2), 2011.—Ordered to be printed

Mr. KERRY, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Treaty Doc. 112–1]

The Committee on Foreign Relations, to which was referred the Protocol Amending the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income, Signed at Washington on October 2, 1996, signed on September 23, 2009, at Washington, as corrected by an exchange of notes effected November 16, 2010, together with a related agreement effected by an exchange of notes on September 23, 2009 (Treaty Doc. 112–1) (collectively, the "Protocol"), having considered the same, reports favorably thereon with one declaration, as indicated in the resolution of advice and consent, and recommends that the Senate give its advice and consent to ratification thereof, as set forth in this report and the accompanying resolution of advice and consent.

CONTENTS

I. PURPOSE

The purpose of the Protocol, along with the underlying treaty, is to promote and facilitate trade and investment between the United States and Switzerland, and to bring the existing treaty with Switzerland (the "Treaty") into conformity with current U.S. tax treaty

99–115

policy. Principally, the Protocol will modernize the existing Treaty's rules governing exchange of information; provide for the establishment of a mandatory arbitration rule to facilitate resolution of disputes between the U.S. and Swiss revenue authorities about the Treaty's application to particular taxpayers; and provide an exemption from source country withholding tax on dividends paid to individual retirement accounts.

II. Background

The United States has a tax treaty with Switzerland that is currently in force, which was concluded in 1996 along with a separate protocol to the treaty concluded on the same day ("1996 Protocol"). The proposed Protocol was negotiated to modernize our relationship with Switzerland in this area and to update the current treaty to better reflect current U.S. and Swiss domestic tax policy.

III. Major Provisions

A detailed article-by-article analysis of the Protocol may be found in the Technical Explanation Published by the Department of the Treasury on June 7, 2011, which is included in Annex 2. In addition, the staff of the Joint Committee on Taxation prepared an analysis of the Protocol, JCX-31-11 (May 20, 2011), which was of great assistance to the committee in reviewing the Protocol. A summary of the key provisions of the Protocol is set forth below.

The Protocol is primarily intended to update the existing Swiss Convention to conform to current U.S. and Swiss tax treaty policy. It provides an exemption from source country withholding tax on dividends paid to individual retirement accounts; provides for the establishment of a mandatory arbitration rule to facilitate resolution of disputes between the U.S. and Swiss revenue authorities about the treaty's application to particular taxpayers; and modernizes the existing Convention's rules governing exchange of information.

INDIVIDUAL RETIREMENT ACCOUNTS

The Protocol updates the provisions of the existing Convention, as requested by Switzerland, to provide an exemption from source country withholding tax on dividends paid to individual retirement accounts.

MANDATORY ARBITRATION

The Protocol incorporates mandatory, binding arbitration in certain cases that the competent authorities of the United States and Switzerland have been unable to resolve after a reasonable period of time under the mutual agreement procedure. The procedures include (1) the opportunity for taxpayer participation by providing information directly to the arbitral panel through position papers; and (2) a prohibition against either state appointing an employee of its tax administration as a member of the arbitration panel.

EXCHANGE OF INFORMATION

The Protocol would replace the existing Treaty's tax information exchange provisions (contained in Article 26) with updated rules that are consistent with current U.S. tax treaty practice. The Protocol provides the tax authorities of to the two countries shall exchange information relevant to carrying out the provisions of the Convention or the domestic tax laws of either country. This includes information that would otherwise be protected by the bank secrecy laws of either country. This broadens the Treaty's existing information sharing provisions, which provide for information sharing only where necessary for the prevention of income tax fraud or similar activities. The Protocol also enables the United States to obtain information (including from financial institutions) from Switzerland whether or not Switzerland needs the information for its own tax purposes.

IV. Entry Into Force

The proposed Protocol will enter into force between the United States and Switzerland on the date of the later note in an exchange of diplomatic notes in which the Parties notify each other that their respective applicable procedures for ratification have been satisfied. The various provisions of this Protocol shall have effect as described in paragraph 2 of Article V of the Protocol.

V. Implementing Legislation

As is the case generally with income tax treaties, the Protocol is self-executing and does not require implementing legislation for the United States.

VI. Committee Action

The committee held a public hearing on the Convention on June 7, 2011. Testimony was received from Manal Corwin, Deputy Assistant Secretary (International Tax Affairs) at the Treasury Department, and Thomas Barthold, Chief of Staff of the Joint Committee on Taxation. A transcript of the hearing is included in Annex 2.

On July 26, 2011, the committee considered the Protocol and ordered it favorably reported by voice vote, with a quorum present and without objection.

VII. Committee Comments

The Committee on Foreign Relations believes that the Protocol will stimulate increased trade and investment, strengthen provisions regarding the exchange of tax information, and promote closer co-operation between the United States and Switzerland. The committee therefore urges the Senate to act promptly to give advice and consent to ratification of the Protocol, as set forth in this report and the accompanying resolution of advice and consent.

A. Mandatory Arbitration

The arbitration provision in the Protocol is largely consistent with the arbitration provisions included in recent treaties negotiated with Canada, Germany, Belgium, and France. It includes the modifications which were made first to the French treaty provisions to reflect concerns expressed by the Senate during its approval of the other treaties. Significantly, the provision in the Protocol includes (1) the opportunity for taxpayer participation by providing information directly to the arbitral panel through position papers; and (2) a prohibition against either state appointing an employee of its tax administration as a member of the panel.

B. EXCHANGE OF INFORMATION

The Protocol would replace the existing Treaty's tax information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice. The Protocol would allow the tax authorities of each country to exchange information relevant to carrying out the provisions of the Treaty or the domestic tax laws of either country, including information that would otherwise be protected by the bank secrecy laws of either country. It would also enable the United States to obtain information (including from financial institutions) from Switzerland whether or not Switzerland needs the information for its own tax purposes.

The committee takes note of the difficulties faced in 2008–2009 by the Internal Revenue Service and the Department of Justice in obtaining information needed to enforce U.S. tax laws against U.S. persons who utilized the services of UBS AG, a multinational bank based in Switzerland. The committee expects that the proposed Protocol—including in particular the express provisions making clear that a country's bank secrecy laws cannot prevent the exchange of tax information requested pursuant to the treaty—should put the government of Switzerland in a position to prevent recurrence of such an incident in the future.

The committee takes note of Article 4 of the Protocol which sets forth information that should be provided to the requested State by the requesting State when making a request for information under the Treaty. It is the committee's understanding based upon the testimony and Technical Explanation provided by the Department of the Treasury that, while this paragraph contains important procedural requirements that are intended to ensure that "fishing expeditions" do not occur, the provisions of this paragraph will be interpreted by the United States and Switzerland to permit the widest possible exchange of information and not to frustrate effective exchange of information. In particular, the committee understands that with respect to the requirement that a request must include "information sufficient to identify the person under examination or investigation," it is mutually understood by the United States and Switzerland that there can be circumstances in which there is information sufficient to identify the person under examination or investigation even though the requesting State cannot provide the person's name.

C. DECLARATION ON THE SELF-EXECUTING NATURE OF THE PROTOCOL

The committee has included one declaration in the recommended resolution of advice and consent. The declaration states that the Protocol is self-executing, as is the case generally with income tax treaties. Prior to the 110th Congress, the committee generally included such statements in the committee's report, but in light of the Supreme Court decision in *Medellin* v. *Texas,* 128 S. Ct. 1346 (2008), the committee determined that a clear statement in the Resolution is warranted. A further discussion of the committee's views on this matter can be found in Section VIII of Executive Report 110-12.

D. AGREEMENTS RELATING TO REQUESTS FOR INFORMATION

In connection with efforts to obtain from Switzerland information relevant to U.S. investigations of alleged tax fraud committed by account holders of UBS AG, in 2009 and 2010 the United States and Switzerland entered into two agreements pursuant to the U.S.-Switzerland Tax Treaty.

In particular, on August 19, 2009, the two governments signed an Agreement Between the United States of America and the Swiss Confederation on the request for information from the Internal Revenue Service of the United States of America regarding UBS AG, a corporation established under the laws of the Swiss Confederation. On March 31, 2010, the two governments signed a separate protocol amending the August 19, 2009 agreement.

The committee supports the objective of these agreements to facilitate the exchange of information between Switzerland and the United States in support of U.S. efforts to investigate and prosecute alleged tax fraud by account holder of UBS AG.

The committee notes its concern, however, about one provision of the March 31, 2010 protocol. Paragraph 4 of that protocol provides that "For the purposes of processing the Treaty Request, this Agreement and its Annex shall prevail over the existing Tax Treaty, its Protocol and the Mutual Agreement in case of conflicting provisions."

Some could interpret the March 31, 2010, protocol's language indicating that the August 19, 2009 agreement "shall prevail" over the existing U.S.-Switzerland tax treaty to mean that the agreement has the effect of amending the tax treaty. The U.S.-Switzerland tax treaty is a treaty concluded with the advice and consent of the Senate. Amendments to treaties are themselves ordinarily subject to the advice and consent of the Senate. The executive branch has not sought the Senate's advice and consent to either the August 19, 2009 agreement or the March 31, 2010 protocol. The executive branch has assured the committee that the two governments did not intend this language to have any effect on the obligations of the United States under the U.S.-Switzerland tax treaty.

In order to avoid any similar confusion in the future, the committee expects that the executive branch will refrain from the use of similar language in any future agreements relating to requests for information under tax treaties unless it intends to seek the Senate's advice and consent for such agreements.

VIII. TEXT OF RESOLUTION OF ADVICE AND CONSENT TO RATIFICATION

Resolved (two-thirds of the Senators present concurring therein),

SECTION 1. SENATE ADVICE AND CONSENT SUBJECT TO A DECLARATION

The Senate advises and consents to the ratification of the Protocol Amending the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income, Signed at Washington on October 2, 1996, signed on September 23, 2009, at Washington, as corrected by an exchange of notes effected November 16, 2010, together with a related agreement effected by an exchange of notes on September 23, 2009 (the "Protocol") (Treaty Doc. 112–1), subject to the declaration of section 2.

SECTION 2. DECLARATION

The advice and consent of the Senate under section 1 is subject to the following declaration:

The Protocol is self-executing.

IX. Annex 1.—Technical Explanation

DEPARTMENT OF THE TREASURY TECHNICAL EXPLANATION OF THE PROTOCOL SIGNED AT WASHINGTON ON SEPTEMBER 23, 2009 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE SWISS CONFEDERATION FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT WASHINGTON ON OCTOBER 2, 1996, AS AMENDED BY THE PROTOCOL SIGNED ON OCTOBER 2, 1996

This is a Technical Explanation of the Protocol signed at Washington on September 23, 2009 and the related Exchange of Notes (hereinafter the "Protocol" and "Exchange of Notes" respectively), amending the Convention between the United States of America and the Swiss Confederation for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on October 2, 1996 as amended by the Protocol also signed on October 2, 1996 (together, the "existing Convention").

Negotiations took into account the U.S. Department of the Treasury's current tax treaty policy and the Treasury Department's Model Income Tax Convention, published on November 15, 2006 (the "U.S. Model"). Negotiations also took into account the Model Tax Convention on Income and on Capital, published by the Organisation for Economic Cooperation and Development (the "OECD Model"), and recent tax treaties concluded by both countries.

This Technical Explanation is an official guide to the Protocol and Exchange of Notes. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol and the Exchange of Notes.

References to the existing Convention are intended to put various provisions of the Protocol into context. The Technical Explanation does not, however, provide a complete comparison between the provisions of the existing Convention and the amendments made by the Protocol and Exchange of Notes. The Technical Explanation is not intended to provide a complete guide to the existing Convention as amended by the Protocol and Exchange of Notes. To the extent that the existing Convention has not been amended by the Protocol and Exchange of Notes, the technical explanation of the Convention signed at Washington on October 2, 1996 and the Protocol signed on also signed on October 2, 1996 remains the official explanation. References in this Technical Explanation to "he" or "his" should be read to mean "he or she" or "his or her." References to the "Code" are to the Internal Revenue Code of 1986, as amended.

The Exchange of Notes relates to the implementation of new paragraphs 6 and 7 of Article 25 (Mutual Agreement Procedure), which provide for binding arbitration of certain disputes between the competent authorities.

ARTICLE 1

Article 1 of the Protocol revises Article 10 (Dividends) of the existing Convention by restating paragraph 3. New paragraph 3 provides that dividends paid by a company resident in a Contracting State shall be exempt from tax in that State if the dividends are paid to and beneficially owned by a pension or other retirement arrangement which is a resident of the other Contracting State, or an individual retirement savings plan set up in and owned by a resident of the other Contracting State, and the competent authorities of the Contracting States agree that the pension or retirement arrangement, or the individual retirement savings plan, in a Contracting State generally corresponds to a pension or other retirement arrangement, or to an individual retirement savings plan, recognized for tax purposes in the other Contracting State.

The exemption from tax provided in new paragraph 3 shall not apply if the pension or retirement arrangement or the individual retirement savings plan receiving the dividend controls the company paying the dividend. Additionally, in order to qualify for the benefits of new paragraph 3, a pension or retirement arrangement or individual retirement savings plan must satisfy the requirements of paragraph 2 of Article 22 (Limitation on Benefits).

ARTICLE 2

Article 2 of the Protocol replaces paragraph 6 of Article 25 (Mutual Agreement Procedure) of the existing Convention with new paragraphs 6 and 7. New paragraphs 6 and 7 provide a mandatory binding arbitration proceeding. Paragraph 1 of the Exchange of Notes provides that binding arbitration will be used to determine the application of the Convention in respect of any case where the competent authorities have endeavored but are unable to reach an agreement under Article 25 regarding such application (the competent authorities may, however, agree that the particular case is not suitable for determination by arbitration. Paragraph 1 of the Exchange of Notes provides additional rules and procedures that apply to a case considered under the arbitration provisions.

New paragraph 6 provides that a case shall be resolved through arbitration when the competent authorities have endeavored but are unable to reach a complete agreement regarding a case and the following three conditions are satisfied. First, tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case. Second, the case is not a case that the competent authorities agree before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration. Third, all concerned persons and their authorized representatives agree, according to the provisions of new subparagraph 7(d), not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of the board (confidentiality agreement). The confidentiality agreement may also be executed by any concerned person that has the legal authority to bind any other concerned person on the matter. For example, a parent corporation with the legal authority to bind its subsidiary with respect to confidentiality may execute a comprehensive confidentiality agreement on its own behalf and that of its subsidiary.

New paragraph 6 provides that an unresolved case shall not be submitted to arbitration if a decision on such case has already been rendered by a court or administrative tribunal of either Contracting State.

New paragraph 7 provides additional rules and definitions to be used in applying the arbitration provisions. Subparagraph 7(a) provides that the term "concerned person" means the person that brought the case to competent authority for consideration under Article 25 and includes all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration. For example, a concerned person does not only include a U.S. corporation that brings a transfer pricing case with respect to a transaction entered into with its Swiss subsidiary for resolution to the U.S. competent authority, but also the Swiss subsidiary, which may have a correlative adjustment as a result of the resolution of the case.

Subparagraph 7(c) provides that an arbitration proceeding begins on the later of two dates: two years from the commencement date of that case (unless both competent authorities have previously agreed to a different date), or the earliest date upon which all concerned persons have entered into a confidentiality agreement and the agreements have been received by both competent authorities. The commencement date of the case is defined by subparagraph 7(b) as the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities.

Subparagraph 1(c) of the Exchange of Notes provides that notwithstanding the initiation of an arbitration proceeding, the competent authorities may reach a mutual agreement to resolve the case and terminate the arbitration proceeding. Correspondingly, a concerned person may withdraw its request for the competent authorities to engage in the Mutual Agreement Procedure and thereby terminate the arbitration proceeding at any time.

Subparagraph 1(p) of the Exchange of Notes provides that each competent authority will confirm in writing to the other competent authority and to the concerned persons the date of its receipt of the information necessary to undertake substantive consideration for a mutual agreement. Such information will be submitted to the competent authorities under relevant internal rules and procedures of each of the Contracting States. The information will not be considered received until both competent authorities have received copies of all materials submitted to either Contracting State by concerned persons in connection with the mutual agreement procedure.

The Exchange of Notes provides several procedural rules once an arbitration proceeding under paragraph 6 of Article 25 has commenced, but the competent authorities may complete these rules as necessary. In addition, as provided in subparagraph 1(f) of the Exchange of Notes, the arbitration panel may adopt any procedures necessary for the conduct of its business, provided the procedures are not inconsistent with any provision of Article 25 or of the Exchange of Notes.

Subparagraph 1(e) of the Exchange of Notes provides that each Contracting State has 90 days from the date on which the arbitration proceeding begins to send a written communication to the other Contracting State appointing one member of the arbitration panel. The members of the arbitration panel shall not be employees of the tax administration which appoints them. Within 60 days of the date the second of such communications is sent, these two board members will appoint a third member to serve as the chair of the panel. The competent authorities will develop a non-exclusive list of individuals familiar in international tax matters who may potentially serve as the chair of the panel, but in any case, the chair can not be a citizen or resident of either Contracting State. In the event that the two members appointed by the Contracting States fail to agree on the third member by the requisite date, these members will be dismissed and each Contracting State will appoint a new member of the panel within 30 days of the dismissal of the original members.

Subparagraph 1(g) of the Exchange of Notes establishes deadlines for submission of materials by the Contracting States to the arbitration panel. Each competent authority has 60 days from the date of appointment of the chair to submit a Proposed Resolution describing the proposed disposition of the specific monetary amounts of income, expense or taxation at issue in the case, and a supporting Position Paper. Copies of each State's submissions are to be provided by the panel to the other Contracting State on the date on which the later of the submissions is submitted to the panel. Each of the Contracting States may submit a Reply Submission to the panel within 120 days of the appointment of the chair to address points raised in the other State's Proposed Resolution or Position Paper. If one Contracting State fails to submit a Proposed Resolution within the requisite time, the Proposed Resolution of the other Contracting State is deemed to be the determination of the arbitration panel in the case and the arbitration proceeding will be terminated. Additional information may be supplied to the arbitration panel by a Contracting State only at the panel's request. The panel will provide copies of any such requested information, along with the panel's request, to the other Contracting State on the date on which the request or response is submitted. All communication from the Contracting States to the panel, and vice versa, is to be in writing between the chair of the panel and the designated competent authorities with the exception of communication regarding logistical matters.

Subparagraph 1(h) of the Exchange of Notes provides that the presenter of the case to the competent authority of a Contracting State may submit a Position Paper to the panel for consideration by the panel. The Position Paper must be submitted within 90 days of the appointment of the chair, and the panel will provide copies of the Position Paper to the Contracting States on the date on which the later of the submissions of the Contracting States is submitted to the panel. Subparagraph 1(i) of the Exchange of Notes provides that the arbitration panel must deliver a determination in writing to the Contracting States within six months of the appointment of the chair. The determination must be one of the two Proposed Resolutions submitted by the Contracting States. Subparagraph 1(b) of the Exchange of Notes provides that the determination may only provide a determination regarding the amount of income, expense or tax reportable to the Contracting States. The determination has no precedential value, and consequently the rationale behind a panel's determination would not be beneficial and may not be provided by the panel.

Subparagraphs 1(j) and 1(k) of the Exchange of Notes provide that unless any concerned person does not accept the decision of the arbitration panel, the determination of the panel constitutes a resolution by mutual agreement under Article 25 and, consequently, is binding on both Contracting States. Within 30 days of receiving the determination from the competent authority to which the case was first presented, each concerned person must advise that competent authority whether the person accepts the determination. In addition, if the case is in litigation, each concerned person who is a party to the litigation must also advise, within the same time frame, the court of its acceptance of the arbitration determination, and withdraw from the litigation the issues resolved by the arbitration proceeding. If any concerned person fails to advise the competent authority and relevant court within the requisite time, such failure is considered a rejection of the determination. If a determination is rejected, the case cannot be the subject of a subsequent arbitration proceeding.

For purposes of the arbitration proceeding, the members of the arbitration panel and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article 26 (Exchange of Information). Subparagraph 1(n) of the Exchange of Notes provides that all materials prepared in the course of, or relating to the arbitration proceeding are considered information exchanged between the Contracting States. No information relating to the arbitration proceeding or the panel's determination may be disclosed by members of the arbitration panel or their staffs or by either competent authority, except as permitted by the Convention and the domestic laws of the Contracting States. Members of the arbitration panel and their staffs must agree in statements sent to each of the Contracting States in confirmation of their appointment to the arbitration board to abide by and be subject to the confidentiality and nondisclosure provisions of Article 26 of the Convention and the applicable domestic laws of the Contracting States, with the most restrictive of the provisions applying.

