113TH CONGRESS
2nd Session

SENATE

EXEC. REPT.
113–7

PROTOCOL AMENDING TAX CONVENTION WITH SWITZERLAND

APRIL 29, 2014.—Ordered to be printed

Mr. MENENDEZ, 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 and conditions related to reporting on mandatory arbitration, 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 Swit-

39–119

zerland (the "Treaty") into conformity with current U.S. tax treaty 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 1. 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 that the tax authorities of 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 February 26, 2014. Testimony was received from Robert Stack, Deputy Assistant Secretary (International Tax Affairs) at the U.S. Department of the Treasury, Thomas Barthold, Chief of Staff of the Joint Committee on Taxation, William Reinsch, President of the National Foreign Trade Council, Paul Nolan, Vice President, Tax for McCormick & Company, Inc., and Nancy McLernon, President & CEO of the Organization for International Investment. A transcript of the hearing is included in Annex 2 of this report.

On April 1, 2014, 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 that 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. CONDITIONS RELATED TO REPORTING ON MANDATORY ARBITRATION

The committee has included conditions in the recommended resolution of advice and consent. These types of conditions have been included in prior resolutions of advice and consent for tax treaties that provide for mandatory arbitration.

Specifically, not later than 2 years after the Protocol enters into force and prior to the first arbitration conducted pursuant to the binding arbitration mechanism provided for in the Protocol, the Secretary of the Treasury is required to transmit to the Committees on Finance and Foreign Relations of the Senate and the Joint Committee on Taxation the text of the rules of procedure applicable to arbitration panels, including conflict of interest rules to be applied to members of the arbitration panel.

In addition, not later than 60 days after a determination has been reached by an arbitration panel in the tenth arbitration proceeding conducted pursuant to the Protocol or any similar treaties specifically identified, the Secretary of the Treasury must submit to the Joint Committee on Taxation and the Committee on Finance of the Senate a detailed report regarding the operation and application of the arbitration mechanism contained in the Protocol and such treaties. The Secretary of the Treasury is further required to submit this type of report on March 1 of the year following the year in which the first report is submitted, and on an annual basis thereafter for a period of five years. Finally, the section clarifies that these reporting requirements supersede the reporting requirements contained in paragraphs (2) and (3) of section 3 of the resolution of advice and consent to ratification of the 2009 France Protocol, approved by the Senate on December 3, 2009.

E. 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 October 2, 1996, signed September 23, 2009, at Washington, with a related agreement effected by an exchange of notes September 23, 2009, as corrected by an exchange of notes effected November 16, 2010 (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.

SECTION 3. CONDITIONS

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

(1) Not later than 2 years after the Protocol enters into force and prior to the first arbitration conducted pursuant to the binding arbitration mechanism provided for in the Protocol, the Secretary of the Treasury shall transmit to the Committees on Finance and Foreign Relations of the Senate and the Joint Committee on Taxation the text of the rules of procedure applicable to arbitration panels, including conflict of interest rules to be applied to members of the arbitration panel.

(2)(A) Not later than 60 days after a determination has been reached by an arbitration panel in the tenth arbitration proceeding conducted pursuant to the Protocol or any of the treaties described in subparagraph (B), the Secretary of the Treasury shall prepare and submit to the Joint Committee on Taxation and the Committee on Finance of the Senate, subject to laws relating to taxpayer confidentiality, a detailed report regarding the operation and application of the arbitration mechanism contained in the Protocol and such treaties. The report shall include the following information:

(i) For the Protocol and each such treaty, the aggregate number of cases pending on the respective dates of entry into force of the Protocol and each treaty, including the following information:

(I) The number of such cases by treaty article or articles at issue.

(II) The number of such cases that have been resolved by the competent authorities through a mutual agreement as of the date of the report.

(III) The number of such cases for which arbitration proceedings have commenced as of the date of the report.

(ii) A list of every case presented to the competent authorities after the entry into force of the Protocol and each such treaty, including the following information regarding each case:

(I) The commencement date of the case for purposes of determining when arbitration is available.

(II) Whether the adjustment triggering the case, if any, was made by the United States or the relevant treaty partner.

(III) Which treaty the case relates to.

(IV) The treaty article or articles at issue in the case.

(V) The date the case was resolved by the competent authorities through a mutual agreement, if so resolved.

(VI) The date on which an arbitration proceeding commenced, if an arbitration proceeding commenced.

(VII) The date on which a determination was reached by the arbitration panel, if a determination was reached, and an indication as to whether the panel found in favor of the United States or the relevant treaty partner.

