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ADDITIONAL PROTOCOL MODIFYING THE INCOME TAX CONVENTION WITH MEXICO

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

REPORT

[To accompany Treaty Doc. 103–31, 103rd Congress, 2d Session]

The Committee on Foreign Relations, to which was referred the Additional Protocol that Modifies the Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Washington on September 18, 1992 (the additional protocol was signed at Mexico City on September 8, 1994), having considered the same, reports favorably thereon, without amendment, and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The purpose of the proposed additional protocol is to broaden the scope of the current treaty's provisions relating to the exchange of information between the United States and the United Mexican States (″Mexico″). The proposed additional protocol's amendments to these rules permits the exchange of information with respect to the administration and enforcement of taxes imposed by States, municipalities, or other political subdivisions or local authorities of the two countries.

II. BACKGROUND

The proposed additional (second) protocol (″proposed additional protocol″) to the income tax treaty between the United States and Mexico was signed in Mexico City on September 8, 1994. The proposed additional protocol would amend the current U.S.-Mexico income tax treaty, as amended by the first protocol, both of which

were signed in Washington, D.C. on September 18, 1992, and entered into force on December 28, 1993.

The proposed additional protocol was transmitted to the Senate for advice and consent to its ratification on September 19, 1994 (see Treaty Doc. 103-31). The proposed additional protocol was the subject of a hearing before the Senate Committee on Foreign Relations on June 13, 1995.

III. Summary

The proposed additional protocol revises Article 27 (Exchange of Information) of the current income tax treaty between the United States and Mexico. The revisions entail two specific changes to the current treaty. First, the proposed additional protocol eliminates specific reference in that article to the Agreement Between the United States of America and the United Mexican States for the Exchange of Information with Respect to Taxes that was signed on November 9, 1989 (the "Tax Information Exchange Agreement" or "TIEA"). Such change incorporates into the income tax treaty's exchange of information provisions any amendments or revisions to the TIEA or to any subsequent agreement for the exchange of information which might supersede the TIEA. A proposed protocol to the TIEA (the "TIEA protocol"), which is not subject to Senate advice and consent, was signed by the two countries on September 8, 1994.

Second, the proposed additional protocol makes the exchange of information provisions applicable to any tax covered by any exchange of information agreement between the two countries. Under the current treaty, exchange of information applies with respect to all taxes imposed in either country at the Federal level. Taxes presently covered by the TIEA's provisions are the Federal income taxes, Federal taxes on employment income, and Federal excise taxes imposed by either the United States or Mexico. Also covered are the Federal taxes on transfers to avoid income tax and the Federal estate and gift taxes imposed by the United States, and the Federal taxes on business assets and Federal value added taxes imposed by Mexico.

The TIEA protocol increases the scope of taxes covered by the TIEA. Under the TIEA protocol, taxes covered by the TIEA include taxes imposed by a State, municipality, or other political subdivision or local authority of either the United States or Mexico. The TIEA does not, however, cover taxes imposed by a possession of either country. Moreover, the proposed additional protocol provides that if no TIEA or similar agreement were in effect, the income tax treaty's exchange of information provisions are extended to cover sub-Federal-level taxes imposed in either country. The effect of the TIEA protocol coupled with the proposed additional protocol to the income tax treaty is to extend application of the income tax treaty's exchange of information provisions to such sub-Federal-level taxes.

IV. Entry Into Force

The proposed additional protocol will enter into force when the instruments of ratification are exchanged.

V. Committee Action

The Committee on Foreign Relations held a public hearing on the proposed additional protocol to the income tax treaty between the United States and Mexico, and on other proposed tax treaties and protocols, on June 13, 1995. The hearing was chaired by Senator Thompson. The Committee considered the proposed additional protocol to the income tax treaty between the United States and Mexico on July 11, 1995, and ordered the proposed additional protocol favorably reported by a voice vote, with the recommendation that the Senate give its advice and consent to the ratification of the proposed additional protocol.

VI. Committee Comments

On balance, the Committee believes that this additional protocol is in the interest of the United States and urges that the Senate act promptly to give its advice and consent to ratification. The Committee has taken note of certain issues raised by the proposed additional protocol, and believes that the following comments may be useful to U.S. Treasury officials in providing guidance on these matters should they arise in the course of future treaty negotiations.