Subparagraph 1(m) of the Exchange of Notes provides that the applicable domestic law of the Contracting States determines the treatment of any interest or penalties associated with a competent authority agreement achieved through arbitration.

Subparagraph 1(l) of the Exchange of Notes provides that any meetings of the arbitration panel shall be in facilities provided by the Contracting State whose competent authority initiated the mutual agreement proceedings in the case. Subparagraph 1(o) of the Exchange of Notes provides that fees and expenses are borne equally by the Contracting States, including the cost of translation services. In general, the fees of members of the arbitration panel will be set at the fixed amount of $2,000 per day or the equivalent amount in Swiss francs. The expenses of members of the panel will be set in accordance with the International Centre for Settlement of Investment Disputes (ICSID) Schedule of Fees for arbitrators (in effect on the date on which the arbitration board proceedings begin). The competent authorities may amend the set fees and expenses of members of the board. Meeting facilities, related resources, financial management, other logistical support, and general and administrative coordination of the arbitration proceeding will be provided, at its own cost, by the Contracting State whose competent authority initiated the mutual agreement proceedings. All other costs are to be borne by the Contracting State that incurs them.

ARTICLE 3

Article 3 of the Protocol replaces Article 26 (Exchange of Information) of the existing Convention. This Article provides for the exchange of information and administrative assistance between the competent authorities of the Contracting States.

Paragraph 1 of Article 26

The obligation to obtain and provide information to the other Contracting State is set out in new Paragraph 1. The information to be exchanged is that which may be relevant for carrying out the provisions of the Convention or the domestic laws of the United States or of Switzerland concerning taxes covered by the Convention, insofar as the taxation thereunder is not contrary to the Convention. This language incorporates the standard in 26 U.S.C. Section 7602 which authorizes the IRS to examine "any books, papers, records, or other data which may be relevant or material." (emphasis added) In United States v. Arthur Young & Co., 465 U.S. 805, 814 (1984), the Supreme Court stated that the language "may be" reflects Congress's express intention to allow the IRS to obtain "items of even potential relevance to an ongoing investigation, without reference to its admissibility." (emphasis in original) However, the language "may be" would not support a request in which a Contracting State simply asked for information regarding all bank accounts maintained by residents of that Contracting State in the other Contracting State.

Exchange of information with respect to each State's domestic law is authorized to the extent that taxation under domestic law is not contrary to the Convention. Thus, for example, information may be exchanged with respect to a covered tax, even if the transaction to which the information relates is a purely domestic transaction in the requesting State and, therefore, the exchange is not made to carry out the Convention. An example of such a case is provided in the OECD Commentary: a company resident in one Contracting State and a company resident in the other Contracting State transact business between themselves through a third-country resident company. Neither Contracting State has a treaty with the third State. To enforce their internal laws with respect to transactions of their residents with the third-country company (since there is no relevant treaty in force), the Contracting States may exchange information regarding the prices that their residents paid in their transactions with the third-country resident.

New paragraph 1 clarifies that information may be exchanged that relates to the administration or enforcement of the taxes covered by the Convention. Thus, the competent authorities may request and provide information for cases under examination or criminal investigation, in collection, on appeals, or under prosecution.

Information exchange is not restricted by paragraph 1 of Article 1 (General Scope). Accordingly, information may be requested and provided under this Article with respect to persons who are not residents of either Contracting State. For example, if a third-country resident has a permanent establishment in Switzerland, and that permanent establishment engages in transactions with a U.S. enterprise, the United States could request information with respect to that permanent establishment, even though the third-country resident is not a resident of either Contracting State. Similarly, if a third-country resident maintains a bank account in Switzerland, and the Internal Revenue Service has reason to believe that funds in that account should have been reported for U.S. tax purposes but have not been so reported, information can be requested from Switzerland with respect to that person's account, even though that person is not the taxpayer under examination.

The obligation to exchange information under paragraph 1 does not limit a Contracting State's ability to employ unilateral procedures otherwise available under its domestic law to obtain, or to require the disclosure of, information from a taxpayer or third party. Thus, the Protocol does not prevent or restrict the United States' information gathering authority or enforcement measures provided under its domestic law.

Although the term "United States" does not encompass U.S. possessions for most purposes of the Convention, Section 7651 of the Code authorizes the Internal Revenue Service to utilize the provisions of the Internal Revenue Code to obtain information from the U.S. possessions pursuant to a proper request made under Article 26. If necessary to obtain requested information, the Internal Revenue Service could issue and enforce an administrative summons to the taxpayer, a tax authority (or a government agency in a U.S. possession), or a third party located in a U.S. possession.

Paragraph 2 of Article 26

New paragraph 2 provides assurances that any information exchanged will be treated as secret, subject to the same disclosure constraints as information obtained under the laws of the requesting State. Information received may be disclosed only to persons, including courts and administrative bodies, involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of the of appeals in relation to, the taxes covered by the Convention. The information must be used by these persons in connection with the specified functions. Information may also be disclosed to legislative bodies, such as the tax-writing committees of Congress and the Government Accountability Office, engaged in the oversight of the preceding activities. Information received by these bodies must be for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received may be disclosed in public court proceedings or in judicial decisions.

New paragraph 2 also provides that information received by a Contracting State may be used for other purposes when such information may be used for such other purpose under the laws of both States, and the competent authority of the requested State has authorized such use. This provision is derived from the OECD Model Commentary, which explains that Contracting States may add this provision to broaden the purposes for which they may use information exchanged to allow other non-tax law enforcement agencies and judicial authorities on certain high priority matters (e.g., to combat money laundering, corruption, or terrorism financing). To ensure that the laws of both States would allow the information to be used for such other purpose, the Contracting States will only seek consent under this provision to the extent that the non-tax use is allowed under the provisions of the Mutual Legal Assistance Treaty between the United States and Switzerland which entered into force on January 23, 1977 (or as it may be amended or replaced in the future).

Paragraph 3 of Article 26

New paragraph 3 provides that the obligations undertaken in paragraphs 1 and 2 to exchange information do not require a Contracting State to carry out administrative measures that are at variance with the laws or administrative practice of either State. Nor is a Contracting State required to supply information not obtainable under the laws or administrative practice of either State, or to disclose trade secrets or other information, the disclosure of which would be contrary to public policy.

Thus, a requesting State may be denied information from the other State if the information would be obtained pursuant to procedures or measures that are broader than those available in the requesting State. However, the statute of limitations of the Contracting State making the request for information should govern a request for information. Thus, the Contracting State of which the request is made should attempt to obtain the information even if its own statute of limitations has passed. In many cases, relevant information will still exist in the business records of the taxpayer or a third party, even though it is no longer required to be kept for domestic tax purposes.

While paragraph 3 states conditions under which a Contracting State is not obligated to comply with a request from the other Contracting State for information, the requested State is not precluded from providing such information, and may, at its discretion, do so subject to the limitations of its internal law.

Paragraph 4 of Article 26

New paragraph 4 provides that when information is requested by a Contracting State in accordance with this Article, the other Contracting State is obligated to obtain the requested information as if the tax in question were the tax of the requested State, even if that State has no direct tax interest in the case to which the request relates. In the absence of such a paragraph, some taxpayers have argued that paragraph 3(a) prevents a Contracting State from requesting information from a bank or fiduciary that the Contracting State does not need for its own tax purposes. This paragraph clarifies that paragraph 3 does not impose such a restriction and that a Contracting State is not limited to providing only the information that it already has in its own files.

Paragraph 5 of Article 26

New paragraph 5 provides that a Contracting State may not decline to provide information because that information is held by financial institutions, nominees or persons acting in an agency or fiduciary capacity. Thus, paragraph 5 would effectively prevent a Contracting State from relying on paragraph 3 to argue that its domestic bank secrecy laws (or similar legislation relating to disclosure of financial information by financial institutions or intermediaries) override its obligation to provide information under paragraph 1. This paragraph also requires the disclosure of information regarding the beneficial owner of an interest in a person, such as the identity of a beneficial owner of bearer shares. Paragraph 5 further provides that the requested State has the power to meet its obligations under Article 26, and paragraph 5 in particular, even though it may not have such powers for purposes of enforcing its own tax laws.

Paragraph 2 of the Exchange of Notes provides that the Contracting States understand that there may be instances when paragraph 3 of Article 26 may be invoked to decline a request to supply information that is held by a person described in paragraph 5 of the Article. Such refusal must be based, however, on reasons unrelated to that person's status as a bank, financial institution, agent, fiduciary or nominee, or the fact that the information relates to ownership interests. For example, a Contracting State may decline to provide information relating to confidential communications between attorneys and their clients that are protected from disclosure under that State's domestic law.

Treaty effective dates and termination in relation to exchange of information

Article 5 of the Protocol sets forth rules governing the effective dates of the provisions of Articles 3 and 4 of the Protocol. The competent authorities are obligated to exchange information described in new paragraph 5 of Article 26 if that information relates to any date beginning on or after September 23, 2009, the date on which the Protocol was signed notwithstanding the provisions of the existing Convention. In all other cases of application of new Article 26, the competent authorities are obligated to exchange information that relates to taxable periods beginning on or after January 1 of the year following the date of signature of the Protocol.

A tax administration may also seek information with respect to a year for which a treaty was in force after the treaty has been terminated. In such a case the ability of the other tax administration to act is limited. The treaty no longer provides authority for the tax administrations to exchange confidential information. They may only exchange information pursuant to domestic law or other international agreement or arrangement.

ARTICLE 4

Article 4 of the Protocol replaces paragraph 10 of the Protocol to the existing Convention. New Protocol paragraph 10 provides greater detail regarding how the provisions of revised Article 26 (Exchange of Information) will be applied.

New Protocol paragraph 10(a) lists the information that should be provided to the requested State by the requesting State when making a request for information under paragraph 26 of the Convention. Clause (i) of paragraph 10(a) provides that a request must contain information sufficient to identify the person under examination or investigation. In a typical case, information sufficient to identify the person under examination or investigation would include a name, and to the extent known, an address, account number or similar identifying information. It is mutually understood that there can be circumstances in which there is information sufficient to identify the person under examination or investigation even though the requesting State cannot provide a name.

Clause (ii) of paragraph 10(a) provides that a request for information must contain the period of time for which the information is requested. Clause (iii) of paragraph 10(a) provides that a request for information must contain a statement of the information sought, including its nature and the form in which the requesting State wishes to receive the information from the requested State. Clause (iv) of paragraph 10(a) provides that a request for information must contain a statement of the tax purpose for which the information is sought. Clause (v) of paragraph 10(a) provides that the request must include the name and, to the extent known, the address of any person believed to be in possession of the requested information.

New Protocol paragraph 10(b) provides confirmation of the extent to which information is to be exchanged pursuant to new paragraph 1 of Article 26. The purposes of referring to information that may be relevant is to provide for exchange of information to the widest extent possible. This standard nevertheless does not allow the Contracting States to engage in so-called "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. For example, the language "may be" would not support a request in which a Contracting State simply asked for information regarding all bank accounts maintained by residents of that Contracting State in the other Contracting State. New Protocol paragraph 10(b) further confirms that the provisions of new Protocol paragraph 10(a) are to be interpreted in order not to frustrate effective exchange of information.

New Protocol paragraph 10(c) provides that the requesting State may specify the form in which information is to be provided (e.g., authenticated copies of original documents (including books, papers, statements, records, accounts and writings)). The intention is to ensure that the information may be introduced as evidence in the judicial proceedings of the requesting State. The requested State should, if possible, provide the information in the form requested to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes.

New Protocol paragraph 10(d) confirms that Article 26 of the Convention does not restrict the possible methods for exchanging information, but also does not commit either Contracting State to exchange information on an automatic or spontaneous basis. The Contracting States expect to provide information to one another necessary for carrying out the provisions of the Convention.

New Protocol paragraph 10(e) provides clarification regarding the application of paragraph 3(a) of revised Article 26, which provides that in no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation to carry out administrative measures at variance with the laws and administrative practice of that or the other Contracting State. The Contracting States understand that the administrative procedural rules regarding a taxpayer's rights (such as the right to be notified or the right to an appeal) provided for in the requested State remain applicable before information is exchanged with the requesting State. Notification procedures should not, however, be applied in a manner that, in the particular circumstances of the request, would frustrate the efforts of the requesting State. The Contracting States further understand that such rules are intended to provide the taxpayer a fair procedure and are not to prevent or unduly delay the exchange of information process.

ARTICLE 5

Article 5 of the Protocol contains the rules for bringing the Protocol into force and giving effect to its provisions.

Paragraph 1

Paragraph 1 provides for the ratification of the Protocol by both Contracting States according to their constitutional and statutory requirements. Instruments of ratification shall be exchanged as soon as possible.

In the United States, the process leading to ratification and entry into force is as follows: Once a treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the treaty to the President who formally transmits it to the Senate for its advice and consent to ratification, which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice for the Senate Committee on Foreign Relations to hold hearings on the treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After the Senate gives its advice and consent to ratification of the protocol or treaty, an instrument of ratification is drafted for the President's signature. The President's signature completes the process in the United States.

Paragraph 2

Paragraph 2 provides that the Convention will enter into force upon the exchange of instruments of ratification. The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraph 2, therefore, also contains rules that determine when the provisions of the treaty will have effect.

Under paragraph 2(a), the Convention will have effect with respect to taxes withheld at source (principally dividends, interest and royalties) for amounts paid or credited on or after the first day of January of the year following the entry into force of the Protocol. For example, if instruments of ratification are exchanged on October 25 of a given year, the withholding rates specified in paragraph 3 of Article 10 (Dividends) would be applicable to any dividends paid or credited on or after January 1 of the following year. If for some reason a withholding agent withholds at a higher rate than that provided by the Convention (perhaps because it was not able to re-program its computers before the payment is made), a beneficial owner of the income that is a resident of the other Contracting State may make a claim for refund pursuant to section 1464 of the Code.

Paragraph 2(b) provides rules for the effective dates of Articles 3 and 4 of the Protocol. Those Articles shall have application for requests made on or after the date of entry into force of the Protocol. Clause (i) provides that information described in paragraph 5 of revised Article 26 (Exchange of Information) shall be exchanged upon request if such information relates to any date beginning on or after September 23, 2009, the date of signature of the Protocol. Clause (ii) provides that in all other cases, information shall be exchanged pursuant to Articles 3 and 4 if the information relates to taxable periods beginning on or after January 1, 2010.

Paragraph 2(c) sets forth a specific effective date for purposes of the binding arbitration provisions of new paragraphs 6 and 7 of revised Article 25 (Mutual Agreement Procedure) (Article 2 of the Protocol). Paragraph 2(c) provides new paragraphs 6 and 7 of revised Article 25 is effective for cases (i) that are under consideration by the competent authorities as of the date on which the Protocol enters into force, and (ii) cases that come under such consideration after the Protocol enters into force. In addition, paragraph 2(c) provides that the commencement date for cases that are under consideration by the competent authorities as of the date on which the Protocol enters into force is the date the Protocol enters into force. As a result, cases that are open and unresolved as of the entry into force of the Protocol will go into binding arbitration on the later of two years after the entry into force of the Protocol (unless both competent authorities have previously agreed to a different date) and the earliest date upon which the agreement required by new paragraph 6(d) of revised Article 25 has been received by both competent authorities.

X. ANNEX 2.—TRANSCRIPT OF HEARING OF JUNE 7, 2011

TREATIES

TUESDAY, JUNE 7, 2011

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The committee met, pursuant to notice, at 2:30 p.m., in room SD–419, Dirksen Senate Office Building, Hon. Benjamin L. Cardin, presiding.

Present: Senators Cardin, Udall, and Lee.

OPENING STATEMENT OF HON. BENJAMIN L. CARDIN, U.S. SENATOR FROM MARYLAND

Senator CARDIN. The Senate Foreign Relations Committee will come to order. I want to thank Senator Kerry for allowing me to chair this hearing.

We will be examining five treaties that have been brought to the Senate's attention, for their consent. This hearing of the Senate Foreign Relations Committee will examine these five treaties that are currently pending before the United States Senate: a new treaty with Hungary, two protocols that amend our existing tax treaties with Switzerland and Luxembourg, a treaty with Bermuda regarding mutual legal assistance in criminal matters, and a bilateral investment treaty with Rwanda.

Today, we will have witnesses from the Treasury Department, the Joint Committee on Taxation, the Justice Department, and the State Department to testify on these treaties. It's my understanding that Deborah McCarthy, the Principal Deputy Assistant Secretary, Bureau of Economics, Energy and Business Affairs of the Department of State, is caught in a situation at the State Department in which there are foreign guests that are being—so her attendance here will be delayed. We understand she will be here, so we will begin the hearing and give her a chance to comment once she arrives, and we'll hold our questions as it relates to the State Department until she's here.

As we will hear shortly, these treaties are designed to help America from an economic perspective; a law enforcement perspective; in the case of the tax treaties, both of these perspectives.

The Mutual Legal Assistance Treaty with Bermuda will help solidify our working relationship with Bermuda on criminal matters by providing an international law framework for cooperation that has already been taking place. Bermuda has been a good partner on counternarcotics and money-laundering matters. And I look forward to hearing from the Deputy Assistant Attorney General Swartz from the Justice Department and Assistant Legal Adviser Johnson from the State Department as to how these treaties will make that partnership stronger.

The bilateral investment treaty with Rwanda is one this committee knows very well. Senator Kaufman chaired a hearing on the treaty last November. On December 14, 2010, shortly before Congress adjourned, the committee reported the treaty out favorably to the full Senate for its advice and consent. Obviously, there was not enough time remaining in the 111th Congress to consider that treaty for ratification. And I am pleased that the chairman has scheduled that for hearing today, so that we cannot promptly on that treaty.

Ms. McCarthy, welcome.

So I'd like to thank Deputy Assistant Secretary of State McCarthy for testifying today so that we can—update us on the investments in Rwanda and explain why this treaty is good for both countries.

I should add that this morning Senator Coons chaired a hearing for the President's nominee to serve as Ambassador to Rwanda, and later this week Secretary of State Clinton will be attending the AGOA Forum in Zimbabwe. So now it's a good time to talk about Rwanda and about investments in sub-Sahara Africa more broadly, and how trade, when paired with responsible investment policy, is a useful tool available to us in helping raise a country's economic growth, institutional capacity, and even its human rights standards.

The three tax treaties that we will examine today are important in several aspects. Our tax treaties, generally, are intended to prevent double taxation, so that U.S. companies are not necessarily inhibited from doing business overseas, and foreign companies are not inhibited from doing business here in the United States. So they are part of a broader effort to create a better economic climate between our countries, something I believe we all agree on and will be interested to see how these treaties advance those goals.

At the same time, our tax treaties also have an important provision designed to help both the United States and our treaty partners enforce our respective tax laws, and combat tax evasion and corruption, and make sure that everyone pays the taxes they owe.

Many will recall the controversy surrounding the investigation of UBS, a Swiss bank, and the difficulties our authorities had in obtaining information from their Swiss counterparts because of Swiss bank secrecy laws. The specific matter was resolved, but it took a long time and effort to get there.

The changes that are contained in the protocol would provide a more permanent solution for future cases involving Switzerland. This is good for both countries. It is my understanding the Swiss Parliament has already approved this treaty.

The protocol with Luxembourg, another country with bank secrecy laws, is very similar and is designed to have a similar effect on future cooperation between the two countries. And the tax treaty with Hungary contains important provisions that are designed to help prevent certain types of tax avoidance that have been a problem with Hungary in the past.

I look forward to hearing from Deputy Assistant of Treasury Corwin and the Chief of Staff of the Joint Committee on Taxation Barthold to explain how these important provisions work and why it's important to the United States that we ratify them quickly.

So we will begin. We have one panel, in the interest of time, so we'll hear from each one of you, and then we'll have a chance to question on all five of the treaties and will be a little bit more generous on time.

Senator Lee, if you need more time in order to question, because we have five treaties—I'm also willing to recognize you whenever you need to be recognized, so please let us know.

With that in mind, let me just remind our witnesses that your entire statements will be made part of the record. You may proceed as you wish.

And we'll start with Ms. Corwin.

STATEMENT OF MANAL CORWIN, DEPUTY ASSISTANT SECRETARY (INTERNATIONAL TAX AFFAIRS), DEPARTMENT OF TREASURY, WASHINGTON, DC

Ms. CORWIN. Thank you, Senator Cardin, Senator Lee. I appreciate the opportunity to appear before you today to recommend on behalf of the administration favorable action on three tax agreements that are pending before this committee.