(iii) With respect to each dispute submitted to arbitration and for which a determination was reached by the arbitration panel pursuant to the Protocol or any such treaty, the following information:

(I) In the case of a dispute submitted under the Protocol, an indication as to whether the presenter of the case to the competent authority of a Contracting State submitted a Position Paper for consideration by the arbitration panel.

(II) An indication as to whether the determination of the arbitration panel was accepted by each concerned person.

(III) The amount of income, expense, or taxation at issue in the case as determined by reference to the filings that were sufficient to set the commencement date of the case for purposes of determining when arbitration is available.

(IV) The proposed resolutions (income, expense, or taxation) submitted by each competent authority to the arbitration panel.

(B) The treaties referred to in subparagraph (A) are—

(i) the 2006 Protocol Amending the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, done at Berlin June 1, 2006 (Treaty Doc. 109–20) (the "2006 German Protocol");

(ii) the Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, and accompanying protocol, done at Brussels July 9, 1970 (the "Belgium Convention") (Treaty Doc. 110–3);

(iii) the Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital, signed at Washington September 26, 1980 (the "2007 Canada Protocol") (Treaty Doc. 110–15); or

(iv) the Protocol Amending the Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Paris August 31, 1994 (the "2009 France Protocol") (Treaty Doc. 111–4).

(3) The Secretary of the Treasury shall prepare and submit the detailed report required under paragraph (2) on March 1 of the year following the year in which the first report is submitted to the Joint Committee on Taxation and the Committee on Finance of the Senate, and on an annual basis thereafter for a period of five years. In each such report, disputes that were resolved, either by a mutual agreement between the relevant competent authorities or by a determination of an arbitration panel, and noted as such in prior reports may be omitted.

(4) The reporting requirements referred to in paragraphs (2) and (3) supersede the reporting requirements contained in paragraphs (2) and (3) of section 3 of the resolution of advice and consent to ratification of the 2009 France Protocol, approved by the Senate on December 3, 2009.

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 thirdcountry 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 FEBRUARY 26, 2014

TREATIES

WEDNESDAY, FEBRUARY 26, 2014

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

The committee met, pursuant to notice, at 10:31 a.m., in room SD–419, Dirksen Senate Office Building, Hon. Benjamin L. Cardin presiding.

Present: Senators Cardin and Barrasso.

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

Senator CARDIN. Good morning and welcome to the Senate Foreign Relations Committee hearing dealing with treaties that are currently pending before the United States Senate.

I want to thank Senator Menendez and Senator Corker for allowing Senator Barrasso and I to conduct this hearing. It is a very important area, the Senate consideration of treaties under the Constitution.

So today we will consider five treaties that are before the Senate, a tax treaty with Hungary, a tax treaty with Chile, an amendment of a tax treaty with Switzerland, an amendment of a tax treaty with Luxembourg, and the Convention on Mutual Administration Assistance on Tax Matters.

The primary purpose of tax treaties is to avoid double taxation so that U.S. companies can do business overseas and not be discriminated against, and foreign companies can do business in the United States.

The second primary function is to aid enforcement of our respective tax laws to combat tax evasion and corruption.

Now, there are many other side benefits in addition to avoiding double taxation and assisting in proper tax administration. The side benefits of tax treaties are open markets. It is a clear signal of our willingness to do business in other countries. It removes barriers to trade. And it also encourages new countries to join our treaty network, making it easier for us to do international business.

Specifically, the five treaties that are before us, Hungary, this tax treaty was completed in 2010, and it prevents treaty shopping by using uniform rules to determine the applicable laws. Chile represents over a decade of negotiations and the completion of a tax treaty.

I note that if the Chilean treaty is ratified it would be the third Latin American country that we will have a tax treaty with. This is a region in our hemisphere that is critically important to the United States. So moving forward with tax treaties in our hemisphere is a matter of high priority.

And Switzerland and Luxembourg, these are amendments to treaties that were negotiated 3 years ago. They basically deal with the exchange of information. I do point out the timing of the Switzerland one is particularly relevant, in that the initial interest in modifying the treaty with Switzerland came out of a hearing in 2008, the Permanent Subcommittee on Investigation dealing with greater access for U.S. tax collectors on information from Switzerland. That has been the main reason for the amendments to the existing tax treaty with Switzerland. The same thing is true with Luxembourg, as far as access to information.

The convention similarly allows for the free exchange of information to assist in tax administration. It has 60 signatures.