The proposed additional protocol between the United States and Mexico extends application of the income tax treaty's information-exchange program to cover taxes imposed by sub-Federal-level taxing authorities, such as States, counties, cities, etc., of either country. Thus, for example, the proposed additional protocol could require one country to obtain and provide information to the other country, if so requested, which might assist one or more of the other country's State or local taxing authorities in administering and enforcing the various taxes (e.g., sales and use taxes, property taxes, franchise taxes, income taxes, inheritance taxes) imposed by such authority.

The income tax treaty exchange of information provision, as implemented by the TIEA, imposes on the competent authority of a country the obligation to use all legal means and its best efforts to execute a request for information from the other competent authority. Specifically, the two countries are to cooperate with one another to carry out the objective of facilitating the exchange of information between them on the assessment and collection of taxes, with a view to better enable them to prevent fiscal evasion and fraud, and to develop improved information sources for tax matters. As a general rule, if the competent authority of one country requests assistance as specified under the TIEA, the competent authority of the other country must execute the request, except to the extent that such execution would cause the requested competent authority to exceed its legal authority or would otherwise be prohibited by the laws of that other country. A competent authority is not required to comply with a request for assistance if the information requested is not obtainable under the laws of that country or in the normal course of its administration. In such cases where a request cannot be complied with in the manner requested, the two competent authorities are to consult with one another to establish alternative lawful means for rendering assistance.

In addition, a competent authority of a country is not required to comply with a request for assistance to the extent that (1) such compliance would in its judgment be contrary to the country's national security or public policy; (2) the supplying of requested information would disclose any trade, business, industrial, commercial, or professional secret or trade process; (3) the request does not comply with the provisions of the TIEA; or (4) the supplying of the requested information would discriminate against a national of the country whose competent authority is receiving the request.

The TIEA defines "information" for the purpose of information exchange as any fact or statement, in whatever form, that may be relevant or material to tax administration and enforcement, including (but not limited to) testimony of an individual, and documents, records or other personal property of a person or of one of the countries. Such information includes information to effect the determination, assessment, and collection of tax, the recovery and enforcement of tax claims, or the investigation or prosecution of tax crimes or crimes involving the contravention of tax administration. Under the TIEA, the competent authorities are to automatically transmit information to each other for this purpose, and are to determine the items of information to be exchanged and the procedures to be used.

A competent authority is required to transmit spontaneously to the other competent authority information which has come to its attention and which is likely to be relevant to, and bear significantly on, accomplishment of the purposes of the exchange of information provisions. It is further required to take such measures and implement such procedures as are necessary to ensure that information is forwarded to the other competent authority.

If information in the tax files of a competent authority is insufficient to comply with a request, the competent authority is to take all necessary measures to provide the requesting country with the information requested. The requested competent authority is granted the authority (1) to examine any books, papers, records, or other tangible property which may be relevant or material to the inquiry; (2) to question any person having knowledge of or in possession, custody or control of information which may be relevant or material to the inquiry; (3) to compel any person having knowledge or in possession, custody or control of information which may be relevant or material to the inquiry to appear at a stated time and place and testify under oath and produce books papers, records, or other tangible property; and (4) to take such testimony of any individual under oath. If information is requested of a competent authority, the competent authority is to obtain the information requested in the same manner, and provide it in the same form, as if the tax of the requesting country were the tax of the requested country and were being imposed by it.

Extension of coverage of exchange-of-information provisions to taxes imposed below the Federal level is unprecedented under U.S. income tax treaties and tax information exchange agreements currently in force. No other proposed treaty containing such a provi-

sion has ever come before the Committee for its consideration.[1] As described above, the exchange of information provisions place considerable levels of responsibility on the competent authority of each country to respond to requests for assistance by the other competent authority. The Committee observes that it would be undesirable if extension of information-exchange responsibilities in such a manner in this or other future treaties placed an unmanageable administrative burden on the U.S. competent authority. The Committee also anticipates that these consequences will not arise, in light of the fact that the Treasury Department's Technical Explanation of the TIEA protocol indicates that the competent authorities will develop mechanisms to ensure the effective and efficient administration of these exchange-of-information provisions.