This administration is committed to eliminating barriers to cross-border trade and investment, and preventing offshore tax evasion. Tax treaties play a vital role in supporting both of these objectives.

Tax treaties facilitate cross-border investment and provide greater certainty to taxpayers regarding their potential tax liability in foreign jurisdictions. They do so by allocating taxing rights between jurisdictions, minimizing incidences of double taxation, and ensuring that U.S. taxpayers are not subject to discriminatory taxation.

Tax treaties also play an important role in preventing tax evasion. A key element of U.S. tax treaties is exchange of information between tax authorities. Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange is a top priority for the U.S. tax treaty program.

The agreements before the committee today with Hungary, Luxembourg, and Switzerland serve to further our tax treaty program goals of facilitating cross-border trade and investment, increasing transparency, and preventing fiscal evasion. In particular, consistent with the international recognition of the need for maximum transparency in tax matters, all three agreements contain updated provisions for the full exchange of information between tax authorities that are consistent with international and U.S. standards.

In addition, the proposed agreement with Hungary contains comprehensive provisions that will protect the agreement from abuse by third-country investors.

Finally, the proposed agreement with Switzerland provides, in certain circumstances, for the use of mandatory, binding arbitration to resolve disputes between the United States and Swiss revenue authorities.

Because my written statement and the official Treasury technical explanations provide detailed explanations of the provisions in each of these agreements, I will describe very briefly only the most significant features of the agreements before you today.

The proposed income tax treaty and accompanying exchange of notes with Hungary were negotiated to bring the current treaty, signed in 1979, into closer conformity with current U.S. tax treaty policy. Most importantly, the proposed treaty includes a new comprehensive limitation on benefits article designed to address so-called treaty shopping, which is the inappropriate use of tax treaties by residents of a third country.

The current treaty does not contain such treaty-shopping protections and, as a result, has been used inappropriately by third-country investors in recent years. For this reason, revising the current treaty has been a top tax treaty priority for the Treasury Department.

In addition, consistent with several recent United States treaties, the proposed treaty with Hungary provides that the transfer pricing guidelines established by the Organization for Economic Co-operation and Development, the OECD, which are consistent with United States transfer pricing standards, apply by analogy in determining the amount of business profits attributable to a permanent establishment in a treaty country.

The proposed treaty also follows the U.S. model approach regarding the taxation of payments to individuals, including income from personal services and employment, pensions, and Social Security.

Finally, consistent with the OECD and United States model treaties, the proposed treaty with Hungary provides for the full exchange between the tax authorities of each country of information relevant to carrying out the provisions of the proposed treaty or the domestic laws of either country.

The proposed protocol with Luxembourg is the first protocol amending the current tax treaty with Luxembourg signed in 1996. The most significant feature of this protocol is the replacement of the limited information-exchange provisions of the existing tax treaty with updated rules that are consistent with current international standards for exchange of information developed by the OECD and adopted by the United States.

In particular, the proposed protocol allows the tax authorities of each country to exchange information that is foreseeably relevant to carrying out the provisions of the agreement or the domestic tax laws of either country. In addition, the proposed protocol would allow the United States to obtain information from Luxembourg, whether or not Luxembourg needs the information for its own domestic tax purposes, and provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution.

Finally, the proposed protocol with Switzerland is the second protocol amending the current income tax treaty with Switzerland signed in 1996. The most significant provisions of this protocol relate to information exchange and the adoption of mandatory arbitration to facilitate the resolution of disputes.

Specifically, like the protocol with Luxembourg, the protocol with Switzerland replaces the limited information exchange provisions in the current treaty with updated rules that are consistent with current international standards for information exchange and United States tax treaty practice.

In this regard, the new protocol does not limit exchange of information, only as is necessary for purposes of carrying out the provisions of the treaty, or for the prevention of tax fraud, or the like. Rather, as with the Luxembourg protocol, the treaty also allows for exchange of information that may be relevant for carrying out the domestic laws of each party to the agreement.

As with the Luxembourg treaty, such information must be exchanged even in the absence of a domestic law interest in the country providing the information and cannot be protected by domestic bank secrecy rules.

The Treasury Department believes that the updated information-exchange provisions in the proposed protocol with Switzerland will greatly improve the collaboration between the United States and Swiss revenue authorities in exchanging information to enforce tax laws.

The proposed protocol with Switzerland also provides for mandatory binding arbitration of certain cases that the competent authorities of the United States and Switzerland have been unable to resolve after a reasonable period of time. The arbitration provision in the proposed protocol with Switzerland is similar to the arbitration provisions in current United States tax treaties with Germany, Belgium, Canada, and France, which this committee and the Senate have approved in the past few years.

Let me conclude by thanking you for the opportunity to appear before the committee to discuss the administration's efforts with respect to the three agreements under consideration. We thank the committee members and staff for devoting time and attention to the review of these agreements, and we are grateful for the assistance and cooperation of the staff of the Joint Committee on Taxation.

Finally, I would like to acknowledge and express my appreciation for the work done on the proposed treaties by the teams at Treasury, the Internal Revenue Service, and the State Department.

On behalf of the administration, we urge the committee and the Senate to take prompt and favorable action on all three agreements before you today.

I'd be happy to answer any questions you may have.

[The prepared statement of Ms. Corwin follows:]

PREPARED STATEMENT OF MANAL CORWIN

Chairman Kerry, Ranking Member Lugar, and distinguished members of the committee, I appreciate the opportunity to appear today to recommend, on behalf of the administration, favorable action on three tax treaties pending before this committee. We appreciate the committee's interest in these treaties and in the U.S. tax treaty network overall.

This administration is committed to eliminating barriers to cross-border trade and investment, and tax treaties are one of the primary means for eliminating such tax barriers. Tax treaties provide greater certainty to taxpayers regarding their potential liability to tax in foreign jurisdictions, and they allocate taxing rights between jurisdictions to reduce the risk of double taxation. Tax treaties also ensure that taxpayers are not subject to discriminatory taxation in foreign jurisdictions.

This administration is also committed to preventing tax evasion, and our tax treaties play an important role in this area as well. A key element of U.S. tax treaties is exchange of information between tax authorities. Under tax treaties, one country may request from the other such information as may be relevant for the proper administration of the first country's tax laws. Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange is a top priority for the United States in its tax treaty program. Moreover, the United States has been a leader in the development of new international standards for greater transparency through full exchange of tax information.

A tax treaty reflects a balance of benefits that is agreed to when the treaty is negotiated. In some cases, changes in law or policy in one or both of the treaty partners make the partners more willing to increase the benefits beyond those provided in an existing treaty; in these cases, negotiation of revisions to a treaty may be very beneficial. In other cases, developments in one or both countries, or international developments more generally, may make it desirable to revisit an existing treaty to prevent improper exploitation of treaty provisions and eliminate unintended and inappropriate consequences in the application of the treaty. Both in setting our overall negotiation priorities and in negotiating individual treaties, our focus is on ensuring that our tax treaty network fulfills its goals of facilitating cross-border trade and investment and preventing fiscal evasion.

The tax treaties before the committee today with Hungary, Luxembourg, and Switzerland, serve to further the goals of our tax treaty network. The tax treaty with Hungary would replace an existing treaty the revision of which has been a top tax treaty priority for the Treasury Department. The protocols with Luxembourg and Switzerland modify existing tax treaty relationships. We urge the committee and the Senate to take prompt and favorable action on all of these agreements.

Before talking about the pending treaties in more detail, I would like to discuss some more general tax treaty matters.

Purposes and Benefits of Tax Treaties

Tax treaties set out clear ground rules that govern tax matters relating to trade and investment between the two countries. One of the primary functions of tax treaties is to provide certainty to taxpayers regarding a threshold question with respect to international taxation: whether a taxpayer's cross-border activities will subject it to taxation by two or more countries. Tax treaties answer this question by establishing the minimum level of economic activity that must be conducted within a country by a resident of the other country before the first country may tax any resulting business profits. In general terms, tax treaties provide that if branch operations in a foreign country have sufficient substance and continuity, the country where those activities occur will have primary (but not exclusive) jurisdiction to tax. In other cases, where the operations in the foreign country are relatively minor, the home country retains the sole jurisdiction to tax.

Another primary function of tax treaties is relief of double taxation. Tax treaties protect taxpayers from potential double taxation primarily through the allocation of taxing rights between the two countries. This allocation takes several forms. First, because residence is relevant to jurisdiction to tax, a treaty has a mechanism for resolving the issue of residence in the case of a taxpayer that otherwise would be considered to be a resident of both countries. Second, with respect to each category of income, a treaty assigns primary taxing rights to one country, usually (but not always) the country in which the income arises (the "source" country), and the residual right to tax to the other country, usually (but not always) the country of residence of the taxpayer (the "residence" country). Third, a treaty provides rules for determining the country of source for each category of income. Fourth, a treaty establishes the obligation of the residence country to eliminate double taxation that otherwise would arise from the exercise of concurrent taxing jurisdiction by the two countries. Finally, a treaty provides for resolution of disputes between jurisdictions in a manner that avoids double taxation.

In addition to reducing potential double taxation, tax treaties also reduce potential "excessive" taxation by reducing withholding taxes that are imposed at source. Under U.S. law, payments to non-U.S. persons of dividends and royalties as well as certain payments of interest are subject to withholding tax equal to 30 percent of the gross amount paid. Most of our trading partners impose similar levels of withholding tax on these types of income. This tax is imposed on a gross, rather than net, amount. Because the withholding tax does not take into account expenses incurred in generating the income, the taxpayer that bears the burden of withholding tax frequently will be subject to an effective rate of tax that is significantly higher than the tax rate that would be applicable to net income in either the source or residence country. Tax treaties alleviate this burden by setting maximum levels for the withholding tax that the treaty partners may impose on these types of income or by providing for exclusive residence-country taxation of such income through the elimination of source-country withholding tax. As a complement to these substantive rules regarding allocation of taxing rights, tax treaties provide a mechanism for dealing with disputes between countries regarding the proper application of a treaty. To resolve treaty disputes, designated tax authorities of the two governments—known as the "competent authorities" in tax treaty parlance—are required to consult and to endeavor to reach agreement. Under many such agreements, the competent authorities agree to allocate a taxpayer's income between the two taxing jurisdictions on a consistent basis, thereby preventing the double taxation that might otherwise result. The U.S. competent authority under our tax treaties is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated this function to the Deputy Commissioner (International) of the Large Business and International Division of the Internal Revenue Service.

Tax treaties also include provisions intended to ensure that cross-border investors do not suffer discrimination in the application of the tax laws of the other country. This is similar to a basic investor protection provided in other types of agreements, but the nondiscrimination provisions of tax treaties are specifically tailored to tax matters and, therefore, are the most effective means of addressing potential discrimination in the tax context. The relevant tax treaty provisions explicitly prohibit types of discriminatory measures that once were common in some tax systems, and clarify the manner in which possible discrimination is to be tested in the tax context.

In addition to these core provisions, tax treaties include provisions dealing with more specialized situations, such as rules addressing and coordinating the taxation of pensions, Social Security benefits, and alimony and child-support payments in the cross-border context (the Social Security Administration separately negotiates and administers bilateral totalization agreements). These provisions are becoming increasingly important as more individuals move between countries or otherwise are engaged in cross-border activities. While these matters may not involve substantial tax revenue from the perspective of the two governments, rules providing clear and appropriate treatment are very important to the affected taxpayers.

Tax treaties also include provisions related to tax administration. A key element of U.S. tax treaties is the provision addressing the exchange of information between the tax authorities. Under tax treaties, the competent authority of one country may request from the other competent authority such information as may be relevant for the proper administration of the first country's tax laws (the information provided pursuant to the request is subject to the strict confidentiality protections that apply to taxpayer information). Because access to information from other countries is critically important to the full and fair enforcement of U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank secrecy rules that would operate to prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not enter into a new tax treaty relationship with that country. Indeed, the need for appropriate information exchange provisions is one of the treaty matters that we consider nonnegotiable.

TAX TREATY NEGOTIATING PRIORITIES AND PROCESS

The United States has a network of 60 income tax treaties covering 68 countries. This network covers the vast majority of foreign trade and investment of U.S. businesses and investors. In establishing our negotiating priorities, our primary objective is the conclusion of tax treaties that will provide the greatest benefit to the United States and to U.S. taxpayers. We communicate regularly with the U.S. business community and the Internal Revenue Service, seeking their input regarding the areas on which we should focus our treaty network expansion and improvement efforts and regarding practical problems encountered under particular treaties or particular tax regimes.

The primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. Ensuring that the various functions to be performed by tax treaties are all properly taken into account makes the negotiation process exacting and time consuming.

Numerous features of a country's particular tax legislation and its interaction with U.S. domestic tax rules are considered in negotiating a tax treaty. Examples include whether the country eliminates double taxation through an exemption system or a credit system, the country's treatment of partnerships and other transparent entities, and how the country taxes contributions to, earnings of, and distributions from pension funds.

Moreover, a country's fundamental tax policy choices are reflected not only in its tax legislation but also in its tax treaty positions. These choices differ significantly from country to country, with substantial variation even across countries that seem to have quite similar economic profiles. A treaty negotiation must take into account all of these aspects of the particular treaty partner's tax system and treaty policies to arrive at an agreement that accomplishes the United States tax treaty objectives.

Obtaining the agreement of our treaty partners on provisions of importance to the United States sometimes requires concessions on our part. Similarly, the other country sometimes must make concessions to obtain our agreement on matters that are critical to it. Each tax treaty that is presented to the Senate represents not only the best deal that we believe can be achieved with the particular country, but also constitutes an agreement that we believe is in the best interests of the United States.

In some situations, the right result may be no tax treaty at all. Prospective treaty partners must evidence a clear understanding of what their obligations would be under the treaty, especially those with respect to information exchange, and must demonstrate that they would be able to fulfill those obligations. Sometimes a tax treaty may not be appropriate because a potential treaty partner is unable to do so.

In other cases, a tax treaty may be inappropriate because the potential treaty partner is not willing to agree to particular treaty provisions that are needed to address real tax problems that have been identified by U.S. businesses operating there. If the potential treaty partner is unwilling to provide meaningful benefits in a tax treaty, investors would find no relief, and accordingly there would be no merit to entering into such an agreement. The Treasury Department would not negotiate a tax treaty that did not provide meaningful benefits to U.S. investors or which could be construed by potential treaty partners as an indication that we would settle for a tax treaty with inferior terms.

Sometimes a potential treaty partner insists on provisions to which the United States will not agree, such as providing a U.S. tax credit for investment in the foreign country (so-called "tax sparing"). With other countries there simply may not be the type of cross-border tax issues that are best resolved by treaty. For example, if a country does not impose significant income taxes, there is little possibility of double taxation of cross-border income, and an agreement that focuses exclusively on the exchange of tax information (so-called "tax information exchange agreements" or "TIEAs") may be the more appropriate agreement.

ENSURING SAFEGUARDS AGAINST ABUSE OF TAX TREATIES

A high priority for improving our overall treaty network is continued focus on prevention of "treaty shopping." The U.S. commitment to including comprehensive "limitation on benefits" provisions is one of the keys to improving our overall treaty network. Our tax treaties are intended to provide benefits to residents of the United States and residents of the particular treaty partner on a reciprocal basis. The reductions in source-country taxes agreed to in a particular treaty mean that U.S. persons pay less tax to that country on income from their investments there and residents of that country pay less U.S. tax on income from their investments in the United States. Those reductions and benefits are not intended to flow to residents of a third country. If third-country residents are able to exploit one of our tax treaties to secure reductions in U.S. tax, such as through the use of an entity resident in a treaty country that merely holds passive U.S. assets, the benefits would flow only in one direction, as third-country residents would enjoy U.S. tax reductions for their U.S. investments, but U.S. residents would not enjoy reciprocal tax reductions for their investments in that third country. Moreover, such third-country residents may be securing benefits that are not appropriate in the context of the interaction between their home country's tax systems and policies and those of the United States. This use of tax treaties is not consistent with the balance of the deal negotiated in the underlying tax treaty. Preventing this exploitation of our tax treaties is critical to ensuring that the third country will sit down at the table with us to negotiate on a reciprocal basis, so we can secure for U.S. persons the benefits of reductions in source-country tax on their investments in that country. Effective antitreaty shopping rules also ensure that the benefits of a U.S. tax treaty are not enjoyed by residents of countries with which the United States does not have a bilateral tax treaty because that country imposes little or no tax, and thus the potential of unrelieved double taxation is low.

In this regard, the proposed tax treaty with Hungary that is before the committee today includes a comprehensive limitation on benefits provision and represents a major step forward in protecting the U.S. tax treaty network from abuse. As was discussed in the Treasury Department's 2007 Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties, the existing income tax treaty with Hungary, which was signed in 1979, is one of three U.S. tax treaties that, as of 2007, provided an exemption from source-country withholding on interest payments, but contained no protections against treaty shopping. The other two agreements in this category were the 1975 tax treaty with Iceland and the 1974 tax treaty with Poland. The revision of these three agreements has been a top priority for the Treasury Department's treaty program, and we have made significant progress. In 2007, we signed a new tax treaty with Iceland which entered into force in 2008. Like the proposed tax treaty with Hungary, the U.S.-Iceland tax treaty contains a comprehensive limitation on benefits provision. In addition, the Treasury Department has recently concluded negotiations of a new income tax treaty with Poland, which the administration hopes to sign and transmit to the Senate for its advice and consent soon. These achievements demonstrate that the Treasury Department has been effective in addressing concerns about treaty shopping through bilateral negotiations and amendment of our existing tax treaties.

COMBATING TAX EVASION AND IMPROVING TRANSPARENCY THROUGH FULL EXCHANGE OF INFORMATION

As noted above, effective information exchange to combat tax evasion and ensure full and fair enforcement of the law is a top priority for the United States. The United States has been a leader in developing and promoting global adoption of the international standards for information exchange. A key element of U.S. income tax treaties is to provide for the exchange of information between tax authorities where the economic relationship between two countries is such that an income tax treaty is appropriate. Where an income tax treaty is not appropriate, information exchange can be secured through a tax information exchange agreement (a "TIEA") which contains provisions exclusively on sharing of tax information. For example, the administration was pleased to sign last November a TIEA with Panama that follows international standards, and which entered into force this past April.

The proposed protocols with Switzerland and Luxembourg that are before the committee today revise the existing tax treaties with Switzerland and Luxembourg to ensure full exchange of information to prevent tax evasion and enhance transparency. These protocols incorporate the current international standards for exchange of information, which require countries to obtain and exchange information for both civil and criminal matters, and which require the tax authorities to obtain and exchange information that is held by a bank or other financial institution.

CONSIDERATION OF ARBITRATION

Tax treaties cannot facilitate cross-border investment and provide a more stable investment environment unless the treaty is effectively implemented by the respective tax administrations of the two countries. Under our tax treaties, when a U.S. taxpayer becomes concerned about implementation of the treaty, the taxpayer can bring the matter to the U.S. competent authority who will seek to resolve the matter with the competent authority of the treaty partner. The competent authorities are expected to work cooperatively to resolve genuine disputes as to the appropriate application of the treaty.

The U.S. competent authority has a good track record in resolving disputes. Even in the most cooperative bilateral relationships, however, there may be instances in which the competent authorities will not be able to reach a timely and satisfactory resolution. Moreover, as the number and complexity of cross-border transactions increases, so do the number and complexity of cross-border tax disputes. Accordingly, we have considered ways to equip the U.S. competent authority with additional tools to assist in resolving disputes promptly, including the possible use of arbitration in the competent authority mutual agreement process.

The first U.S. tax agreement that contemplated arbitration was the U.S.-Germany income tax treaty signed in 1989. Tax treaties with some other countries, including Mexico and the Netherlands, incorporate authority for establishing voluntary binding arbitration procedures based on the provision in the prior U.S.-Germany treaty (although these provisions have not been implemented). Although we believe that the presence of such voluntary arbitration provisions may have provided some limited incentive to reaching more expeditious mutual agreements, it has become clear that providing the mere ability to enter into voluntary arbitration is not nearly as effective as providing for mandatory arbitration, under certain circumstances, within the treaty itself.