Let me just make one final comment before yielding to Senator Barrasso. In three of these matters—Hungary, Luxembourg, and Switzerland—this is deja vu for me. I chaired a hearing on these three tax treaties in 2011, so these are not new to our committee.

They cleared our committee, were reported out, but we were not able to get them considered on the floor of the United States Senate.

I do welcome today's hearing, because it allows us to have an update on the three treaties we had previous hearings on, in addition to making a record on the other two treaties.

The difference between this hearing and the one in 2011, is in 2011, we only had administration witnesses. Today, we will also have witnesses from the private sector, which I think is also very helpful for us to establish a full record as to the need for the Senate to consider these tax treaties.

And I do hope that we will act promptly in the committee and also on the floor of the United States Senate, so that we can carry out one of our most important responsibilities, and that is the ratification of treaties entered into by the United States.

With that, let me yield to Senator Barrasso.

OPENING STATEMENT OF HON. JOHN BARRASSO, U.S. SENATOR FROM WYOMING

Senator BARRASSO. Thank you very much, Mr. Chairman.

I appreciate all of the witnesses being here today to talk about these five international tax treaties.

The United States has entered into numerous tax treaties with foreign countries to address double taxation. The treaties also attempt to prevent tax avoidance, tax evasion, through the exchange of sensitive tax-related information.

As we examine these treaties, it is important that we make sure that measures are in place to protect U.S. taxpayer information.

So I look forward to the hearing today, Mr. Chairman, and learning more about how the United States can benefit from these agreements.

Thank you, Mr. Chairman.

Senator CARDIN. We do have a statement from Credit Suisse that, without objection, will be made part of our record.

I know we are still waiting for Mr. Stack, but we will start with Mr. Barthold, the chief of staff of the Joint Committee on Taxation, a familiar face in the United States Senate. We normally see you in a different committee setting, but it is nice to see you in the Senate Foreign Relations Committee.

Mr. Barthold, we will start with your testimony.

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

Mr. BARTHOLD. Thank you very much, Chairman Cardin and Senator Barrasso. My name is Thomas A. Barthold. I am the chief of staff of the Joint Committee on Taxation, and it is my pleasure to present the testimony of the staff of the Joint Committee today concerning the proposed income tax treaties with Hungary and Chile, and the proposed tax protocols with Luxembourg and Sweden, and the proposed protocol amending the Multilateral Mutual Administrative Assistance Treaty.

The Joint Committee, as is our custom, has prepared pamphlets covering the proposed treaties and protocols, providing detailed descriptions of the protocols and treaties, making comparisons to the U.S. Model Income Tax Treaty, where appropriate. In addition, our pamphlets have provided a detailed discussion of issues raised by the proposed treaties and protocols.

My testimony today will highlight three issues related to the agreements before you today. I will focus on the limitation on benefits provisions in the treaties with Chile and Hungary, the general issues related to exchange of information, and the expansion of the Mutual Administrative Assistance agreement.

Regarding limitation on benefits provisions, like the U.S. Model, the proposed treaties with Chile and Hungary include extensive limitation on benefit rules. I note that this is a really important development in the case of Hungary, because the present treaty between the United States and Hungary is one of only seven U.S. income tax treaties that does not presently include any limitation on benefit rules.

Now, while the limitation on benefits rules in the proposed treaties with Chile and Hungary are similar to the rules in other recent treaties and similar to those in the U.S. Model, they are not identical. And I will highlight two particular differences.

First, there are provisions in the Hungary treaty related to what are called derivative benefits. This is like other recent treaties in that there are rules that are generally intended to allow a treaty country company to receive treaty benefits for an item of income if that company's owners reside in a country that is in the same trading bloc as the treaty country—Hungary, in this case—and would have been entitled to the same benefits for that income had those owners derived the income directly. In essence, this is a broadened sense of the notion of resident, for purposes of this tax treaty. The Chile treaty, on the other hand, like the U.S. Model treaty, does not include a derivative benefits rule.

Both the proposed treaties with Chile and Hungary include special rules intended to allow treaty country benefits for a resident of a treaty country that functions as a headquarters company. Again, this is a broadened notion of the idea of resident for purposes of these treaties. While U.S. income tax treaties in force with Austria, Australia, Belgium, the Netherlands, and Switzerland include similar rules for headquarters companies, the United States model treaty does not include these rules.

An increasingly important area of treaties, as the chairman noted, has been provisions related to the exchange of information, and I would like to highlight three points related to the treaties and protocols that are before you today.