The Committee observes that the extension of coverage to sub-Federal-level taxes in this treaty may be viewed by other treaty partners as precedent setting and may lead to a desire for the inclusion of similar provisions in treaties with other countries where extensive sub-Federal-level taxes are imposed. However, the Committee observes that the Treasury Department has stated that relatively few current or potential treaty partners have extensive sub-Federal-level taxes. Consequently, this issue may not arise in many future treaty negotiations.

In its hearings on the proposed additional protocol, the Committee requested the Treasury Department to provide additional information regarding the protocol. Relevant portions of Treasury's response to this inquiry, contained in a July 5, 1995 letter from Joseph H. Guttentag, International Tax Counsel, to Senator Thompson, are reproduced below:

> 1. What will the administrative burdens of this Protocol be on the United States?
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> The Internal Revenue Service will carry out the provisions of the Protocol. The IRS has participated in a dialogue with the Mexican competent authority and the Border States Caucus concerning how information flows to and from the states can be managed most efficiently. Upon ratification, the IRS will meet with the Border States Caucus and the Mexican competent authority to complete and implement the necessary procedures. This provision was agreed only after careful consideration of the administrative ramifications it would have on federal and state tax authorities. The IRS is well-equipped to administer this provision and we do not anticipate that performing its obligations under the Protocol will unduly tax the IRS' re-

[1] The Convention on Mutual Administrative Assistance in Tax Matters, among the member States of the Council of Europe and the Organization for Economic Co-operation and Development (OECD), applies to taxes imposed by political subdivisions and local authorities (Article 2, subparagraphs 1(b)(i) and 1(b)(iv), Senate Treaty Doc. 101–6, November 8, 1989). The Convention entered into force on April 1, 1995. The United States ratified the Convention subject to a reservation that the United States will not provide any form of assistance with respect to taxes imposed by or on behalf of possessions, political subdivisions, or local authorities. The proposed U.S.-Canada protocol, also ordered reported on July 11, 1995, extends the exchange-of-information provisions below the Federal level in a much more limited way than would occur under the U.S.-Mexico protocol. The U.S.-Canada protocol allows the United States to provide its sub-Federal-level entities with information (in specified circumstances) that the United States has previously obtained for its own purposes, but does not permit the United States to request information on behalf of its sub-Federal-level entities.

sources. Moreover, the provision of information by the Mexican tax authorities will reduce administrative burdens on tax authorities in the United States.

2. Will Mexico be able to meet its administrative burdens under the Protocol?

Yes. Mexico's ability to provide information has grown continuously since the inception of the information exchange program between the United States and Mexico, which dates back to the entry into force of the Tax Information Exchange Agreement in 1989. The Mexican tax authorities are committed to ensuring that the exchange contemplated under the pending protocol is accomplished properly and efficiently.

3. Will such a provision be a precedent for future treaties?

Like all tax treaty provisions, exchange of information provisions are tailored to meet the administrative needs of the tax administrators and taxpayers in the two countries. There are few current or potential treaty partners with extensive sub-federal-level taxes. Consequently, this issue is not likely to arise in many future treaty negotiations. However, it is possible that a similar provision would be included in a future treaty where, as in this case, the facts and circumstances indicate that it would be in the interests of federal and state tax administrators and taxpayers.

4. Why does the Canadian protocol not contain a similar provision?

The Canadian protocol makes tax information available to sub-federal jurisdictions to a more limited extent. Under the Canadian protocol, the IRS may provide information received from Canada to a state only when the information is relevant to taxes that are substantially similar to the federal taxes covered by the treaty (e.g., income taxes). The U.S. and Canadian negotiators determined that this provision was adequate to meet their needs.

VII. Budget Impact

The Committee has been informed by the staff of the Joint Committee on Taxation that the proposed additional protocol would cause minimal increases in fiscal year receipts between 1995 and 2000.

VIII. Explanation of Additional Protocol Provisions

For a detailed explanation of the proposed additional protocol, see the "Treasury Department Technical Explanation of the Additional Protocol Signed at Mexico City, on September 8, 1994, and Modifying the Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Signed at Washington, D.C., on September 18, 1992."

IX. Text of the Resolution of Ratification

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Additional Protocol that Modifies the Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Washington on September 18, 1992. The Additional Protocol was signed at Mexico City on September 8, 1994 (Treaty Doc. 103–31).