Over the past few years, we have carefully considered and studied various types of mandatory arbitration procedures that could be included in our treaties and used as part of the competent authority mutual agreement process. In particular, we examined the experience of countries that adopted mandatory binding arbitration provisions with respect to tax matters. Many of them report that the prospect of impending mandatory arbitration creates a significant incentive to compromise before commencement of the arbitration process. Based on our review of the U.S. experience with arbitration in other areas of the law, the success of other countries with arbitration in the tax area, and the overwhelming support of the business community, we concluded that mandatory binding arbitration as the final step in the competent authority process can be an effective and appropriate tool to facilitate mutual agreement under U.S. tax treaties.

One of the treaties before the committee, the proposed protocol with Switzerland, includes a type of mandatory arbitration provision that in general terms is similar to arbitration provisions in several of our recent treaties (Canada, Germany, Belgium and France) that have been approved by the committee and the Senate over the last 5 years.

In the typical competent authority mutual agreement process, a U.S. taxpayer presents its case to the U.S. competent authority and participates in formulating the position the U.S. competent authority will take in discussions with the treaty partner. Under the arbitration provision proposed in the Switzerland protocol, as in the similar provisions that are now part of our treaties with Canada, Germany, Belgium, and France, if the competent authorities cannot resolve the issue within 2 years, the competent authorities must present the issue to an arbitration board for resolution, unless both competent authorities agree that the case is not suitable for arbitration. The arbitration board must resolve the issue by choosing the position of one of the competent authorities. That position is adopted as the agreement of the competent authorities and is treated like any other mutual agreement (i.e., one that has been negotiated by the competent authorities) under the treaty.

The arbitration process proposed in the agreement with Switzerland is mandatory and binding with respect to the competent authorities. However, consistent with the negotiation process under the mutual agreement procedure generally, the taxpayer can terminate the arbitration at any time by withdrawing its request for competent authority assistance. Moreover, the taxpayer retains the right to litigate the matter (in the United States or the treaty partner) in lieu of accepting the result of the arbitration, just as it would be entitled to litigate in lieu of accepting the result of a negotiation under the mutual agreement procedure.

The arbitration rule in the proposed protocol with Switzerland is very similar to the arbitration rule in the protocol with France, but differs slightly from the arbitration rules in the agreements with Canada, Germany, and Belgium. This is because in negotiating the arbitration rule in the protocol with France, we took into account concerns expressed by this committee over certain aspects of the arbitration rules negotiated earlier with Canada, Germany, and Belgium. Accordingly, the proposed arbitration rule with Switzerland, like the provision with France, differs from its earlier predecessors in three key respects. First, consistent with the committee's comment in its report on the Canada protocol that future arbitration rules should provide a mechanism for taxpayer input in the arbitration process, the proposed rules with Switzerland allow the taxpayers who presented the original case that is subjected to arbitration to submit a position paper directly to the arbitration panel. Second, the rule in the proposed Switzerland protocol disallows a competent authority from appointing an employee from its own tax administration to the arbitration board. Finally, the rule in the proposed Switzerland Protocol does not prescribe a hierarchy of legal authorities that the arbitration panel must use in making its decision. Thus, customary international law rules on treaty interpretation will apply. Currently, we are discussing the possible inclusion of a similar arbitration provision with a number of our other key tax treaty partners.

Because the arbitration board can only choose between the positions of each competent authority, the expectation is that the differences between the positions of the competent authorities will tend to narrow as the case moves closer to arbitration. In fact, if the arbitration provision is successful, difficult issues will be resolved without resort to arbitration. Thus, it is our objective that these arbitration provisions will be rarely utilized, but that their presence will encourage the competent authorities to take approaches to their negotiations that result in mutually agreeable conclusions without invoking the arbitration process.

It is still very early in our experience with arbitration, and at this time we cannot report definitively on the effects of arbitration on our tax treaty relationships. However, we are hopeful that our desired objectives for arbitration are being realized. Our sense is that, where mandatory arbitration has been included in the treaty, the competent authorities are negotiating with more intention to reach principled and timely resolution of disputes, and thus, effectively eliminating double taxation and in a more expeditious manner.

Arbitration is a growing and developing field, and there are many forms of arbitration from which to choose. We intend to continue to study other arbitration provisions and to monitor the performance of the provisions in the agreements with Canada, Belgium, Germany, and France, as well as the performance of the provision in the agreement with Switzerland, if ratified. The Internal Revenue Service has published the administrative procedures necessary to implement the arbitration rules with Germany, Belgium, and Canada. It is possible that one or more tax disputes with Canada will be submitted for resolution by arbitration, and the administration looks forward to updating the committee on the arbitration process, in particular through the reports that are called for in the committee's reports on 2007 protocol to the Canada tax treaty. We look forward to continuing to work with the committee to make arbitration an effective tool in promoting the fair and expeditious resolution of treaty disputes.

DISCUSSION OF PROPOSED TREATIES

I now would like to discuss the three tax treaties that have been transmitted for the Senate's consideration. The three treaties are generally consistent with modern U.S. tax treaty practice as reflected in the Treasury Department's 2006 U.S. Model Income Tax Convention. As with all bilateral tax conventions, the treaties contain some minor variations that reflect particular aspects of the treaty policies and domestic laws of the partner countries as well as their economic relations with the United States. We have submitted a Technical Explanation of each treaty that contains detailed discussions of the provisions of each treaty. These Technical Explanations serve as the Treasury Department's official explanation of each tax treaty.

Hungary

The proposed income tax Convention and related agreement effected by exchange of notes with Hungary were negotiated to bring tax treaty relations based on the current Convention, signed in 1979, into closer conformity with current U.S. tax treaty policy. The proposed Convention contains a comprehensive "Limitation on Benefits" article designed to address treaty shopping. The current Convention does not contain treaty shopping protections and, as a result, has been used inappropriately by third-country investors in recent years. For this reason, as stated above, entering into a revised Convention has been a top tax treaty priority for the Treasury Department. The new Limitation on Benefits article includes a provision granting so-called "derivative benefits" similar to the provision included in all recent U.S. tax treaties with countries that are members of the European Union. The new Limitation on Benefits article also contains a special rule for so-called "headquarters companies" that is identical to what the Treasury has agreed to with a number of other tax treaty partners.

The proposed Convention incorporates updated rules that provide that a former citizen or long-term resident of the United States may, for the period of 10 years following the loss of such status, be taxed in accordance with the laws of the United States. The proposed treaty also coordinates the U.S. and Hungarian tax rules to address the "mark-to-market" provisions enacted by the United States in 2007 that apply to individuals who relinquish U.S. citizenship or terminate long-term residency.

The withholding rates on investment income in the proposed Convention are the same as or lower than those in the current treaty. The proposed Convention provides for reduced source-country taxation of dividends distributed by a company resident in one Contracting State to a resident of the other Contracting State. The proposed Convention generally allows for taxation at source of 5 percent on direct dividends (i.e., where a 10-percent ownership threshold is met) and 15 percent on all other dividends. Additionally, the proposed Convention provides for an exemption from withholding tax on certain cross-border dividend payments to pension funds.

The proposed Convention updates the treatment of dividends paid by U.S. Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) to prevent the use of structures designed to inappropriately avoid U.S. tax.

Consistent with the current treaty, the proposed Convention generally eliminates source-country withholding taxes on cross-border interest and royalty payments. However, consistent with current U.S. tax treaty policy, source-country tax may be imposed on certain contingent interest and payments from a U.S. real estate mortgage investment conduit.

The taxation of capital gains under the proposed Convention generally follows the format of the U.S. Model. Gains derived from the sale of real property and from real property interests may be taxed by the State in which the property is located. Likewise, gains from the sale of personal property forming part of a permanent establishment situated in a Contracting State may be taxed in that State. All other gains, including gains from the alienation of ships, boats, aircraft and containers used in international traffic and gains from the sale of stock in a corporation, are taxable only in the State of residence of the seller.

The proposed Convention, like several recent tax treaties, provides that the OECD Transfer Pricing Guidelines apply by analogy in determining the amount of business profits of a resident of the other country. The source country's right to tax such profits is generally limited to cases in which the profits are attributable to a permanent establishment located in that country. The proposed Convention generally defines a "permanent establishment" in a way that grants rights to tax business profits that are consistent with those found in the U.S. Model.

The proposed Convention preserves the U.S. right to impose its branch profits tax on U.S. branches of Hungarian corporations. The proposed Convention also accommodates a provision of U.S. domestic law that attributes to a permanent establishment income that is earned during the life of the permanent establishment, but is deferred, and not received until after the permanent establishment no longer exists.

The proposed Convention would change the rules currently applied under the existing Convention regarding the taxation of independent personal services. Under the proposed treaty an enterprise performing services in the other country will become taxable in the other country only if the enterprise has a fixed place of business in that country.

The rules for the taxation of income from employment under the proposed Convention are generally similar to those under the U.S. Model. The general rule is that employment income may be taxed in the State where the employment is exercised unless three conditions constituting a safe harbor are satisfied.

The proposed Convention preserves the current Convention's rules that allow for exclusive residence-country taxation of pensions, and consistent with current U.S. tax treaty policy, provides for exclusive source-country taxation of Social Security payments.

Consistent with the OECD standard, the proposed Convention provides for the exchange between the tax authorities of each country of information relevant to carrying out the provisions of the proposed Convention or the domestic tax laws of either country. The proposed Convention allows the United States to obtain information (including from financial institutions) from Hungary whether or not Hungary needs the information for its own tax purposes.

The proposed Convention would enter into force on the date of the exchange of instruments of ratification. It would have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date of entry into force, and with respect to other taxes, for taxable years beginning on or after the first day of January next following the date of entry into force. The current Convention will, with respect to any tax, cease to have effect as of the date on which this proposed Convention has effect with respect to such tax.

Luxembourg

The proposed protocol to amend the income tax Convention with Luxembourg and the related agreement effected by exchange of notes were negotiated to bring the existing Convention, signed in 1996, into closer conformity with current U.S. tax treaty policy regarding exchange of information.

The proposed protocol replaces the existing Convention's tax information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the standards for exchange of information developed by the OECD. The proposed protocol allows the tax authorities of each country to exchange information that is foreseeably relevant to carrying out the provisions of the agreement or the domestic tax laws of either country. Among other things, the proposed protocol would allow the United States to obtain information from Luxembourg whether or not Luxembourg needs the information for its own tax purposes, and provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution. The proposed related agreement effected by exchange of notes sets forth agreed understandings between the parties regarding the updated provisions on tax information exchange, and includes obligations on the United States and Luxembourg to ensure that their respective competent authorities have the authority to obtain and provide upon request information held by banks and other financial institutions and information regarding ownership of certain entities; and information shall be exchanged without regard to whether the conduct being investigated would be a crime under the laws of the requested State.

The proposed protocol would enter into force once both the United States and Luxembourg have notified each other that their respective applicable procedures for ratification have been satisfied. It would have effect with respect to requests made on or after the date of entry into force with regard to tax years beginning on or after January 1, 2009. The related agreement effected by exchange of notes would enter into force on the date of entry into force of the proposed protocol and would become an integral part of the Convention on that date.

Switzerland

The proposed protocol to amend the income tax convention with the Swiss Confederation and related agreement effected by exchange of notes were negotiated to bring the existing Convention, signed in 1996, into closer conformity with current U.S. tax treaty policy regarding exchange of information. There are, as with all bilateral tax conventions, some variations from these norms. In the proposed protocol, these minor differences reflect particular aspects of Swiss law and treaty policy, and generally follow the OECD standard for exchange of information.

The proposed protocol replaces the existing Convention's tax information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the standards for exchange of information developed by the OECD. The proposed protocol allows the tax authorities of each country to exchange information that may be relevant to carrying out the provisions of the agreement or the domestic tax laws of either country, including information that would otherwise be protected by the bank secrecy laws of either country. The proposed protocol would allow the United States to obtain information from Switzerland whether or not Switzerland needs the information for its own tax purposes, and provides that requests for information cannot be declined solely because the information is held by a bank or other financial institution. The proposed protocol amends a paragraph of the existing protocol to the existing Convention by incorporating procedural rules to govern requests for information and an agreement by the United States and Switzerland that such procedural rules are to be interpreted in order not to frustrate effective exchange of information.

The proposed protocol and related agreement effected by exchange of notes update the provisions of the existing Convention with respect to the mutual agreement procedure by incorporating mandatory arbitration of certain cases that the competent authorities of the United States and the Swiss Confederation have been unable to resolve after a reasonable period of time.

Finally, the proposed protocol updates the provisions of the existing Convention to provide that individual retirement accounts are eligible for the benefits afforded a pension under the existing Convention.

The proposed protocol would enter into force when the United States and the Swiss Confederation exchange instruments of ratification. The proposed protocol would have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of January of the year following entry into force. With respect to tax information exchange, the proposed protocol would have effect with respect to requests for bank information that relates to any date beginning on or after the date the proposed protocol is signed and, with respect to all other cases, would have effect with respect to requests for information that relates to taxable periods beginning on or after the first day of January next following the date of signature. The mandatory arbitration provision would have effect with respect both to cases that are under consideration by the competent authorities as of the date on which the protocol enters into force and to cases that come under consideration after that date.

TREATY PROGRAM PRIORITIES

A key continuing priority for the Treasury Department is updating the few remaining U.S. tax treaties that provide for significant withholding tax reductions but do not include the limitation on benefits provisions needed to protect against the possibility of treaty shopping. As mentioned above, I am pleased to report that in this regard we have made significant progress. Most notably, in June 2010 we concluded the negotiation of a new tax treaty with Poland. The new Poland treaty, which we hope to sign soon, will contain a comprehensive limitation on benefits provision that will ensure that only residents of the United State and Poland enjoy the benefits of the treaty.

Concluding agreements that provide for the full exchange of information, including information held by banks and other financial institutions, is another key priority of the Treasury Department. The past couple of years have been a period of fundamental change in transparency, as many secrecy jurisdictions announced their intentions to comply with the international standard of full information exchange during this time. With the revisions to the Switzerland and Luxembourg tax treaties completed, in the near future we hope to commence or renew tax treaty negotiations with a number of our other trading partners with bank secrecy rules once those countries have eliminated all domestic law impediments to full exchange of information.

Beyond the two chief priorities of curbing treaty shopping and expanding exchange of information relationships, the Treasury Department continues to maintain a very active calendar of tax treaty negotiations. In our efforts to establish new tax treaty relationships, in February 2010 we signed a tax treaty with Chile, which the administration hopes to transmit to the Senate for its consideration in the near term. If approved by the Senate the Chile tax treaty would be especially noteworthy because it would be only the second U.S. tax treaty in force with a South American country. We have also opened tax treaty negotiations with Vietnam. Additionally, we are in the process of discussing ways to update existing tax treaties with many of our treaty partners including the United Kingdom and Spain.

CONCLUSION

Mr. Chairman and Ranking Member Lugar, let me conclude by thanking you for the opportunity to appear before the committee to discuss the administration's efforts with respect to the three agreements under consideration. We appreciate the committee's continuing interest in the tax treaty program, and we thank the members and staff for devoting time and attention to the review of these new agreements. We are also grateful for the assistance and cooperation of the staff of the Joint Committee on Taxation.

On behalf of the administration, we urge the committee to take prompt and favorable action on the agreements before you today. I would be happy to respond to any question you may have.

Senator CARDIN. Thank you very much.

We will now hear from Mr. Barthold, the Chief of Staff of the Joint Committee on Taxation.

STATEMENT OF THOMAS A. BARTHOLD, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION, WASHINGTON, DC

Mr. BARTHOLD. Thank you, Mr. Chairman and Senator Lee. My name is Thomas Barthold. I'm the Chief of Staff of the Joint Committee on Taxation, and it's my pleasure to present the testimony of the staff of the joint committee concerning the proposed treaty with Hungary and the proposed tax protocols with Luxembourg and Switzerland.

The joint committee staff has prepared detailed pamphlets covering the treaty and protocols. The pamphlets provide descriptions of these agreements, including comparisons with the United States model tax treaty and with other recent U.S. tax treaties approved by the Senate. Those pamphlets are JCX–30–11 describing the Swiss protocol, JCX–31 describing the Luxembourg protocol, and JCX–32 describing the Hungary treaty.

I'll use my time to highlight several points that the joint committee staff thinks is important. First, with respect to the Hungary treaty, the Hungary treaty, with respect to treatment of many of the provisions—including the payments of dividends, interest, and royalties—generally follows the U.S. model. And, as Ms. Corwin pointed out, of particular note, the proposed treaty with Hungary includes the extensive limitation on benefits rules of the U.S. model. Limitation on benefits provisions are intended to prevent third-country residents from benefiting inappropriately from a treaty that generally is granting benefits only to residents of the two treaty countries, a practice that is commonly referred to as treaty shopping.

The present treaty between the United States and Hungary is one of only seven United States income tax treaties that do not include any limitation on benefits provisions. And two of those seven treaties, including the current treaties with Hungary and Poland, include provisions providing for complete exemption of withholding on interest payments from one treaty country to the other, a situation that may present very attractive opportunities for treaty shopping. So with the inclusion of the modern limitation on benefits rules, the proposed treaty with Hungary represents a significant opportunity to mitigate treaty shopping.

The two protocols before the committee today are largely about the exchange of information provisions of those existing treaties. There has been and continues to be multicountry concern regarding tax avoidance through offshore accounts, and it is tax treaties that establish the scope of information that can be exchanged between treaty countries. The proposed protocols are an attempt to improve the exchange of information in this regard.

The proposed Swiss protocol may facilitate much greater exchange of information than has occurred in the past, chiefly by eliminating the present treaty's requirements that the requesting treaty country first establish tax fraud or fraudulent conduct as a basis for the exchange of information, and providing that domestic bank secrecy laws and a lack of domestic interest in the requested information may be possible grounds for refusing to provide the requested information.

While the changes are made, to make changes in those requirements, the joint committee staff notes that the protocol permits "limitation of administrative assistance to individual cases and, thus, no fishing expeditions." I think this limitation poses some questions for the committee and for the Senate regarding individual cases, the extent to which the Swiss may continue to reject requests that do not name the taxpayer as a result of the requirement in the treaty that a taxpayer be "typically" identified by name may be of some concern in terms of the applicability of the revised exchange in information agreement.

In addition, what is to be the standard of relevance to be applied to requests for information in light of the caveat against "fishing expeditions."

The proposed protocol with Luxembourg is consistent with both the OECD and United States model treaties. However, the joint committee staff does see some potential areas of concern in the statements in the diplomatic notes accompanying this agreement. Regarding the obligation to ensure that tax authority access to information regarding beneficial ownership of certain entities, to the extent the information is of a type within the possession or control of someone within that territory's jurisdiction, one might ask if this potentially imposes a new burden on the United States. Also, the proposed Luxembourg protocol contains a requirement that all requests must provide the identity of the person under investigation. Again, I think this raises a concern similar to that that I noted a moment ago with respect to the Swiss protocol.

A third question, there's a standard of relevance issue to be raised in terms of what is the stated purpose for which information may be sought.

And last, there is a requirement that any requests include a representation that all other means of obtaining that information have been attempted, except to the extent that to do so would cause disproportionate difficulties. Does such a requirement impose a limit or retard the ability of the United States to obtain necessary information?

That concludes my oral comments. I'd be pleased to answer any questions that the committee might have. And I do thank the Treasury for their cooperation and understanding in interpreting these treaty documents.

Thank you.

[The prepared statement of Mr. Barthold follows:]

PREPARED STATEMENT OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION PRESENTED BY THOMAS A. BARTHOLD [1]

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 treaty with Hungary and the proposed tax protocols with Luxembourg and Switzerland.

OVERVIEW

As in the past, the Joint Committee staff has prepared pamphlets covering the proposed treaty and protocols. The pamphlets provide detailed descriptions of the proposed treaty and protocols, including comparisons with the 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.[2] The pamphlets also provide detailed discussions of issues raised by the proposed treaty and protocols. We consulted with the Treasury Department and with the staff of your committee in analyzing the proposed treaty and protocols and in preparing the pamphlets.

The principal purposes of the treaty 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 treaty 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. 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 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.

My testimony today will highlight some of the key features of the proposed treaty and protocols and certain issues that those agreements raise.

U.S. MODEL TREATY

As a general matter, U.S. model tax treaties provide a framework for U.S. tax treaty policy and a starting point for tax treaty negotiations with our treaty partners. These models provide helpful information to taxpayers, the Congress, and foreign governments about U.S. policies on tax treaty matters. The present U.S. Model treaty incorporates important developments in U.S. income tax treaty policy that

[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 Treaty with Hungary and the Proposed Tax Protocols with Luxembourg and Switerland" (JCX–35–11), June 7, 2011. 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–31–1 1), May 20, 2011.

had been reflected in U.S. income tax treaties signed in the years immediately preceding the Model's publication in 2006. Treaties that the United States has negotiated since 2006 in large part follow the U.S. Model treaty. The proposed treaty 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.