One type of information exchange known as automatic exchange of information or routine exchange of information occurs when the treaty countries identify categories of information that are consistently relevant to the tax administration of the receiving treaty country and the countries agree to share such information on an ongoing basis. The United States, for example, is annually providing over 2½ million items of information about U.S. source income by residents of treaty countries in a number of different treaty relationships today.

In 2012, the Treasury finalized some regulations that expand information reporting by United States financial institutions on interest paid to nonresident aliens. Now, presently, we only routinely share that information with Canada. This is potentially a substantial expansion of the amount of information that we might be willing to share on an automatic basis, and I think that gives rise to questions related to what the Treasury hopes to achieve, if they, in fact, hope to achieve expanded sharing of this information. Do they have the administrative capability to expand the exchange of information that might be sought under the treaties that are before you today?

And more generally, since there have been issues related to how automatic information is exchanged—the requirements, the details—perhaps the committee might request some guidance from the Treasury related to the United States experience under present practice, and what they see as possible impediments to greater use of automatic exchanges and perhaps ideas also for improving those exchanges.

Now the second area of information exchange is referred to as specific requests for information. Specific exchange is an exchange that occurs when one treaty country provides information to the other 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.

Now, a problem that has arisen, and this has been a recurring issue with potential exchanges with Switzerland, has been that some treaty countries have declined to exchange information in response to specific requests intended to identify classes of persons. In the United States, an example of this is the John Doe summons for information. So the committee might be interested in the Treasury's views with respect to the agreements with Hungary, Chile, Luxembourg, and Sweden, as to whether the required exchange of information in response to specific requests will allow exchanges that are comparable to our John Doe summons.

The final point on exchange of information is there has been specific criticism by other countries of the United States regarding our standards for "know your customer rules" for financial institutions—are they in sync with foreign practice?—and the extent to which we can or cannot provide information on beneficial ownership of business entities in the United States.

Do these issues, do these areas of controversy, limit, perhaps, the Treasury's ability to make effective use of the reciprocal exchange agreements that are in place in these and other treaties?

Permit me to take a last moment just to highlight what I think is perhaps the most important aspect of the expansion of the Mutual Administrative Assistance agreement. This agreement opens membership in that Convention to states that are neither OECD nor Council of Europe members.

On one hand, the inclusive standard for permitting nations to participate has opened this Convention to a number of significant trade partners of the United States. On the other hand, it requires the United States to initiate an exchange of information program with jurisdictions with which we have not previously entered into any bilateral relationship.

So to the extent that there may be jurisdictions with whom the United States has no exchange of information program, a relevant question would be the extent to which we are able to satisfy ourselves that each jurisdiction is in fact an appropriate partner for exchange of information, and also, given the potential expansive nature of the number of countries included, whether it will be a manageable project for the Treasury Department to handle expanded information requirements.

A number of other issues are addressed in more detail in the Joint Committee pamphlets that I referenced earlier. I am happy to answer any questions that the committee may have at this time or in the future.

Thank you very much.

[The prepared statement of Mr. Barthold follows:]

Prepared Statement of Thomas A. Barthold

My name is Thomas A. Barthold. I am Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation today concerning the proposed income tax treaties with Hungary and Chile, the proposed tax protocols with Luxembourg and Switzerland, and the proposed protocol amending the Multilateral Mutual Administrative Assistance Ttreaty.[1]

OVERVIEW

As in the past, the Joint Committee staff has prepared pamphlets covering the proposed treaties and protocols.[2] The pamphlets provide detailed descriptions of the proposed treaties and protocols, including, in the case of the income tax treaties and protocols, comparisons with the United States Model Income Tax Convention of November 15, 2006 ("U.S. Model treaty"), which reflects preferred U.S. tax treaty policy, and with other recent U.S. tax treaties. The pamphlets also provide detailed discussions of issues raised by the proposed treaties and protocols. We consulted with the Treasury Department and with the staff of your committee in analyzing the proposed treaties and protocols and in preparing the pamphlets.

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

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

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

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

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

LIMITATION-ON-BENEFITS PROVISIONS IN TREATIES WITH CHILE AND HUNGARY

In general

Like the U.S. Model treaty, the proposed treaties with Chile and Hungary include extensive limitation-on-benefits rules (Chile, Article 24; Hungary, Article 22). Limitation-on-benefits provisions are intended to prevent third-country residents from 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 with Hungary represents a significant opportunity to mitigate treaty shopping. Nevertheless, your committee may wish to inquire of the Treasury Department as to its plans to address the remaining U.S. income tax treaties that do not include limitation-on-benefits provisions.

Contrasts with the U.S. Model treaty

Although the limitation-on-benefits rules in the proposed treaties with Chile and Hungary are similar to the rules in other recent and proposed U.S. income tax treaties and protocols and in the U.S. Model treaty, they are not identical, and your committee may wish to inquire about certain differences. In particular, your committee may wish to examine the rules for publicly traded companies, derivative benefits, and certain triangular arrangements. Your committee also may wish to ask the Treasury Department about the special limitation-on-benefits rules applicable to headquarters companies.

Publicly traded companies

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

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

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

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

Derivative benefits

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

Triangular arrangements

The proposed treaties with Chile and Hungary include special antiabuse rules intended to deny treaty benefits in certain circumstances in which a Chilean or Hungarian resident company earns U.S.-source income attributable to a third-country permanent establishment and is subject to little or no tax in the third jurisdiction and (as applicable) Chile or Hungary. A rule on triangular arrangements is not included in the U.S. Model treaty, but similar antiabuse rules are included in other recent treaties and protocols.

Headquarters companies

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

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

EXCHANGE OF INFORMATION

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

Although the United States has long had bilateral income tax treaties in force with Hungary, Luxembourg, and Switzerland, the United States has engaged in relatively limited exchange of information under these tax treaties. With Luxembourg and Switzerland, the limitations stem from strict bank secrecy rules in those jurisdictions. The proposed protocols with Luxembourg and Switzerland are a response to that history as well as part of the international trend in exchange of information.

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

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

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

Effectiveness of U.S. information exchange agreements in general

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

Automatic exchange of information

The OECD standards do not require exchange other than upon specific requests for information, although the language permits the treaty countries to agree to provide for other exchange mechanisms. The OECD, in its commentary to the exchange of information provisions in the OECD Model treaty, specifies that the treaty "allows" the competent authorities to exchange information in any of three ways that treaty countries have traditionally operated[10]—routine, spontaneous,[11] or specific exchanges.[12]

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

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

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

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

Ability of United States to provide beneficial ownership information

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

Specific requests for information

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

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

To the extent that there were perceived deficiencies in the former information exchange relationships with Luxembourg and Switzerland, to the extent that the United States may have little recent practical experience in cooperating with Chile or Hungary on tax matters, and to the extent that OECD peer reviews have concluded that impediments to effective information exchange exist in Chile, Hungary, Luxembourg, or Switzerland, your committee may wish to seek reassurances that any obstacles to effective information exchange have been eliminated.[24]

Information exchange with Luxembourg and Switzerland

Switzerland

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

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

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

Nevertheless, there are several areas in which questions about the extent to which the exchange of information article in the proposed protocol may prove effective are warranted. The proposed revisions to paragraph 10 of the 1996 protocol reflect complete adoption of the first element listed above in the Swiss negotiating position, "limitation of administrative assistance to individual cases and thus no fishing expeditions." The limitation poses issues regarding (1) the extent to which the Swiss will continue to reject requests that do not name the taxpayer as a result of the requirement that a taxpayer be "typically" identified by name, and (2) the standard of relevance to be applied to requests for information, in light of the caveat against "fishing expeditions." In addition, the appropriate interpretation of the scope of purposes for which exchanged information may be used may be unnecessarily limited by comments in the Technical Explanation. In particular, although paragraph 2 of Article 26 (Exchange of Information), as modified by the proposed protocol, generally prohibits persons who receive information exchanged under the article from using the information for purposes other than those related to the administration, assessment, or collection of taxes covered by the treaty, the paragraph also allows the information to be used for other purposes so long as the laws of both the United

States and Switzerland permit that use and the competent authority of the requested country consents to that use. The Technical Explanation, however, states that one treaty country (for example, the United States) will seek the other treaty country's (for example, Switzerland's) consent under this expanded use provision only to the extent that use is allowed under the provisions of the U.S.-Switzerland Mutual Legal Assistance Treaty that entered into force in 1977.

Luxembourg

The proposed protocol with Luxembourg, by replacing Article 28 (Exchange of Information and Administrative Assistance) of the 1996 treaty, is consistent with both the OECD and U.S. Model treaties. There are several areas in which questions are warranted about the extent to which the new article as revised in the proposed protocol may prove effective. These questions arise not from the language in the proposed protocol itself but from the mutual understandings reflected in diplomatic notes exchanged at the time the protocol was signed. Potential areas of concern are found in statements in the diplomatic notes concerning (1) the obligation to ensure tax authority access to information about beneficial ownership of juridical entities and financial institutions, other than publicly traded entities, to the extent that such information is of a type that is within the possession or control of someone within the territorial jurisdiction, (2) the requirement that all requests must provide the identity of the person under investigation, (3) the standard of relevance to be applied in stating a purpose for which the information is sought, and (4) the requirement that requests include a representation that all other means of obtaining the information have been attempted, except to the extent that to do so would cause disproportionate difficulties.