HUNGARY: LIMITATION-ON-BENEFITS PROVISIONS

In general

Like the U.S. Model treaty, the proposed treaty with Hungary includes extensive limitation-on-benefits rules (Article 22). Limitation-on-benefits provisions are intended to prevent third-country residents from benefiting 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 represents a significant opportunity to mitigate treaty shopping. Nevertheless, the 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.

Deviations from the U.S. Model treaty

Although the limitation-on-benefits rules in the proposed treaty 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 the committee may wish to inquire about certain differences. In particular, the committee may wish to examine the rules for publicly traded companies, derivative benefits, and certain triangular arrangements. The committee also may wish to ask the Treasury Department about the special limitation-on-benefits rules applicable to headquarters companies.

Publicly traded companies

A 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 and either a management and control test or a primary trading test. The primary trading test requires that

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[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). 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.

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. Although the list of recognized stock exchanges in EU and EFTA countries had some differences, a similar primary trading test was included in the recent protocols with France and New Zealand. Under the U.S. Model treaty, the required trading must 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.

Derivative benefits

Like other recent treaties, the proposed treaty 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 U.S. Model treaty does not include derivative benefits rules.

Triangular arrangements

The proposed treaty includes special antiabuse rules intended to deny treaty benefits in certain circumstances in which a 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 Hungary. A rule on triangular arrangements is not included in the U.S. Model treaty, but similar antiabuse rules are included in other recent treaties and protocols.

Headquarters companies

The proposed treaty includes 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: (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. As part of their efforts to restore integrity and stability to financial institutions, the United States and other G20 jurisdictions have made significant efforts to modernize and standardize the ways in which jurisdictions provide administrative assistance under the network of tax treaties.

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 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 treaty and the two proposed

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

protocols. They also describe the extent to which they differ from the U.S. Model treaty. I note that since the publication of those pamphlets on May 20, 2011, additional information about the exchange of information programs of Hungary, Switzerland, and the United States has become available. On June 1, 2011, the Organization for Economic Cooperation 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 11 Peer Review of the United States.

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 treaty and proposed protocols under consideration today, and second, the 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 extent to which the United States maintains and can produce information about beneficial ownership of certain foreign-owned entities, and, finally, whether there is consensus as to the standard for determining whether a request for specific exchange of information is sufficiently specific to require response by a treaty country.[7]

Automatic information exchange

The extent to which automatic information exchange occurs and how it is used by the recipients is not clear. Such exchanges occur when the parties to a tax treaty typically enter into a memorandum of understanding to share on a regular basis information that is deemed to be consistently relevant to the tax administration of the other treaty country; the treaty countries are not required to specifically request this information from one another. The United States, for example, annually provides over 2.5 million items of information about U.S.-source income received by residents of treaty countries to those treaty partners. Problems identified in the use of automatic exchange of information under tax treaties have included the lack of timeliness in providing information; differences in the tax reporting periods used by treaty countries; the recipient country difficulty in translating text on forms; and the large volume of information included in such exchanges.

In publishing regulations earlier this year to expand information reporting on payments to nonresident aliens, the Secretary of Treasury noted the improvement of the United States exchange of information program as a beneficial outcome of implementing such regulations. In the preamble to those regulations, the Secretary stated that "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."[8] The regulations in question would require U.S. financial institutions to report on interest paid to any nonresident aliens, not only residents of Canada as currently required.[9] The committee may wish to inquire about those recently proposed regulations and the extent to which expanded regulations would strengthen exchange of information under the pending protocol, as well as any additional attendant burdens that may arise as a result of these regulations.[10] The committee may also wish to explore the usability of the information exchanged with Canada under present regulations, and its relationship to the exchange of information program with Canada.

Second, the United States has been criticized for Federal and State rules that may facilitate attempts by foreign persons to evade their home-country tax laws. In the past, there have been claims that the U.S. "know-your-customer" rules for financial institutions are less strict than other countries in their requirements for the determination of beneficial owners of financial accounts. A second criticism has been that the entity formation laws of some U.S. States make it difficult for government officials to ascertain the identities of owners of entities. The OECD report on the United States exchange of information program notes that, despite an otherwise robust regulatory framework and broad powers of the Federal authorities to gather information responsive to treaty requests for exchange of information, the gaps in

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[7] A third method of information exchange is spontaneous exchange, which occurs when one treaty country determines that information in its possession may be relevant to the other treaty country's tax administration and thus transmits the information to the other country.

[8] Prop. Treas. Reg. sec. 1.6049–4, 76 Fed. Reg. 1105 (January 7, 2011).

[9] Treas. Reg. sec. I.6049–4(b)(5).

[10] The IRS and Treasury Department have requested written and electronic comments on the proposed regulations. A public hearing at which oral comments were presented was held on May 18. 2011.

beneficial ownership information on certain entities remains troublesome. The specific example noted in the report is that of a limited liability company owned by a single foreign person. Your committee may wish to ask about the extent to which it may be appropriate to consider policy changes to ensure that the United States is able to respond effectively to information requests from its treaty partners.

Specific exchange

A second method of exchange is known as the "specific" 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.[11] Your committee may wish to seek assurances that, under the proposed treaty with Hungary 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.[12] 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 relationship with Luxembourg and Switzerland, and to the extent that the United States may have little recent practical experience in cooperating with Hungary on tax matters, your committee may wish to seek reassurances that any obstacles to effective information exchange have been eliminated. With respect to Hungary, we note that the OECD report on Phase I of the peer review determined that many of the elements required to determine that a jurisdiction is in compliance with international standards are not in place, and cited as a factor for that determination the numerous ambiguities in Hungary's domestic laws concerning the recordkeeping obligations applicable to different types of entities, the scope of confidentiality afforded business secrets, and the authority of Hungarian officials to gain access to information. All of these factors pose potential impediments to effective exchange of information.

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.[13]

In March 2009, the Swiss Federal Council withdrew its reservation regarding Article 26 (Exchange of Information) of the OECD Model treaty, thus apparently

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[11] 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.

[12] 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.

[13] "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).

adopting the OECD standards on administrative assistance in tax matters.[14] 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 recently published 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 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. One such concern is the extent to which the agreement that information may be used for purposes beyond the purposes identified in paragraph 1 of Article 26, is consistent with the comment in the Technical Explanation that such authority will only be exercised if consistent with the Mutual Legal Assistance Agreements.

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 (I) 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

[14] 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).

the information have been attempted, except to the extent that to do so would cause disproportionate difficulties.

ARTICLE-BY-ARTICLE SUMMARIES

The Joint Committee staff's pamphlets provide detailed article-by-article explanations of the proposed treaty and the two proposed protocols. Below is a summary of significant features of each agreement.

Hungary

Like other U.S. tax treaties, the proposed treaty with Hungary includes rules that limit each country's right, in specified situations, to tax income derived from its territory by residents of the other country. For example, the proposed treaty contains provisions under which each country generally agrees not to tax business income derived from sources within that country by residents of the other country unless the business activities in the taxing country are substantial enough to constitute a permanent establishment (Article 7). Similarly, the proposed treaty contains certain exemptions under which residents of one country performing personal services in the other country will not be required to pay tax in the other country unless their contact with the other country exceeds specified minimums (Articles 14 and 16). The proposed treaty also provides that pensions and other similar remuneration paid to a resident of one country may be taxed only by that country and only at the time and to the extent that a pension distribution is made (Article 17).

The proposed treaty provides that dividends and certain gains derived by a resident of one country from sources within the other country generally may be taxed by both countries (Articles 10 and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends may be limited by the proposed treaty. Generally, source-country taxation of dividends is limited to 15 percent of the gross amount of the dividends paid to residents of the other treaty country. A lower rate of 5 percent applies if the beneficial owner of the dividends is a company that owns directly at least 10 percent of the voting stock of the dividend-paying company.

The proposed treaty provides that, subject to certain rules and exceptions, interest and most types of royalties derived by a resident of one country from sources within the other country may be taxed only by the residence country (Articles 11 and 12). Notwithstanding this general rule, the source country may impose tax on certain interest in an amount not to exceed 15 percent of the gross amount of such interest.

In situations in which the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the proposed treaty generally provides for relief from the potential double taxation through the allowance by the country of residence of a tax credit for certain foreign taxes paid to the other country (Article 23).

The proposed treaty contains the standard provision (the "saving clause") included in U.S. tax treaties pursuant to which each country retains the right to tax its residents and citizens as if the treaty had not come into effect (Article 1). In addition, the proposed treaty contains the standard provision providing that the treaty may not be applied to deny any taxpayer any benefits to which the taxpayer would be entitled under the domestic law of a country or under any other agreement between the two countries (Article 1).

The proposed treaty (Articles 19 and 20) generally provides that students, business trainees, teachers, professors, and researchers visiting the other treaty country are exempt from host country taxation on certain types of payments received.

The proposed treaty provides authority for the two countries to resolve disputes (Article 25) and exchange information (Article 26) in order to carry out the provisions of the proposed treaty.

The proposed treaty also contains a detailed limitation-on-benefits provision that reflects the anti-treaty-shopping provisions included in the United States Model Income Tax Convention of November 15, 2006 (the "U.S. Model treaty") and more recent U.S. income tax treaties. The new rules are intended to prevent the inappropriate use of the treaty by third-country residents. (Article 22).

The provisions of the proposed treaty will have effect generally on or after the first day of January following the date that the proposed treaty enters into force. However, with respect to withholding taxes (principally dividends, interest, and royalties), the proposed treaty has effect for amounts paid or credited on or after the first day of the second month following the date on which the proposed treaty enters into force.

Luxembourg

Article of the proposed protocol with Luxembourg replaces Article 28 (Exchange of Information) of the present treaty with rules that conform closely to the U.S. Model treaty. The proposed rules generally provide that the two competent authorities will exchange such information as may be foreseeably relevant in carrying out the provisions of the domestic laws of the United States and Luxembourg concerning taxes imposed at a national level, to the extent the taxation under those laws is not contrary to the treaty.

Article II of the proposed protocol provides that the proposed protocol will enter into force upon the exchange of instruments of ratification, and it sets forth rules for when the provisions of the proposed protocol will take effect.

Switzerland

The proposed protocol with Switzerland amends Article 10 (Dividends) of the present treaty to expand the prohibition on source-country taxation of dividends beneficially owned by pension or other retirement arrangements resident in the other treaty country. Under the proposed protocol, the prohibition on source-country taxation also applies to dividends that are beneficially owned by an individual retirement savings plan set up in, and owned by a resident of the other treaty country, so long as the competent authorities agree that the individual retirement savings plan generally corresponds to an individual retirement savings plan recognized in the other treaty country for tax purposes. The prohibition on source-country taxation is not available if the beneficial owner controls the company paying the dividend.

The proposed protocol changes the voluntary arbitration procedure of Article 25 (Mutual Agreement Procedure) of the present treaty to a mandatory arbitration procedure that is sometimes referred to as "last best offer" arbitration, in which each of the competent authorities proposes one and only one figure for settlement, and the arbitrator must select one of those figures as the award. Under the proposed protocol, unless a taxpayer or other "concerned person" (in general, a person whose tax liability is affected by the arbitration determination) does not accept the arbitration determination, it is binding on the treaty countries with respect to the case. A mandatory and binding arbitration procedure is included in the U.S. treaties with Belgium, Canada, France, and Germany.

Mutual administrative assistance is modernized under the proposed protocol. The proposed protocol replaces Article 26 (Exchange of Information) of the present treaty and paragraph 10 of the 1996 Protocol with rules that conform generally to the OECD standards. The proposed rules generally provide that. in response to specific requests. the two competent authorities will exchange such information as may be relevant in carrying out the provisions of the domestic laws of the United States and Switzerland concerning taxes covered by the treaty, to the extent the taxation under those laws is not contrary to the treaty.

Article 5 of the proposed protocol provides that the proposed protocol will enter into force upon the exchange of instruments of ratification, and it sets forth rules for when the provisions of the proposed protocol will take effect.

CONCLUSION

These provisions and issues are all discussed in more detail in the Joint Committee staff pamphlets on the proposed treaty and protocols. I am happy to answer any questions that your committee may have at this time or in the future.

Senator CARDIN. Thank you very much for your testimony.

We'll now hear from Bruce Swartz, the Deputy Assistant Attorney General at the Department of Justice.

STATEMENT OF HON. BRUCE SWARTZ, DEPUTY ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. SWARTZ. Mr. Chairman, Senator Lee, members of the committee, thank you for this opportunity to present the views of the United States Department of Justice on the U.S.-Bermuda Mutual Legal Assistance Treaty.

I would like to highlight this afternoon five ways in which this treaty not only solidifies, Mr. Chairman, as you note, the relationship with Bermuda on law enforcement matters but advances the Department of Justice's and the United States Government's international law enforcement priorities.

First, of course, this treaty creates a binding legal obligation to provide mutual legal assistance, replacing a collegial and good relationship with one that now has a treaty basis.

Second, the treaty provides for assistance in a wide range of criminal justice matters. As the committee knows, the treaty provides that assistance shall be granted in connection "with the investigation, prosecution, and prevention of criminal offenses for which the maximum penalty is deprivation of liberty for at least one year" as measured by the laws of the party seeking assistance. This means that the treaty will ensure that we are not spending time in either of our jurisdictions on claims or cases that are not of significance, but, at the same time, also ensures that we will be able to deal with cases in a wide range of criminal offenses, from terrorism to organized crime, narcotics trafficking, money laundering, fraud, tax offenses, intellectual-property crimes, and environmental offenses.

Third, the treaty also makes clear that assistance will be available through proceedings by the Securities and Exchange Commission, when those proceedings are incidental to or connected with pending criminal investigations and proceedings, which of course is important for our financial crime investigations.

Fourth, the treaty also provides for a broad range of different types of cooperation in criminal matters, including taking the testimony or statements of persons; providing documents, records, and other types of evidence; transferring persons in custody for testimony or other purposes; conducting searches and seizures; assisting in proceedings relating to the forfeiture of assets; and any other form of assistance not inconsistent with the laws of the party granting the assistance.

Fifth and finally, the treaty with Bermuda also pierces bank secrecy and provides a mechanism for addressing legal and policy issues, such as confidentiality, inadmissibility requirements for evidence, and custodial transfer of witnesses.

Significantly, the Bermuda Mutual Legal Assistance Treaty also provides a framework for cooperation in the tracing, seizure, and forfeiture of criminally derived assets.

In conclusion, we appreciate the committee's support for our efforts over the years to strengthen and enlarge the framework of treaties of assistance in combating international crime. We at the Department of Justice view mutual legal assistance treaties as particularly useful tools in this regard. Accordingly, we join with our colleagues at the Department of State in urging the prompt and favorable consideration of the Mutual Legal Assistance Treaty with Bermuda.

I'll be pleased to answer any questions the committee may have. Thank you.

[The prepared statement of Mr. Swartz follows:]

PREPARED STATEMENT OF BRUCE SWARTZ

Mr. Chairman and members of the committee, I am pleased to appear before you today to present the views of the Department of Justice on the Mutual Legal Assistance Treaty (Treaty or MLAT) signed by the United States and Bermuda. The treaty, jointly negotiated by the Departments of State and Justice, reflects the international law enforcement priorities of the Department of Justice. Accordingly, we join the Department of State in urging the committee to report favorably to the Senate and recommend its advice and consent to ratification of the treaty.

I realize that the committee has become acquainted with the significant benefits MLATs provide to the international law enforcement community since the first such treaty came into force in 1977. Nearly 35 years later, we now have MLATs in force with over 60 countries. Moreover, the transmittal package for the MLAT with Bermuda provides a detailed article-by-article analysis of the treaty, which I will not attempt to repeat here. Rather, I would like to highlight how the MLAT with Bermuda reflects our international law enforcement priorities.

The MLAT, signed on January 12, 2009, is the first such treaty between the United States and Bermuda and is the culmination of a lengthy negotiation first begun in June 2000. Upon entry into force, the MLAT will significantly enhance the existing mutual assistance relationship with Bermuda, currently characterized by collegial but discretionary cooperation based upon the exchange of letters of request. For example, the MLAT will establish a direct channel of communication between designated Central Authorities. The Central Authority for each party will be its Attorney General, or a person designated by the Attorney General. In the United States, the authority to handle the duties of the Central Authority has been delegated to the Office of International Affairs in the Criminal Division of the Department of Justice. In addition, replacing the current practice of discretionary cooperation, the treaty will establish a binding, legal obligation to provide assistance "in connection with the investigation, prosecution, and prevention of criminal offenses for which the maximum penalty is deprivation of liberty for at least one year, and in proceedings related to criminal matters." Limiting applicability to offenses punishable by at least 1 year's imprisonment, as measured by the penalty provisions in the party seeking the assistance, makes clear that the treaty is to be used for requests relating to serious offenses, while still providing for assistance in a wide spectrum of criminal matters, including terrorism, organized crime, narcotics trafficking, money laundering, fraud, tax offenses, intellectual property crimes and environmental offenses. For requests relating to investigations of multiple offenses, assistance will also be available for "lesser included offenses," provided at least one of the offenses under investigation is punishable by at least 1 year's imprisonment. Article 21 of the treaty further clarifies that assistance would be available for proceedings by the Securities and Exchange Commission when those proceedings are incidental to or connected with pending criminal investigations and proceedings.

The treaty with Bermuda also provides for a broad range of different types of cooperation in criminal matters, including taking the testimony or statements of persons; providing documents, records, and other articles of evidence; locating or identifying persons or items; serving documents; transferring persons in custody for testimony or other purposes; conducting searches and seizures; assisting in proceedings related to the forfeiture of assets, restitution, and the collection of criminal fines; and any other form of assistance not inconsistent with the laws of the party granting the assistance.

As with our other MLATs, the treaty with Bermuda also pierces bank secrecy and provides a mechanism for addressing legal and policy issues such as confidentiality, admissibility requirements for evidence, allocation of costs, confrontation of witnesses at foreign depositions, and custodial transfer of witnesses. Significantly, the Bermuda MLAT provides a framework for cooperation in the tracing, seizure, and forfeiture of criminally derived assets.

Finally, despite the many benefits offered by the treaty with Bermuda, we realize that MLATs in themselves are not the solution to all aspects of law enforcement cooperation. Their success depends on our ability to implement them effectively, combining comprehensive and updated legal provisions with the competence and political will of our treaty partners. Our recognition of the importance of effective treaty implementation led to the development of a standard consultation clause for our MLATs, included in the treaty with Bermuda, to ensure that we will have regular dialogues with our treaty partners on the handling of our cases.

CONCLUSION

We appreciate the committee's support for our efforts over the years to strengthen and enlarge the framework of treaties that assist us in combating international crime. We at the Department of Justice view mutual legal assistance treaties as particularly useful tools in this regard. In addition, as our network of international law enforcement treaties has grown in recent years, we have focused increasing efforts on implementing our existing treaties, with a view to making them as effective as possible in the investigation and prosecution of our most serious crimes, including those related to terrorism. We join our colleagues from the Department of State in urging the prompt and favorable consideration of the Mutual Legal Assistance Treaty with Bermuda. I will be pleased to respond to any questions the committee may have.

Senator CARDIN. Thank you very much, Mr. Swartz.

We'll now hear from Cliff Johnson, the Assistant Legal Advisor for Law Enforcement and Intelligence in the Department of State.

STATEMENT OF CLIFTON M. JOHNSON, ASSISTANT LEGAL ADVISER FOR LAW ENFORCEMENT AND INTELLIGENCE, DEPARTMENT OF STATE, WASHINGTON, DC

Mr. JOHNSON. Thank you, Mr. Chairman, members of the committee.

I'm pleased to appear before you today, along with the Department of Justice, to testify in support of the Mutual Legal Assistance Treaty signed by the United States and Bermuda in January of 2009. If approved by the Senate and brought into force, this treaty will be an important step in advancing law-enforcement cooperation with Bermuda. Bermuda has been a longstanding partner in United States law enforcement efforts off our Eastern Shores, in particular in investigating and prosecuting financial crimes. However, as Mr. Swartz pointed out, our current relationship is based solely on informal cooperation. Entering into force of this Mutual Legal Assistance Treaty would formalize this relationship and create a binding legal obligation on Bermuda and the United States to provide the assistance covered by the treaty.