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

EXPANSION OF MUTUAL ADMINISTRATIVE ASSISTANCE AGREEMENT

One of the most significant changes to the multilateral convention made by the proposed protocol is the opening of membership in the convention to states that are neither OECD nor Council of Europe members. In the most recently available list of signatories, dated December 23, 2013, there are a number of countries who are not members of G20,[27] the OECD or the Council of Europe: Colombia, Costa Rica, Ghana, Guatemala, and Tunisia. All members of G20 are among the signatories. Those members of G20 who are not also members of either the OECD or Council of Europe include Argentina, Brazil, India, Indonesia, Saudi Arabia and South Africa. Thus, on the one hand, the inclusive standard for permitting nations to participate has opened the multilateral convention to a number of significant trade partners of the United States. On the other hand, it requires the United States to initiate an exchange of information program with jurisdictions with which it has not previously entered into a bilateral relationship. Among the signatories that have neither a tax treaty nor a TIEA with the United States are Albania, Andorra, Croatia, Ghana, Nigeria, Saudi Arabia, and Singapore.

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

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

CONCLUSION

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

End Notes

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

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

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

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

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

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

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

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

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

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

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

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

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

[14] Treas. Reg. sec. 1.6049–4(b)(5).

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

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

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

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

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

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

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

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

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

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

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

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

[27] G20, or the Group of Twenty, is a forum for international economic cooperation among the member countries and the European Union. The leaders of the members meet annually, while finance and banking regulators meet more frequently throughout the year. They work closely with a number of international organizations, including the OECD.

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

Senator CARDIN. Thank you for your testimony.

Mr. Stack, we understand you were delayed because of a lockdown near the White House, so we certainly understand that and look forward to hearing your testimony.

It is the practice of this committee that the written statements of all of our witnesses, without objection, will be made part of our record.

STATEMENT OF ROBERT STACK, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL TAX AFFAIRS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. STACK. Thank you, Mr. Chairman Cardin, Ranking Member Barrasso. And again, I do apologize for our lateness, and I appreciate your understanding.

I appreciate the opportunity to appear before you today to recommend favorable action on five tax agreements that are pending before this committee. As Senator Cardin has already indicated, the written statement will be made part of the record.

The proposed agreements before the committee today with Chile, Hungary, Luxembourg, and Switzerland, as well as the protocol to the Convention on Mutual Administrative Assistance in Tax Matters, which I will refer to today as the Multilateral Convention, serve to further the goals of our tax treaty network, in particular the goals of increased transparency and relief from double taxation.

Because my written statement and the technical explanations written by the Treasury Department provide detailed explanations of the provisions of the agreements, I would like to describe briefly only the most noteworthy aspects of each of these agreements.

Chile, the proposed income tax convention with Chile, if approved by the Senate and the Chilean legislature, would only be the second income tax convention in force in South America, a region into which the Treasury Department has long sought to expand the U.S. treaty network.

Because all tax conventions are the product of a negotiation, the proposed convention with Chile contains a number of variations from the U.S. Model practice, many of which are typically seen in U.S. tax treaties with developing countries. Other provisions reflect particular aspects of the Chilean tax system and treaty policy, which I am happy to discuss in further detail.

The proposed income tax convention with Hungary was negotiated to bring the current convention, signed in 1979, into closer conformity with current U.S. tax treaty policy. Most importantly, the proposed convention contains a comprehensive limitation on benefits provision designed to prevent third-party investors from inappropriately taking advantage of the treaty, a practice known as treaty shopping. The current convention does not contain a limitation on benefits article, and as result, has been abused by third country investors in recent years.

For this reason, revising the current convention has been a top tax treaty priority for the Department.

The proposed protocol with Luxembourg replaces the limited information exchange provisions of the existing tax convention with Luxembourg 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 laws of either country. 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 another financial institution.

The proposed protocol with Switzerland replaces the limited information exchange provisions of the existing tax convention with Switzerland with updated rules, which are substantively the same as those contained in the proposed protocol with Luxembourg, which I just described. The Treasury Department is hopeful that the proposed protocol with Switzerland, if approved by the Senate, will greatly improve the collaboration between the United States and Swiss revenue authorities to exchange information to enforce tax laws.

The proposed protocol with Switzerland also updates the provisions of the existing convention with respect to the mutual agreement procedure by incorporating mandatory binding arbitration of certain disputes that the tax authorities 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 the U.S. tax treaties with Germany, Belgium, Canada, and France, which have been approved by the Senate in recent years, and also includes the provisions that we have in the French agreement that were specifically indicated by this committee would be helpful addition to our arbitration provisions.

The proposed protocol to the Multilateral Convention, if approved by the Senate, would establish several new information exchange relationships for the United States, which would enhance the IRS's ability to fight tax evasion, but would also bring the exchange provisions in the Multilateral Convention up to modern standards.

The existing Multilateral Convention is open for signature by countries that are members of either the OECD or the Council of Europe. The proposed protocol amends the Multilateral Convention to allow any country to become a signatory provided all the other signatories are satisfied that such country has a sufficient legal framework to ensure that information exchanged pursuant to the agreement will be kept confidential.

Although the existing convention contains broad provisions for the exchange of information, it predates the current internationally agreed standards of information. Thus, the obligations contained in the existing convention are subject to certain domestic law limitations that could impede full exchange of information.

In particular, the existing convention does not require the provision of bank information on request, nor does it override so-called domestic tax interest requirements. Those are requirements that the supplying country itself have a tax interest in the information being sought by the requesting party, and the more modern agreements delete those requirements.

In contrast, the current internationally agreed standards on transparency and exchange of information provide for full exchange of information on request in all tax matters without regard to domestic tax interest requirement or bank secrecy laws.

The proposed protocol amends the existing convention in order to bring it into conformity with these internationally agreed standards, which are also reflected in the OECD's Model Tax Convention on Income and Capital and the U.S. Model Income Tax Convention.

In addition, the proposed protocol brings the confidentiality rules of the existing convention regarding exchanged information, and the limitations regarding the use of such information, in conformity with the United States and OECD models.

Consistent with the international recognition of the need for maximum transparency in tax matters, all five agreements before you today contain updated provisions for the full exchange of information between the tax authorities that are consistent with U.S. and international standards.

I would like to take the opportunity to assure the committee that as part of the Treasury Department's efforts to increase transparency in tax matters, we place a high priority on ensuring that information exchanged pursuant to an international tax agreement will not be misused by our treaty partners. The United States will only exchange tax information with a country if we are satisfied that the country has adequate confidentiality laws that will protect the information we provide.

Let me repeat our appreciation for the committee's interest in these agreements. We are also grateful for the assistance and cooperation of the staffs of the committee and of the Joint Committee on Taxation. And I would like to recognize the tireless work of our Treasury team.

We urge the committee and Senate to take prompt and favorable action on all of these agreements, and we would be happy to answer any questions you have.

[The prepared statement of Mr. Stack follows:]

PREPARED STATEMENT OF ROBERT B. STACK

Chairman Cardin, Ranking Member Barrasso, and distinguished members of the committee, I appreciate the opportunity to appear today to recommend, on behalf of the administration, favorable action on five 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 businesses and individuals 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 businesses and individuals are not subject to discriminatory taxation in foreign jurisdictions.

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, 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. In yet other cases, the United States seeks to establish new income tax treaties with countries in which there is significant U.S. direct investment, and with respect to which U.S. companies are experiencing double taxation that is not otherwise relieved by domestic law remedies, such as the U.S. foreign tax credit. 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 tax evasion.

Additionally, our tax treaties have long played an important role in helping to prevent tax evasion. 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 that is foreseeably 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 has long been a top priority for the United States in its tax treaty program. I would like to emphasize to the committee that as we establish exchange of information relationships, the administration places a high priority on ensuring that any information exchanged will be strictly protected by our treaty partners. The United States will only exchange tax information with a country if we are satisfied that the county will protect the information we have provided.

The proposed tax treaties before the committee today are with Chile, Hungary, Luxembourg, and Switzerland, in addition to the proposed protocol to the Convention on Mutual Administrative Assistance in Tax Matters (the "Multilateral Convention"), and each serves to further the goals of our tax treaty network. The proposed tax treaty with Chile would be the first tax treaty between the United States and Chile, which the U.S. business community has been calling for. The proposed tax treaty with Hungary would replace an existing treaty the revision of which has been a top tax treaty priority for the Treasury Department. It contains a comprehensive "limitation on benefits" article designed to address possible abusive treaty shopping. The proposed protocols with Luxembourg and Switzerland modify existing tax treaty relationships. The proposed protocol to the Multilateral Convention brings the Multilateral Convention, to which the United States is a party, into conformity with the current international standards for exchanges of information between tax authorities to combat tax evasion. We urge the committee and the Senate to take prompt and favorable action on all of these agreements.