As criminal activity grows increasingly transnational, mutual legal assistance treaties are essential tools in the effort to combat serious crimes across borders, including drug trafficking, money laundering, violent crimes, and terrorist activity. The United States has mutual legal assistance treaties covering many of Bermuda's neighbors in the nearby Caribbean region, including Bahamas, Anguilla, the British Virgin Islands, and the Turks and Caicos Islands, and, in general, with over 60 countries across the globe.

If the Senate provides its advice and consent to ratification, this treaty will fill a gap in the legal framework for international law enforcement cooperation in this region.

The treaty is one of a series of modern mutual legal assistance treaties negotiated by the United States since the 1980s and contains all the essential provisions of such treaties that the United States seeks. If approved, it would create a legal obligation for Bermuda to provide assistance "in connection with the investigation, prosecution, and prevention of criminal offenses," with a few limited exceptions. This obligation would extend to proceedings related to criminal matters, such as forfeiture proceedings, as well as proceedings of the Securities and Exchange Commission when ancillary to pending criminal investigations or prosecutions.

The treaty itself also serves to create an additional legal obligation to provide assistance related to criminal tax offenses, including those not covered by the two existing tax agreements we have with Bermuda. The treaty also includes important provisions on freezing and forfeiting assets or property that may be the proceeds or instrumentalities of crime, as well as the authorization for asset sharing.

I would note that unlike a number of our other mutual legal assistance treaties covering overseas territories of the United Kingdom, which have been concluded by the United Kingdom on their behalf, this treaty was concluded directly with the Government of Bermuda. Prior to signature, the United States obtained from the United Kingdom a copy of its entrustment letter to Bermuda, granting Bermuda the authority to sign and conclude this treaty. Engaging directly with the Government of Bermuda on the treaty and its implementation will enhance its effectiveness and facilitate the execution of requests.

It's our understanding that Bermuda has completed the internal legal requirements for entry into force of this treaty. It's, therefore, important that the United States is in a position to bring this treaty into force as soon as possible. We can then begin to benefit from the many tools it provides to enhance our law-enforcement cooperation with Bermuda.

We join our colleagues at the Department of Justice and the Department of Homeland Security in our appreciation of your and your staff's consideration of this treaty, which will bolster our efforts at home and abroad to combat transnational crime.

I will be happy to answer any questions the committee may have. Thank you.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF CLIFTON M. JOHNSON

Mr. Chairman and members of the committee, I am pleased to appear before you today along with the Department of Justice to testify in support of the Mutual Legal Assistance Treaty signed by the United States and Bermuda in Hamilton on January 12, 2009. If approved by the Senate and brought into force, this treaty will be an important step in advancing law enforcement cooperation with Bermuda. Bermuda has been a longstanding partner in United States law enforcement efforts off our Eastern Shores, in particular in investigating and prosecuting financial crimes. However, our current relationship is based solely on informal cooperation. Entry into force of this Mutual Legal Assistance Treaty would formalize this relationship and create a binding legal obligation on Bermuda and the United States to provide assistance covered by the treaty. As criminal activity grows increasingly transnational, mutual legal assistance treaties are essential tools in the effort to combat serious crimes that cross borders, including drug trafficking, money laundering, violent crime and terrorist activity. The United States has mutual legal assistance treaties covering many of Bermuda's neighbors in the nearby Caribbean region, including the Bahamas, Anguilla, the British Virgin Islands and the Turks and Caicos Islands, and in general with over 60 countries across the globe. If the Senate provides its advice and consent to ratification, this treaty will fill a gap in the legal framework for international law enforcement cooperation in this region.

The treaty is one of a series of modern mutual legal assistance treaties negotiated by the United States since the 1980s and contains all the essential provisions of such treaties that the United States seeks. If approved, it would create a legal obligation for Bermuda to provide assistance "in connection with the investigation, prosecution, and prevention of criminal offenses," with a few limited exceptions. This obligation would extend to proceedings related to criminal matters, such as forfeiture proceedings, as well as proceedings of the Securities and Exchange Commission when ancillary to pending criminal investigations or prosecutions. While the preamble to the treaty reaffirms the determination of the parties to share information in matters involving the investigation and prosecution of criminal tax offenses pursuant to either the 1988 Tax Information Exchange Agreement between the United States and United Kingdom, on behalf of Bermuda, or the limited 1986 bilateral tax treaty between the United States and the United Kingdom, on behalf of Bermuda, the treaty itself also serves to create an additional legal obligation to provide assistance related to criminal tax offenses, including those not covered by the two existing tax agreements.

The treaty further creates a direct law enforcement channel of communication on requests for assistance under the treaty through the designation of a "Central Authority" for each party. It includes important provisions on freezing and forfeiting assets or property that may be the proceeds or instrumentalities of crime, as well as authorization for asset-sharing. The one relatively uncommon provision of the treaty is the "Treaty as First Resort" article. It provides that, before a party seeks to enforce a compulsory measure requiring an action to be performed in the other party relating to a matter for which assistance is available under the treaty (such as production of bank records), the party must first attempt in good faith to obtain the desired assistance under the treaty. The Requesting Party can fulfill such obligation under the treaty either by making a formal request or by engaging in consultations to assess whether a request under the treaty would be successful.

I would also note that, unlike a number of other mutual legal assistance treaties covering overseas territories of the United Kingdom, which have been concluded by the United Kingdom on their behalf, this treaty was concluded directly with the Government of Bermuda. Prior to signature, the United States obtained from the United Kingdom a copy of its entrustment letter to Bermuda, granting Bermuda authority to sign and conclude the treaty. Engaging directly with the Government of Bermuda on the treaty and its implementation will enhance its effectiveness and facilitate the execution of requests.

We understand that Bermuda has completed the internal legal requirements for entry into force of this treaty. It is, therefore, important that the United States be in a position to bring this treaty into force as soon as possible. We can then benefit from the many tools it provides to enhance our law enforcement cooperation with Bermuda. We join our colleagues at the Department of Justice and the Department of Homeland Security in our appreciation of your consideration of this treaty, which will bolster our efforts at home and abroad to combat transnational crime. I will be happy to answer any questions the committee may have.

Senator CARDIN. Thank you very much for your testimony.

We'll now hear from Deborah McCarthy, Principal Deputy Assistant Secretary, Bureau of Economics, Energy and Business Affairs, Department of State.

STATEMENT OF DEBORAH A. McCARTHY, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF ECONOMIC, ENERGY AND BUSINESS AFFAIRS, DEPARTMENT OF STATE, WASHINGTON, DC

Ms. McCARTHY. Thank you. Mr. Chairman, Senator Lee, thank you for the opportunity to testify before the Foreign Relations Committee as the administration seeks advice and consent of the Senate to ratification of the United States-Rwanda Bilateral Investment Treaty.

Foreign investment is an important source of economic growth in the United States and around the globe. It improves productivity, provides good jobs, and spurs healthy competition. Secretary of State Clinton, in her remarks at the OECD on May 26, referred to an important international consensus about development, that "while aid is essential, aid alone is not enough; that to help people reach their full potential, we must also promote sustainable and inclusive economic growth."

We want to use the full range of tools at our disposal to promote these objectives, such as promoting corporate social responsibility through the OECD guidelines for multinational enterprises, international efforts to combat bribery of foreign public officials, and tools such as bilateral investment agreements to promote improved investment climates.

Since the inception of U.S. BIT negotiations in the early 1980s, the United States has pursued BITs with the objective of protecting U.S. investment abroad; encouraging the adoption of open, transparent, and nondiscriminatory investment policies; and supporting the development of international legal standards consistent with these objectives, all of which assists developing countries to create welcoming investment climates.

We already have five BITs in force with countries in sub-Saharan Africa. We hope the Rwanda BIT will become the sixth. At the 2009 AGOA Forum, Secretary Clinton and U.S. Trade Representative Kirk launched negotiations with Mauritius. At that time and at the AGOA Forum in 2010, the Secretary expressed our interest in exploring new investment treaties in Africa that advance our objectives at the bilateral or regional level. Later this week, Secretary Clinton and U.S. Trade Representative Kirk will attend the AGOA Forum in Lusaka, Zambia, where they will underscore our commitment to economic partnership with Africa.

The United States chose to negotiate a BIT with Rwanda in part based on its strong economic reform program, which has helped to rebuild the Rwandan economy since the 1994 genocide. As one indicator of Rwanda's efforts, the World Bank recognized that country as the world's top business climate reformer in 2009, a first for a sub-Saharan African country, and the second most improved in 2010.

Foreign investors are increasingly giving Rwanda serious consideration as a destination for investment. According to our Embassy, U.S.-led investment in Rwanda is poised to grow in the coming years. These investments could increase access to energy, significantly for Rwandans and their regional neighbors; increase access to financing for small and medium-sized enterprises; and contribute to improved food security.

The Department of State and the Office of the U.S. Trade Representative co-led the negotiations of this treaty with the participation of the Departments of Commerce, Treasury, and other U.S. Government agencies. The treaty contains high standard, core investor protections and provides investors with the opportunity to resolve investment disputes with host governments through international arbitration.

Once in force, the treaty would reinforce the Rwandan Government's efforts to reform its economy and promote a strong business climate. It would set a very positive example in the region. And it would protect the rights of the United States investors in Rwanda.

The administration thanks the committee for its consideration of the treaty, and we urge you to report it favorably to the full Senate for action.

I'd be happy to answer any questions that you may have.

[The prepared statement of Ms. McCarthy follows:]

Prepared Statement of Deborah A. McCarthy

Mr. Chairman, thank you for the opportunity to testify before the Foreign Relations Committee as the administration seeks advice and consent of the Senate to ratification of the United States-Rwanda Bilateral Investment Treaty (BIT).

INVESTMENT AND DEVELOPMENT OBJECTIVES

Foreign investment is an important source of economic growth in the United States and around the globe. It improves productivity, provides good jobs, and spurs healthy competition. Foreign investment is also a platform for U.S. exports. Over one-fifth of U.S. goods exports were shipped to foreign subsidiaries of U.S. firms in 2008 (latest data available). Approximately 27 percent of all U.S. exports are derived from foreign direct investment either in the United States or abroad. Foreign firms invested in the United States employ over 5.5 million Americans with a payroll of over $400 billion.

Foreign investment can also be a powerful tool for economic development abroad. Overseas development assistance, while valuable and important, cannot match the power, velocity, and impact of private capital—an essential factor for countries to move forward economically.

As Secretary of State Clinton has said, we believe that investment and trade are powerful tools to spread development and opportunity deep within societies. In her remarks at the Organization for Economic Cooperation and Development (OECD) on May 26, Secretary Clinton referred to an important consensus about development—that "while aid is essential, aid alone is not enough; that to help people reach their full potential, we must also promote sustainable and inclusive economic growth. . . . " President Obama's 2010 Presidential Policy Directive on Development focuses U.S. development efforts on broad-based economic growth, democratic governance, game-changing innovations, and sustainable systems for meeting basic human needs. We want to use the full range of tools at our disposal to promote rules of the road in support of these objectives. This includes our work promoting corporate social responsibility through the OECD Guidelines on Multinational Enterprises, international efforts to combat the bribery of foreign public officials, and tools such as BITs to promote improved investment climates.

Since the inception of U.S. BIT negotiations in the early 1980s, successive U.S. administrations have negotiated BITs with the objective of protecting U.S. investment abroad, encouraging the adoption of open, transparent, and nondiscriminatory investment policies, supporting the development of international legal standards consistent with these objectives, and assisting developing countries in creating a welcoming investment climate. U.S. BITs build on the principles contained in earlier U.S. treaties of Friendship, Commerce, and Navigation. The United States presently is a party to BITs with 40 countries.

BITs also support trade linkages. For example, BITs enhance our objectives on the African Growth and Opportunity Act (AGOA) by establishing a legal framework for U.S. investors in Africa—investors that may seek to export AGOA-eligible products back to the U.S. market. This is the type of synergy that can maximize the effectiveness of our policy frameworks. It also reflects our interest in looking to non-assistance-based policy tools to advance the development objectives of our foreign partners. Later this week, Secretary Clinton and U.S. Trade Representative Kirk will attend the AGOA Forum in Lusaka, Zambia, June 8–10, where they will underscore our commitment to economic partnership with Africa.

We already have five BITs in force with countries in sub-Saharan Africa.[1] We hope the Rwanda BIT will become the sixth. At the 2009 AGOA Forum in Nairobi, Secretary Clinton and U.S. Trade Representative Kirk launched BIT negotiations with Mauritius. At that time and at the AGOA Forum in 2010, Secretary Clinton expressed our interest in exploring new opportunities to pursue investment treaties in Africa that advance our objectives at the bilateral or regional level.

THE U.S.-RWANDA INVESTMENT TREATY

The United States chose to negotiate a BIT with Rwanda in part based on its strong economic reform program, which has helped to rebuild the Rwandan economy since the 1994 genocide. The Rwandan Government has opened its economy, improved its business climate, and embraced trade and investment as a means to boost economic development and help alleviate poverty.

The World Bank recognized Rwanda as the world's top business climate reformer in 2009—a first for a sub-Saharan African country—and the second most improved in 2010. Rwanda is the fourth-ranked sub-Saharan African country listed in that report.

Rwanda also maintains a consistent policy of combating corruption. Over the last 2 years Rwanda improved its rankings in Transparency International's "Corruption Perception Index" from 102 in 2008 to 66 in 2010, giving Rwanda the highest ranking of any country in East Africa.

As the result of these reforms, foreign investors are increasingly giving Rwanda serious consideration as a destination for investment. According to our Embassy, U.S.-led investment in Rwanda is poised to increase in the coming years. These investments could increase access to energy significantly for Rwandans and their regional neighbors, increase access to financing for small- and medium-sized enter-

[1] The other U.S. BITs with sub-Saharan African countries are with: Cameroon, the Democratic Republic of Congo, Mozambique, the Republic of Congo, and Senegal.

prises, contribute to improved food security, and provide low-cost "green" housing for middle-income Rwandans. U.S. investment has the potential to change Rwanda's economic landscape and play a significant role in assisting the Rwandan Government's efforts to become a regional economic hub. The BIT with Rwanda, once in force, would reinforce the Rwandan Government's efforts to further reform its economy and promote a strong business climate. It would set a very positive example in the region. It will also protect the rights of U.S. investors in Rwanda.

The Department of State and the Office of the U.S. Trade Representative coled the negotiation of this treaty, with the participation of the Departments of Commerce, the Treasury, and other U.S. Government agencies. The treaty, which was signed on February 19, 2008, contains a set of core investor protections, which include:

- National treatment and most-favored-nation treatment for the full life cycle of investment, including in the establishment, acquisition, operation, management, and ultimate disposition of an investment;
- The free transfer of investment-related funds;
- Prompt, adequate, and effective compensation in the event of an expropriation;
- A minimum standard of treatment grounded in customary international law;
- Freedom of investment from specified performance requirements;
- Prohibitions on nationality-based restrictions for the hiring of senior managers; and
- Provisions on transparency in publication of investment-related laws, regulations, and other measures, and the opportunity, to the extent possible, for interested parties to comment on such proposed measures.

The treaty also provides investors with the opportunity to resolve investment disputes with a host government through international arbitration.

This investment treaty is based on the 2004 U.S. model BIT, which, compared to earlier BITs, includes a number of provisions designed to improve the operation of the treaty. These developments include greater details on key provisions, and procedures designed to eliminate frivolous claims and to enhance efficiency, transparency, and public participation in the arbitration process. The treaty contains provisions in which the two governments recognize that it would be inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental and labor laws. Under the model, each party may take limited exceptions to the core obligations related to national treatment, most-favored-nation treatment, performance requirements, and senior management and boards of directors. In this area, Rwanda has taken only a few, narrow exceptions; the treaty thus sends a powerful signal about Rwanda's openness to foreign investment.

In sum, this treaty will complement Rwanda's reform efforts, help Rwanda attract more foreign investment that is vital to economic prosperity, and deepen our economic relationship with an important partner in Africa.

In conclusion, the administration wishes to thank the committee for its consideration of the treaty and we urge you to report it favorably to the full Senate for action. I would be happy to answer any questions you may have.

Senator CARDIN. Well, let me thank all five of you for your testimony, and we appreciate it very much.

I'm going to start on the treaties concerning Switzerland and Luxembourg and Hungary, and then we'll get over to the other two agreements.

And let me start with Ms. Corwin. Mr. Barthold points out in his statement and in his testimony that our current relationship with Hungary, Luxembourg, and Switzerland has allowed us a relatively limited exchange of information, so that, clearly, moving forward with these agreements are in our national interests, in order to get greater access to information.

Having said that, Mr. Barthold raises three, I think, very important points as to whether these agreements adequately deal with potential problems that may develop between our country and the other country, and that is the limitation on automatic exchange of information, the requirements to be specific in your identification, and the standard of having exhausted other remedies before you use the remedies that are available under the international agreement.

Can you respond to those three points?

Ms. CORWIN. Thank you, Senator. I'd be happy to.

With regard to what we've achieved in the new agreements, in particular with the protocols with Switzerland and Luxembourg, we view them as great improvement with respect to the current information-exchange standards that we have in our current treaties with those countries. In particular, some of the problems that we saw with respect to the Swiss treaty related to the narrowness of the scope of the information-exchange provision in the current treaties, and, in particular, the current treaties provide for exchange of information only with respect to circumstances where you're trying to establish fraud or fraud and the like.

Our new protocols have improved information exchange in a number of ways, including by broadening that standard, so we now have the ability to, on request, get information with regard to any issue that was necessary to enforce our domestic tax laws.

In addition, as with all of our information-exchange provisions, they provide for the ability to have automatic exchange—they don't prohibit that—but, essentially, only require information on request. So there's no limitation within the current treaties on automatic exchange.

With respect to the issue of specificity, there was a lack of clarity in the existing treaties with regard to that, and I think in the current protocols has been addressed. In particular, the terms of the treaty itself make clear, both in the case of Luxembourg and Switzerland, that the name of a taxpayer is not necessary in every case to honor an information request. And the use of the—I think as my colleague pointed out, the use of the "typically" language within the Swiss treaty, in particular, is not viewed as a hindrance to that interpretation but rather as an illustration that where information is available, it's in the interest of both countries to have that and provide that information when making a request. But if the information is not available, in the case of a name, that a request for information is still possible under this new protocol.

That understanding of the Swiss treaty, in particular, as well as the Luxembourg treaty, was achieved. And we went through, in the negotiations, great lengths to ensure a meeting of the minds on that issue and the specificity of a particular request. And we're satisfied that we had a mutual understanding regarding that point.

I think, in this regard, also Switzerland has recently issued statements indicating its intent to interpret all of its treaties, including the provisions with the United States, consistently with the international standard and the mutual understanding that we have with Switzerland, as well as the terms of the agreement itself, in a manner that would not require the name of an individual.

And so we feel that the treaties have addressed a number of the concerns and, as modified, should alleviate a lot of—and improve our information-exchange relationship with both Switzerland and Luxembourg.

Senator CARDIN. Did you want to comment further about the need to exhaust other methods first?

Ms. CORWIN. On the need to exhaust other methods, that is a consistent international standard. The procedural rules within the information-exchange provision in a treaty are intended to protect both the requester of information and the requested from unnecessary administered burden. And the ultimate goal is to exchange as much information as possible.

The standard requires exhaustion of internal remedies, so as to not put undue burden on the requested jurisdiction. It is commonly understood, in the OECD model and the international standard, it's not to be interpreted in a manner to frustrate information exchange.

Senator CARDIN. But we are dealing with Switzerland.

Ms. CORWIN. And I think in acknowledgement of that, the commentary to the OECD language talks about the fact that all of these procedural rules should be interpreted in a manner not to frustrate the intent of exchanging as much information as possible. In the case of Switzerland, we put that right into the legal document, and there's a mutual understanding that that is the way we intend to——

Senator CARDIN. Could you point out the differences between Luxembourg and Switzerland's agreement, as it relates to the exchange of information?

Ms. CORWIN. The two protocols are, actually, substantively the same. Both, as I said, change the current scope of exchange of information in the current agreements, which was narrow and limited to circumstances in order to meet the objectives of the treaty or to deal with fraud or fraud and the like. So both protocols expand that scope to include exchange of information that may be relevant, or is foreseeably relevant to addressing domestic law issues.

In addition, both treaties override existing domestic bank secrecy rules. So under the prior agreements, a country could not respond to—or Switzerland or Luxembourg would not respond to a request because of domestic bank secrecy rules. Under the current agreements, we explicitly provide that information must be exchanged notwithstanding any existing domestic bank secrecy. So if the information is held by a bank or financial institution, it's still required to be exchanged. And, finally, both agreements explicitly say that information must be exchanged even absent a domestic law interest in the country that's providing the information.

Senator CARDIN. Do you believe any additional negotiations are needed with Switzerland, so that we are confident that they will interpret this agreement and apply it consistent with our understandings?

Ms. CORWIN. We do not believe any additional negotiations are necessary with Switzerland. As I said, we were very cognizant of the circumstances that led to UBS and the environment. When we negotiated this protocol with Switzerland, we went to great lengths to establish and memorialize our mutual understanding of how these information-exchange provisions would be interpreted and in a manner consistent with the international standard. And recently, as I said, Switzerland has announced its intent to interpret the information-exchange provisions in its treaties in a manner that is not only consistent with the mutual understanding reached with the United States but the international standard. And that gives us comfort that we ended up with a meeting of the minds that gets to the right place.

Senator CARDIN. Mr. Barthold, would like to respond at all to the response by Ms. Corwin?

Mr. BARTHOLD. I think Ms. Corwin pointed out a number of the important advancements. The questions that my staff colleagues and I raised were really about how it will work out in practice. I believe that that was the thrust of your question. Ms. Corwin said that they're generally satisfied. They think they've pushed substantially. She did note important changes, in terms of overriding bank secrecy laws. Also in the one agreement, there is a provision that essentially overrides domestic law that would make a subsequent change precluding requested information.

So I think Ms. Corwin does point out some important advances.

Some of our staff concerns relate to Swiss statements of need to flesh out details. Of course, that's always true about any sort of agreement, in terms of how things work in practice.

Somewhat recently, and since we prepared our description and discussion for your committee, the OECD peer review panels have released an initial phase-one report on Switzerland. The report noted significant improvement in existing agreements was needed and that they should take action to ensure that all agreements will be interpreted consistently with international norms. Ms. Corwin said that she believes that that is the case.

The report criticized the Swiss authority's initial interpretation of agreements as including specific identification requirements. Again, Ms. Corwin had addressed that issue.

Senator CARDIN. Thank you.

The press has reported that Switzerland is likely to conclude new agreements with Germany and the U.K. in the near future. Under these agreements, the Swiss Government would require Swiss banks to withhold or remit tax from payments of interest and perhaps other forms of investment income owned by residents of Germany and the U.K. who have Swiss bank accounts. Should the United States consider negotiating a similar agreement with Switzerland and other foreign banking centers?

Ms. Corwin.

Ms. CORWIN. We don't think that the United States should consider such agreements. My understanding of the proposed agreements with Germany and the U.K. is that what they are offering is—or what Switzerland is offering is to impose a final withholding tax on accounts of German residents or U.K. residents, as the case may be, in place of identifying those residents to the U.K. Government and the German Government. So it is a collection system in place of a reporting regime, an information-reporting regime.

That doesn't allow the U.K. Government or the German Government to necessarily reconcile whether the collection of this final withholding tax is consistent with what tax might actually be due with respect to the individual on whom the tax is collected.

From the U.S.'s perspective, we think information exchange is the more appropriate means for making sure that we combat offshore tax evasion, and we don't want to give up our ability to assess the tax due on our own residents to another jurisdiction and be comfortable that that tax would be collected appropriately.

Senator CARDIN. So if these agreements are ratified by the Senate, are you saying that we will get enough information about income generated by accounts owned by Americans in just the general exchange of information, which will adequately allow us to audit to make sure the taxes have been paid on that income, similar to the information reports we receive from U.S. banks?

Ms. CORWIN. Thank you, Senator.

I think if these agreements are ratified, it will allow us to make requests of the relevant jurisdictions.

Senator CARDIN. That was my concern. If you're making a request on specific information, you don't know the information.

Ms. CORWIN. Right.

Senator CARDIN. It seems to me what the German and the Brits are doing, they're saying, I'd rather have money in the bank than trying to figure out who have accounts.

Ms. CORWIN. Right, right. And they're depending on Switzerland to impose the right amount of tax on those——

Senator CARDIN. But wouldn't that also be negotiated, if we negotiate with the Swiss?

Ms. CORWIN. Well, certainly, I don't believe that as part of the agreements or the negotiations between Switzerland and then Germany and the U.K., it includes information exchange. The United States has recently enacted the Foreign Account Tax Compliance Act, which would require all foreign institutions, financial institutions, to report directly to the IRS information about U.S. bank accounts in their jurisdictions. That, right now, is providing us with the direct information that we will need direct from financial institutions on an automatic basis from these accounts.

We have said in the context of implementing, because Treasury is now in the position of writing the regulations, to implement that law that we are willing to speak with foreign governments, including Switzerland, to cooperate as to how we can implement those provisions, which is to require reporting on all U.S. accounts to the IRS, implement them in cooperation with the foreign governments and leverage off of our existing treaty relationships, including the proposed protocols that are before you today, to allow the government to facilitate that reporting.

But what we're not willing to do is give up information reporting in exchange for a flat tax, where we have no way to audit whether, in fact, the individuals who have their accounts there are paying the right amount or, in fact, that Switzerland is doing what it should be doing to collect the tax.

Senator CARDIN. I'm not sure I follow that argument. You say, on one hand, that the banks are required to give you that information under current law, so it seems to me you're getting information reports currently from the banks. This is a government arrangement in which they are required with specific requests to supply information to the United States. I assume that's where we have at least some indication that someone is not paying their taxes. But if we don't know about the account and we are not getting adequate information, then we're losing the tax revenue.

So I'm not sure I follow you, from the point of view of the interests of the U.S. taxpayer, and tremendous concern here in Congress that offshore income is properly reported here in the United

States, that we wouldn't be better off negotiating receiving the funds, without compromising our requirements for international banks to supply the information directly to the IRS.

Ms. CORWIN. Thank you, Senator. I think the administration absolutely shares your concern and Congress' concerns about offshore tax evasion. And we view these tools as complementary in achieving the most compliance that we can get.

The act, the Foreign Account Tax Compliance Act that I referenced, is not effective until January 2001, 2013. So while it is current law, it is not yet operable and requires a lot of pieces to go into play before we're getting full reporting. That information reporting, in conjunction with our ability to make requests of a government to provide us additional information, when we suspect or have concerns about a particular scheme, or maybe the facilitation of evasion, is going to, I think, provide us with sufficient tools to go after what has become a significant issue of offshore tax evasion.

Senator CARDIN. Mr. Barthold, any comments you want to make?

Mr. BARTHOLD. Well, perhaps, Senator, just to help clarify, the agreements that you noted between Switzerland and the United Kingdom, remember, this is in lieu of Swiss participation in the E.U. savings directive. And while not expert on the savings directive, I believe, at this stage, it only relates to interest.

I believe the point that Ms. Corwin was making, in terms of information reporting, is that Congress has enacted the Foreign Account Tax Compliance Act that will provide information reports on, essentially, flows into financial accounts, reflecting interest, dividend, and gain. And combining that information with the ability to make specific requests, when based on that information you might think that a taxpayer is underpaying, I believe she's saying that the administration thinks that would dominate a flat withholding tax, particularly since I think the rates of withholding that the European agreements are talking about may be at least moderately below the highest rates of tax in the European countries and the highest rates of tax in the United States.

Senator CARDIN. Thank you.

Ms. Corwin, you note that in the arbitration provisions, that they're similar in Switzerland and Luxembourg. Can you tell us the differences?

Ms. CORWIN. Well, the arbitration provision is in Switzerland only. We've included arbitration in Switzerland and it is——

Senator CARDIN. I meant you said it's similar—I misstated the question—similar to other agreements that we've entered into. How is it different?

Ms. CORWIN. It is identical to the arbitration provision we have in the French protocol, which this committee approved in 2009. The provisions in both the French protocol and this proposed Swiss protocol differ from the agreements or the arbitration provisions we have with Belgium, Canada, and Germany, in response to very useful comments we received from this committee when those treaties were being approved.

And, in particular, I think there are three significant differences that I can point to that come from the suggestions of this committee. First, in response to concerns about the taxpayer in an arbitration proceeding having the ability to participate in the arbitration proceeding, we have added, we've included in the proposed Swiss protocol, as well as the French protocol, a provision that allows a taxpayer to submit a position paper to the arbitration panel, reflecting their views on the issues before the arbitration panel.

Second, in response to concerns about maintaining the independence of the members of the arbitration panel, we, in the Swiss protocol as well as the French protocol, prohibit or put a prohibition on employees of the tax administrations of either government serving as members of the arbitration panel.

And then finally, in response to concerns about following international norms for legal interpretation for treaty interpretation, we removed what had been a hierarchy of laws for treaty interpretation that existed in the prior treaties. They are no longer in these treaties.

Senator CARDIN. Thank you.

In regards to Hungary, for one moment, can you tell us the current status of action of the Hungary Government in modifying its domestic laws that would permit it to adequately implement its exchange of information and limitation on benefit obligations that are in the treaty?

Ms. CORWIN. Sure. On Hungary, with respect to information exchange, we've had a very good information-exchange relationship with Hungary, even under the existing treaty that had the older information-exchange language. So we've never had problems with scope or question, and there are no additional steps that Hungary needs to take domestically to continue that information-exchange relationship under the new, more modern information-exchange language in the treaty.

Similarly, with respect to the limitation on benefits provision, there are no domestic law changes that need to be made in order for the treaty-shopping protections provided for in the limitation on benefits provision to kick in.

Senator CARDIN. There have been some questions raised in regards to the Hungary treaty as to whether the provision of limitation of benefits are sufficient to deter the treaty-shopping concerns that you've raised. I've read your testimony, and you repeated it today, that you're confident that the provisions here are adequate.

Ms. CORWIN. Yes, we are. We have included our model LOB—limitation on benefits—provision to prevent treaty shopping. It is the tightest antitreaty shopping provision in the world. It's recognized as such. And we are confident that the limitations there that look to ownership and limit benefits based on ownership as well as activity are sufficient to combat any treaty-shopping concerns that we might have had with Hungary before this revision.

Senator CARDIN. Well, thank you very much. I want to give you all a break for a moment and turn to Mr. Swartz. You've been very patient, the three of you. I appreciate that very much. Normally, we would have had two panels, but we didn't know how the Senate would be operating today, so in an effort to make sure we got through all the treaties today, we did this as one panel.

Mr. Swartz, you point out in your testimony and your statements that the treaty with Bermuda also pierces bank secrecy and provides a mechanism for us getting the information we need. There have been some mutual legal assistance treaties that contain provisions related directly to sharing bank records or other financial information. Why wasn't a similar provision included in the U.S.-Bermuda MLAT?

Mr. SWARTZ. Thank you, Mr. Chairman. With regard to that particular issue, the committee may be referring to the relatively new provision that appears, for instance, in our E.U.–U.S. Mutual Legal Assistance Treaty, the identification of bank records provision. That was a provision that was drafted and adopted in the context of the E.U. negotiations after the Bermuda Mutual Legal Assistance Treaty was well underway.

Under that provision, it's possible for the requesting party to seek information as to whether an account exists in the requested country, or in the case of the E.U., one of the requested member states. But, thereafter, the request, if there is an identification of an account, must be followed up through a standard mutual legal assistance treaty.

As I said, that's a new provision that came after the bulk of the negotiations were concluded with regard to Bermuda.

And with regard to Bermuda, our record of cooperation has been very good. We believe that the record we have on the production of records, including bank records, is such that we are confident that the provisions included in this mutual legal assistance treaty, which do require cooperation on the production of records, will suffice to ensure that we obtain the records we need for our financial investigations and other investigations.

Senator CARDIN. Some other MLATs also allow for urgent, nonwritten form requests to be made. It's my understanding that in Bermuda, it must be in written form. Any reason why that provision was not included in this agreement?

Mr. SWARTZ. Mr. Chairman, while it is true that the Mutual Legal Assistance Treaty does require requests in written form, it was the judgment of the negotiators that it sufficed that, in this case, with regard to Bermuda, we would be able to obtain expeditious responses to our requests and also provide such responses to Bermuda's requests, particularly because we have a practice already established that will continue, we believe, under the treaty of being able to convey those requests through email or through fax. And we believe that that availability does mean that our requests can be speedily transmitted and responded to.

Senator CARDIN. So was this, basically, a decision made by U.S. negotiators, that it was not necessary, knowing how we can quickly get faxes and e-mails sent? Is that fair enough to say, or not?

Mr. JOHNSON. Senator, if I can help on that one?

Senator CARDIN. Sure.

Mr. JOHNSON. Our negotiators initially did try to get language that provided for nonwritten requests to be made. Bermuda resisted that because they wanted to make sure that the requests were clear and in a more formal way.

But in the negotiations, it also became clear that they accepted that such request could be made by fax or by email. So the real issue they were concerned about was not finding a fast means to make a request, but really just taking oral requests off the table. And, in fact, my understanding is that our informal practice with them has, in fact, been to use email and faxes to make those requests. So we're confident that we've got the means in place that we can make urgent requests of them in a way that will be effective.

Mr. SWARTZ. Mr. Chairman, if I might add, in fact, while it is an advantage to be able to make oral requests, in practice, it's very rare that we do so. Instead, we do use the instrumentalities of fax or email.

Senator CARDIN. My main concern is just, in urgent matters, that it's not delayed. And with modern communication, it seems to me that can probably be handled.

I'm more concerned about bank records. Mr. Johnson, do have any comments on the bank records issue?

Mr. JOHNSON. Again, not specifically on the bank issue. But, again, our sense is that by having an accepted practice and understanding between our two countries that we can use email and faxes and other modern means to make requests very quickly. The difference between being able to do an oral request or being able to use one of these other very rapid means, we think, is not consequential.

Senator CARDIN. There've been some issues raised about the adequacy of Bermuda law with respect to forfeitures of proceeds and instrumentalities of criminal offenses. Are you satisfied that Bermuda law is adequate to comply with their commitments under this treaty?

Mr. SWARTZ. Mr. Chairman, we are. Of course, the development of forfeiture law is an important and progressive matter. We've seen a number of changes over the course of the years, including here in the United States.

But the Mutual Legal Assistance Treaty in Article 17 does obligate Bermuda to provide assistance to the United States in proceedings relating to forfeiture of proceeds and instrumentalities of crime, to the extent permitted by the law of Bermuda.

And we've had experience, in this regard, with Bermuda. We've had two examples of successful requests for restraint and forfeiture of assets. Both instances were a success and we were able to obtain the funds.

As a general matter, assistance is available under the laws of Bermuda, and I do think that's important to stress, with regard to freezing, seizing, and restraining assets, including for matters relating to terrorism and terrorism financing.

In particular, the attorney general of Bermuda can enforce all foreign confiscation and forfeiture orders. But it should be noted that forfeiture assistance is not limited to what is permitted under Bermuda's domestic law. With regard to a U.S. order, Bermuda cannot forfeit a specific instrumentality of nondrug offenses, because that power doesn't exist domestically.

But again, that's limited to instrumentalities in nondrug offense cases. Our experience with Bermuda has, in fact, focused oftentimes on drug offenses but does not go to the broader power to seize or confiscate assets as opposed to instrumentalities.

Senator CARDIN. Thank you.

Let me just ask the general question, and any one of you can respond to it.

In the Bermuda agreement, there's a provision that is not unfamiliar to us, where Bermuda can deny cooperation in capital cases. We understand, I understand that, so I'm not being critical of that provision being included in there.

I would like to get your view as to what impact that has on law enforcement here, on these treaties, when we have criminal offenses that have occurred that are subject to capital punishment in the United States. Are we hindered as a result of that or is there a way in which we are able to cooperate under this treaty, even in those cases?

Mr. SWARTZ. Mr. Chairman, we believe and we hope we still would be able to cooperate.

Bermuda indicated, and has advised the United States, that it reserves the right to deny assistance in capital cases where the sentence includes a possible death penalty, relying on the—contrary to the important public policy provision of Article 3 of the convention.

While the United States does not agree with that interpretation of Article 3, nonetheless, we believe that we will be able to resolve in these matters—we hope we will be able to resolve these matters on a case-by-case basis, as we have done with regard to other jurisdictions.

In fact, we have that experience with other countries that have put similar interpretations on the mutual legal assistance responsibilities, and we've been able to work out arrangements in a number of cases that allow us to obtain evidence or discuss whether the evidence is significant enough to go forward with some kind of further steps being taken.

Senator CARDIN. Mr. Johnson.

Mr. JOHNSON. Yes, Senator, if I could just add to that, one of the reasons this treaty took as long it did to negotiate and conclude is because it was important to us to make sure that there wasn't an express restriction on assistance in capital cases in the treaty itself. So what we, ultimately, worked out with Bermuda was language in the treaty itself that was silent on the issue but enabled them, in appropriate cases, to rely on the language that Mr. Swartz related to you. And that way we think that helps maintain the principle that's important to us, that such cooperation should be available, irrespective of the kind of case.

And we think this has also borne out with some other countries, where even with similar concerns about cooperation in capital cases, they have, for example, been able to provide assistance to the nonpenalty phase of a trial or another party investigation.

So it's our hope that with Bermuda, as well, by having the treaty not include an express prohibition, that we will be able, on a case-by-case basis, to work out with them assistance in appropriate cases.

Senator CARDIN. But they do hold the right under this treaty to deny cooperation where the United States criminal justice system is seeking capital punishment?

Mr. JOHNSON. Senator, they hold the right under the treaty to not provide assistance in cases that are contrary to public policy or their essential interests, and they have told us that they interpret that to allow them, in death penalty cases, to exercise that.

But again, that doesn't mean that it's automatically precluded in all cases.

Senator CARDIN. I understand that. I just wanted to make it clear that they would not be a violation of the treaty. We understand their interpretation, that if there was a case pending here that we needed their help, where, clearly, the prosecutors were seeking the death penalty, Bermuda could decide not to cooperate under this treaty.

Mr. SWARTZ. If I could say, Mr. Chairman, importantly, the treaty would require, since this would be a denial under Article 3 of the treaty, that first there had to be consultations with the United States, before that denial could go forward.

And I think that's an important aspect of the negotiation that Mr. Johnson mentioned. Rather than having an explicit provision, this is one of a set of conditions under which assistance may be denied after consultation, and, among other things, that there must be consideration as to whether assistance can be given, subject to such conditions as the requested country deems necessary.

And our experience in that regard has been that we oftentimes can find appropriate assurances to allow evidence to be produced, at least for initial assessment of the importance of evidence in the case overall.

Senator CARDIN. So we do have some track records with other countries with similar provisions?

Mr. SWARTZ. Yes, Mr. Chairman, we do.

Senator CARDIN. It might be useful just for you to share that information with our committee, so that we know how, in practice, this operates.

As I said, in introducing this line of questioning, I certainly understand why Bermuda insisted upon this type of provision. I think, though, it would be useful for us to understand the challenges that are placed in law enforcement because of the inconsistencies of the United States with the international community on penalties. And I think that would be helpful for us to have that information in this committee.

Mr. SWARTZ. Thank you. We'd be glad to supply that.

Senator CARDIN. Ms. McCarthy, you have the easiest job here, since this agreement was previously approved by this committee.

As I said in my opening, we approved it too late in the 111th Congress for action. We approved it in mid-December, and, of course, Congress adjourned at the end of the month, sine die. Have there been any significant changes in our investment relationship with Rwanda since last November when you gave testimony on this treaty?

Ms. MCCARTHY. Thank you, Mr. Chairman.

What we have seen since last November is an increase in United States investment in Rwanda, and I can give you a few examples.

We have a company called Contour-Global; it has announced that it's going to invest $325 million in methane gas extraction, and they have invested over $125 million of that amount. Also, in February of this year, we have Hilton Hotels; it's is going to open up a major hotel in Kigali. And, also, Marriott Hotels is going in to facilitate the country's growing hospitality industry.

So I would say that, given this pattern of increased investment, that it is important that the protections be afforded for them. So we are seeing increased interest on behalf of U.S. investors.

Senator CARDIN. I thank you for that. You also mentioned the fact that the United States is exploring other bilateral investment treaties in Africa. I believe you mentioned one other country. I think we have five current bilateral investment treaties in Africa. Can you just share with us other countries that the United States has shown interest in negotiating treaties?

Ms. MCCARTHY. Certainly. We are, obviously, looking not only within Africa, but also beyond. I mean, we're engaging in negotiations with a number of countries—China, Georgia, India, Mauritius, and Pakistan. And in recent years, within Africa, we've held exploratory discussions with Ghana, Gabon, and Nigeria.

As you probably know, we have, currently, five BITs in force that have been there for a while. So the discussions are ongoing.

Senator CARDIN. Thank you.

I've been told by the staff that I should ask the question of whether the administration still supports the Senate ratification of the Rwanda treaty, since it was held over from the last Congress. So, for the record?

Ms. MCCARTHY. We certainly do.

Senator CARDIN. Thank you.

I think that completes the questioning. We might have some additional questions for the record. As you know, the record remains open for 24 hours, so you get a break. That's a pretty fast turnaround time for this committee.

But I do appreciate your patience with the committee and thank you very much for your testimony today.

The committee will stand adjourned. Thank you.

[Whereupon, at 3:38 p.m., the hearing was adjourned.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

RESPONSE OF PRINCIPAL DEPUTY ASSISTANT SECRETARY DEBORAH A. MCCARTHY TO QUESTIONS SUBMITTED BY SENATORS JOHN F. KERRY AND RICHARD G. LUGAR

Question. In connection with the committee's consideration of the Rwanda BIT during the 111th Congress, the Department of State witness answered a series of questions concerning the treaty. (The hearing transcript and questions for the record are reproduced in Annex II of Senate Foreign Relations Committee Executive Report 111–3.) Please confirm that the answers provided by the Department's witness remain accurate today, and provide updated responses as necessary.

Answer. As set out below, we would like to provide updated information on reported U.S. investment activity in Rwanda. Other than these updates, the answers provided by the Department's witness in the 111th Congress remain accurate.

In 2009, the stock of U.S. foreign direct investment in Rwanda was $1 million (according to the Bureau of Economic Analysis). However, several U.S. investments in Rwanda have been announced or have progressed since 2009. An updated list of examples follows.

- U.S. firm ContourGlobal announced in 2009 that it reached agreement with the Government of Rwanda to invest in methane gas extraction and power generation in Rwanda. The company has invested more than $125 million already, and the amount of total intended investment has increased to over $400 million. In May, the company announced that the Multilateral Investment Guarantee Agency issued an investment guarantee supporting this project.
- In February of this year, Hilton Hotels announced plans to open a $30 million four-star hotel in Kigali, according to the Rwanda Development Board. Also this

year, Marriott Hotels announced that it would open a new five-star, $60 million hotel facility in the country.

- In the finance sector, Urwego Opportunity Bank, a partnership of three American NGOs, has invested more than $3.5 million and improved access to financing for Rwandan consumers and businesses.
- Rwanda Trading Company has invested more than $2.5 million to become one of the largest exporters of Rwandan coffee.
- Sorwathe, a U.S. tea company that has invested in Rwanda since 1978, opened a new $2 million tea factory in the country in 2009.
- Starbucks Coffee opened a "Farmer Support Center" in Kigali in 2009, the first such investment by the company in Africa.
- MANA Foods has invested more than $1 million to renovate and expand facilities to produce therapeutic supplemental food in Rwanda, helping tens of thousands of children lacking proper nutrition.

We understand from our Embassy in Kigali that a number of other U.S. firms are considering Rwanda as a potential investment destination, particularly in hydropower and other "green" energy projects, financial services, agriculture, and mining.

RESPONSES OF DEPUTY ASSISTANT SECRETARY MANAL CORWIN TO QUESTIONS SUBMITTED BY SENATOR JOHN F. KERRY

Question. Under the proposed protocol with Switzerland, are treaty countries required to exchange information in response to specific requests that are comparable to "John Doe" summonses under U.S. domestic law?

Answer. The language in the proposed protocol with Switzerland regarding the exchange of tax information was intentionally drafted to be identical in substance to Article 26 of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital ("OECD Model Tax Convention"), as well as the relevant text of the OECD Model Agreement on Exchange of Information for Tax Matters ("OCED Model TIEA"), which provide for exchange of information in a broad range of circumstances where it is foreseeably relevant to the administration or enforcement of either treaty partner's tax laws. In the case of specific requests for information, Commentary to the OECD Model TIEA states that a request for information triggering the obligations to exchange information does not necessarily have to include the name of the accountholder under investigation. Similarly, by its terms, the proposed protocol with Switzerland contemplates that a name is not required with respect to every request. As part of our negotiations with Switzerland, we confirmed that Switzerland concurs that the language in the proposed protocol regarding exchange of information was drafted to reflect the OECD standards, and that therefore that language's interpretation should be consistent with OECD standards for information exchange.

Question. The Department's Technical Explanation concerning paragraph 2 of Article 26 of the proposed protocol with Switzerland states that the United States and Switzerland will not request consent to use information obtained under the treaty for purposes beyond the purposes identified in paragraph 1 of Article 26 (i.e., for nontax purposes) except in circumstances where such use would be consistent with the Mutual Legal Assistance Agreement in force between the two countries. Please explain the rationale for this limitation on the scope of paragraph 2 of Article 26.

Answer. Article 26 of the current income tax treaty in force limits the use of information obtained under the treaty to specific purposes, i.e., assessment, collection or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relations to, the taxes covered by the Convention." Nevertheless, granting the ability for authorities to use information exchanged pursuant to a request under an income tax treaty for another purpose is appropriate policy as an efficiency matter where the information could have been obtained for that purpose under another agreement between the United States and the treaty partner and the competent authority of the requested state authorizes such use. For instance, if a requesting country that received information pursuant to a tax treaty request could have obtained the same information pursuant to a request under a Mutual Legal Assistance Treaty (MLAT) to be used for other, nontax, purposes and if the requested state has no objection to the use of that information for those other purposes, there is no reason for that country to have to make a redundant request. However, this policy is appropriate only to the extent that such other agreements separately exist and grant the legal authority to make a request for such information, as in the case of the MLAT with Switzerland.

Question. The diplomatic notes exchanged with Luxembourg require that the requesting country must pursue "all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties" before resorting to treaty procedures. Does the Department have any concerns that Luxembourg may assert an overly narrow view of this requirement, with a view to frustrating the exchange of information under the treaty?

Answer. We do not have such concerns. This language is consistent with the language of the international standard for tax information exchange established by the OECD Model TIEA. The Commentary to the OECD Model TIEA explains that the country requesting information should only contemplate such a request if it has "no convenient" means to obtain the information within its own jurisdiction, or it should explain that the available means to obtain the information within its own territory would pose disproportionate difficulties. Furthermore, the Commentary to the OECD Model TIEA makes clear that the OECD standard is intended to ensure that obtaining the information should be easier for the requested state than for the requesting state. Luxembourg and the United States intentionally drafted the treaty language in question to reflect the OECD model TIEA language.

Question. Under the proposed protocol with Luxembourg, are treaty countries required to exchange information in response to specific requests that are comparable to "John Doe" summonses under U.S. domestic law?

Answer. The language in the proposed protocol with Luxembourg regarding the exchange of tax information was intentionally drafted to be identical in substance to Article 26 of the OECD Model Tax Convention and the relevant text of the OECD Model TIEA, which provides for exchange of information in a broad range of circumstances where it is foreseeably relevant to the administration or enforcement of either treaty partner's tax laws. In the case of specific requests for information, the Commentary to the OECD Model TIEA states that a request for information triggering the obligations to exchange information does not necessarily have to include the name of the accountholder under investigation. As part of our negotiations with Luxembourg, we confirmed that Luxembourg concurs that the language in the proposed protocol on information exchange was drafted to reflect the OECD standards and that therefore that language's interpretation should be consistent with OECD standards for information exchange.

Question. The proposed protocol with Luxembourg limits the information-exchange obligations to information that is foreseeably relevant for carrying out the provisions of the treaty or the domestic tax laws of the two treaty countries.

- Is the requested treaty country permitted to evaluate the relevance of a request independently of the apparent conclusion by the treaty country that the information is relevant to carrying out its domestic tax laws?
- If so, does the Department have any concerns that Luxembourg may assert an overly narrow view of this requirement, with a view to frustrating the exchange of information under the treaty?

Answer. The Commentary to the OECD Model Tax Convention states that the standard of foreseeable relevance should be interpreted to provide for exchange of information to the widest possible extent. The terms of the agreement related to the protocol that would become an integral part of the Convention with Luxembourg, if ratified and in force, specifies what information must be provided to demonstrate the foreseeable relevance of the information to the request. For example, a requesting state has an obligation to provide an explanation of the tax purpose for which the information is sought. As long as the required information is provided, the requesting state does not otherwise need to prove that the information requested is, in fact, relevant. As part of our negotiations with Luxembourg, we confirmed that Luxembourg concurs that the language in the proposed protocol and related agreement regarding exchange of information was drafted to reflect the OECD standards, and that therefore that language's interpretation should be consistent with OECD standards for information exchange.

Question. Under the proposed treaty with Hungary, a company that is a resident of a treaty country is eligible for all the benefits of the treaty if it satisfies a regular trading test and either a management and control test or a primary trading test. Under the U.S. Model treaty, to satisfy the "primary trading" test, the required trading must 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. However, under the proposed treaty, the primary trading test is broader, also allowing benefits, in the case of a Hungarian company, on a recognized stock exchange in another European Union or European Free Trade

Association country, or in the case of a U.S. company, in another North American Free Trade Agreement country.

- Why was the primary trading test set forth in the U.S. Model treaty not used in the proposed treaty with Hungary?
- A similarly broad primary trading test was included in the recent tax protocols concluded with France and New Zealand. Given this, is a change to the U.S. Model tax treaty warranted?

Answer. Although the U.S. Model Tax Convention serves as a starting place for negotiations, the terms of each individual treaty must be negotiated with the treaty partner. As a result, individual limitation on benefits and other provisions may vary from one treaty to another in order to take into account the specific circumstances of the treaty partner.

The overall purpose of the limitation on benefits provisions set forth in the U.S. Model is to provide objective tests that will determine if a resident of one of the treaty partners has a sufficient economic nexus to its country of residence to warrant receiving treaty benefits. One of the objective tests provides benefits to companies that are primarily traded on a recognized stock exchange in their country of residence. However, in certain cases the U.S. Model rule may not provide the appropriate scope. For instance, if the stock exchanges in the treaty partner are limited, companies resident in that country may seek to trade their shares on larger, third-country exchanges. This business decision should not necessarily result in a denial of treaty benefits. During the tax treaty negotiations, Hungary requested that certain third-country exchanges be included in the primary trading test in order to reflect that Hungarian companies may be traded more heavily on larger regional exchanges outside of Hungary. By restricting benefits to companies primarily trading on regional exchanges, the primary trading test in the proposed treaty with Hungary maintains strong protection against treaty-shopping, but reflects the fact that Hungary's stock market is not a regional center.

While the primary trading test in the proposed tax treaty with Hungary and a number of other tax treaties recently concluded by the United States deviate from the analogous rule in the U.S. Model, this does not mean that changes to the U.S. Model in this regard are warranted. The policy set forth in the U.S. Model should remain the starting point for tax treaty negotiations, and variations from the Model should be evaluated on a case-by-case basis.

Question. 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 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 U.S. Model treaty, however, does not include derivative benefits rules.

- Why were derivative benefits rules included in the proposed treaty?
- Given that derivative benefits rules have also been included in other recent treaties concluded by the United States, is a change to the U.S. Model tax treaty warranted?

Answer. Although a derivative benefits rule is not included in the U.S. Model limitation on benefits article, such rules are typically included in agreements with treaty partners that are part of a closely tied regional economic community, such as the European Union or NAFTA. In such circumstances, it is common for corporate residents of a third country within the same economic community to invest in the United States through a subsidiary within the treaty country with no treaty-shopping motivation, or to form joint ventures that include participants from many countries within a trading area. However, because we frequently negotiate treaties with countries that are not part of such an economic community, it would not be appropriate to include such a provision in the U.S. Model.

Question. The proposed treaty with Hungary includes so-called "triangular arrangements" antiabuse rules intended to deny treaty benefits in certain circumstances in which a 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 Hungary. A rule on triangular arrangements is not included in the U.S. Model treaty.

- Why was a "triangular arrangements" rule included in the proposed treaty?
- Given that similar provisions have also been included in other recent treaties concluded by the United States, is a change to the U.S. Model tax treaty warranted?

Answer. The so-called “triangular rule” is intended to prevent abuses of the tax treaty through structures that use a permanent establishment in a third country to avoid taxes in both treaty jurisdictions. Because the potential for such abuses is higher in tax treaties with countries that apply an exemption system, the Treasury Department historically sought to include triangular rules only when the treaty partner applied an exemption system, either under its treaties or in its domestic law. However, for the past several years the Treasury Department has sought to include a triangular rule as a general practice in all of its tax treaties. The Treasury Department plans to incorporate the triangular provision into the U.S. Model in the future.

Question. The proposed treaty with Hungary includes 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. The U.S. Model treaty does not include these rules.

- Why were headquarters company rules included in the proposed treaty?
- Given that similar provisions have also been included in other recent treaties concluded by the United States, is a change to the U.S. Model tax treaty warranted?

Answer. A headquarters company rule is only appropriate where a treaty partner can demonstrate that failing to include such a rule would inappropriately prevent a substantial number of companies that have sufficient nexus with the treaty partner from obtaining appropriate treaty benefits. Because we frequently negotiate treaties with countries that do not have a significant number of true headquarters companies, it would not be appropriate to include such a provision in the U.S. Model.

In the case of Hungary, it is common in the European Union for groups of corporations spanning several countries to centralize management in a single headquarters company. Hungary was concerned that certain existing Hungarian headquarters companies would fail to qualify for benefits without such a rule. As a result, the proposed treaty with Hungary includes a provision designed to grant treaty benefits only to companies providing overall supervision and administration of a multinational group, and not engaging in tax avoidance activities. The headquarters company rule in the proposed treaty is identical to the rule we have agreed to in certain other treaties in the past.

Question. Under the proposed treaty with Hungary, are treaty countries required to exchange information in response to specific requests that are comparable to “John Doe” summonses under U.S. domestic law?

Answer. Hungary has been a cooperative information exchange partner under the existing treaty relationship, and Treasury expects that this cooperative relationship will continue under the proposed treaty. The language in the proposed treaty with Hungary regarding the exchange of tax information was intentionally drafted to be identical in substance to Article 26 of the OECD Model Tax Convention, as well as the relevant text of the OECD Model TIEA, which provides for exchange of information in a broad range of circumstances where it is foreseeably relevant to the administration or enforcement of either treaty partner’s tax laws. In the case of specific requests for information, the Commentary to the OECD Model TIEA states that a request for information triggering the obligations to exchange information does not necessarily have to include the name of the accountholder under investigation. As part of our negotiations with Hungary, we confirmed that Hungary concurs that the language in the proposed treaty regarding exchange of information was drafted to reflect the OECD standards and that therefore, that language’s interpretation should be consistent with OECD standards for information exchange.

Question. In recent years, there has been concern that multinational corporations are using tax treaties to avoid U.S. income taxes. It my understanding that the Treasury Department does not believe legislation which limits treaty benefits is necessary. Can you explain why the Department believes that legislation is not necessary and what actions the Department has taken to prevent tax treaties from being exploited in an effort to avoid U.S. income taxes?

Answer. While the Treasury Department shares the concern that U.S. tax treaties must be adequately protected from treaty shopping abuses, it is our view that the issue should be addressed through bilateral negotiations, not a unilateral treaty override. Overriding treaties unilaterally would strain our existing tax treaty relationships and would jeopardize our ability to achieve U.S. objectives in future tax treaty negotiation and to object to treaty overrides by other countries. Treasury has made significant progress addressing this issue through bilateral negotiations. The proposed tax treaty with Hungary includes a comprehensive limitation on benefits provision and represents a major step forward in protecting the U.S. tax treaty network from abuse. As was discussed in the Treasury Department's 2007 Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties, the existing income tax treaty with Hungary, which was signed in 1979, is one of three U.S. tax treaties that, as of 2007, provided an exemption from source-country withholding on interest payments, but contained no protections against treaty shopping. The other two agreements in this category were the 1975 tax treaty with Iceland and the 1974 tax treaty with Poland. The revision of these three agreements has been a top priority for the Treasury Department's treaty program, and we have made significant progress. In 2007, we signed a new tax treaty with Iceland which entered into force in 2008. Like the proposed tax treaty with Hungary, the U.S.-Iceland tax treaty contains a comprehensive limitation on benefits provision. In addition, the Treasury Department has recently concluded negotiation of a new income tax treaty with Poland, which the administration hopes to sign and transmit to the Senate for its advice and consent in the near future. Based on these experiences, we believe that addressing concerns about treaty shopping is best done through bilateral negotiations and amendment of our existing tax treaties.

RESPONSES OF BRUCE SWARTZ TO QUESTIONS SUBMITTED BY SENATOR BENJAMIN L. CARDIN

Question. In response to a question during your June 7, 2011, testimony concerning whether the United States would be hindered in its acquisition of evidence in capital punishment cases due to Bermuda's position that it may deny assistance under the "essential interests" or "important public policy" provisions of article 3 of the Bermuda MLAT, you indicated that the United States has a track record of resolving such issues with other MLAT partner countries that take a similar position on capital punishment. Please describe that "track record" in more detail.

Answer. Bermuda abolished the death penalty in December 1999 and, during negotiations over the Mutual Legal Assistance Treaty, sought the ability to deny assistance in all such cases. At the same time, the United States sought to ensure that the treaty preserved the ability of the United States to request and obtain assistance, on a case-by-case basis, even where the possible sentence for one of the offenses under investigation included the death penalty. Ultimately, no express restriction was included in the treaty, but Bermuda advised the United States that it intends to interpret article 3, paragraph 1a of the treaty to give Bermuda the right to deny assistance in cases involving capital punishment. Although the United States made clear in negotiations its view that assistance should be possible in such cases, the United States indicated to Bermuda that it understood Bermuda's intention.

The provision of the treaty that is in question is a standard clause found in most mutual legal assistance treaties and states the following: "The Central Authority of the Requested Party may deny assistance if . . . the Requested Party is of the opinion that the request, if granted, would impair its sovereignty, security, or other essential interests or would be contrary to important public policy."

Prior to denying assistance in a specific case upon these grounds, Bermuda first must consult with the United States, as required by article 3, paragraph 2, of the treaty. As a result of such consultations, the United States is hopeful that it still will be possible to obtain all necessary and relevant assistance from Bermudan authorities.

The death penalty issue is not unique to Bermuda. A number of countries in Europe and other parts of the world have raised similar concerns about providing mutual legal assistance to the United States in cases potentially involving the death penalty. In fact, the issue specifically arose during the negotiation of the mutual legal assistance treaty with Australia. At the time of signing, Australia and the United States exchanged diplomatic notes setting forth the understanding of the parties that the term "essential interests" in article 3 of the Australia treaty would be interpreted to include certain limitations on assistance set forth in Australian domestic law, which includes a discretionary limitation on providing assistance in death penalty cases. See Treaty with Australia on Mutual Assistance in Criminal Matters (1997), S. Treaty Doc. 105–27, at p. VI.

If a foreign authority raises a concern about the possibility of the death penalty when responding to a request for mutual legal assistance, the United States engages in consultations with the foreign authority in an attempt to resolve that concern and obtain all necessary and relevant assistance in aid of the United States investigation. For example, foreign authorities may agree that it is premature to deny a request on death penalty grounds in the early stages of an investigation simply because the investigation's initial scope potentially includes offenses carrying the death penalty. In addition, in some cases, as part of the consultation process, foreign authorities have been willing to provide the United States a "preview" of the requested evidence so that a determination can be made as to its true relevance and value to the United States investigation. If the evidence is determined to have little or no value to the United States investigation, the matter simply is closed. On the other hand, if the evidence is determined to have substantial value or the foreign authority will not provide a preview of the evidence to make this determination, the United States will discuss the possibility of accepting the evidence under negotiated conditions. In general, these conditions have included assurances (1) not to introduce the evidence in the actual penalty phase of a death penalty case; (2) to use the requested information only for investigatory purposes, with the understanding that it will not be introduced as evidence in any legal proceeding; or (3) not to impose the death penalty (or, if it is imposed, not to carry it out) in the particular case at issue. The third category of conditions has been undertaken very rarely and, to our knowledge, only in cases in which it was unlikely that the death penalty would have been sought in any event. In a small number of cases, it has not been possible to negotiate conditions acceptable both to the United States and to the foreign authority, with the result that the United States was unable to obtain the requested assistance. However, in most cases the United States has been successful in resolving any concerns about the death penalty and obtaining the requested assistance in the manner described above. Based upon this track record, the United States is hopeful that it will be possible to request and obtain assistance under the mutual legal assistance treaty with Bermuda on a case-by-case basis, even where the possible sentence for one of the offenses under investigation includes the death penalty.

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