Before talking about the proposed treaties in more detail, I would like to discuss some 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 two countries. One of the primary functions of tax treaties is to provide certainty to businesses and individual taxpayers regarding a threshold question with respect to international taxation: whether a taxpayer's cross-border activities will subject it to taxation by more than one country. 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 businesses and individual 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 tax 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 tax 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 tax treaty provides rules for determining the country of source for each category of income. Fourth, a tax 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 tax treaty provides for resolution of disputes between jurisdictions with the goal of avoiding 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 the 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 source country 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.

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. That is, 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 countries' 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, 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, United States and Poland signed a new tax treaty in February 2013 that similarly contains a comprehensive limitation on benefits provision. The administration hopes to transmit the new tax treaty with Poland 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.

CONSIDERATION OF ARBITRATION

Tax treaties cannot provide a stable investment environment unless the respective tax administrations of the two countries effectively implement the treaty. 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 timely and satisfactory resolutions. 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 and entered into force in 1991. 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, which require an exchange of diplomatic notes to enter into force, 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 merely providing the 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 merits of 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. This provision, in general terms, is similar to arbitration provisions in several of our recent protocols to amend treaties (Canada, Germany, Belgium, and France) that have been approved by the committee and the Senate over the last several 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.

The arbitration process in the proposed protocol 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 tax treaty 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 tax treaty 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, consistent with the committee's comment in its report on the Canada protocol. First, the proposed protocol with Switzerland allows the taxpayer who presented the original case that is subjected to arbitration to submit its views on the case for consideration by 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 ensuring that customary international law rules on treaty interpretation will apply.

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 rarely be utilized, but their presence will motivate the competent authorities to approach negotiations in ways that result in mutually agreeable conclusions without invoking the arbitration process.

We are hopeful that our desired objectives for arbitration are being realized, even though we are still in the early stages in our experience with arbitration and at this time cannot report definitively on the effects of arbitration on our tax treaty relationships. Our observation is that, where mandatory arbitration has been included in the treaty, the competent authorities are negotiating with greater intent to reach principled and timely resolution of disputes. Therefore, under the mandatory arbitration provision, double taxation is being effectively eliminated 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, France, and Canada. 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 the 2007 protocol to the Canada tax treaty.

In addition to the proposed protocol with Switzerland, we have concluded protocols to bilateral tax treaties with Spain and Japan that also incorporate mandatory binding arbitration. The administration hopes to transmit those new agreements to the Senate for its advice and consent soon. 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.

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 tax laws has long been a top priority for the United States. A key provision found in all modern U.S. tax treaties is a rule that obligates the competent authorities of the two countries to obtain and exchange information that is foreseeably relevant to tax administration. In recent years there has been a global recognition of the need to strive for greater transparency and for full exchange of information between revenue authorities to combat tax evasion, and the United States has taken a leading role in this movement.

The proposed protocols amending the bilateral tax treaties with Switzerland and Luxembourg and the Multilateral Convention that are before the committee today are intended to facilitate the exchange of information to prevent tax evasion and enhance transparency. These proposed 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.

The international standards on transparency and exchange of information for tax purposes are now virtually universally accepted in the global community. Indeed, all jurisdictions surveyed by the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) are now committed to implementing these standards. The Global Forum, now the largest international tax group in the world with 121 member jurisdictions and 12 observers, promotes exchange of information through a robust and comprehensive monitoring and peer review process by evaluating the compliance of jurisdictions with the international standards of transparency.

Initiated by the Organization for Economic Cooperation and Development (OECD), the Global Forum has been a driving force behind the acceptance and implementation of the international standards. The United States actively participates in the Global Forum. Treasury's Office of Tax Policy, the Office of General Counsel, and IRS Chief Counsel and Large Business and International Division have devoted substantial resources over the past 2 years both to the peer review of the U.S. rules and procedures and to our role as members of the Steering Group and Peer Review Group of the Forum. Since the Global Forum was reorganized in 2009, 124 peer reviews have been completed and published, and more than 1,500 agreements that provide for the exchange of tax information in accordance with the international standards have been signed throughout the world. Roughly 80 percent of the agreements which have been signed as of December 2012 are in force.

In addition, the G20 has, for the past several years, stressed the importance of quickly implementing the international standards for transparency and exchange of information. It also requested proposals to make it easier for developing countries to secure the benefits of the new cooperative tax environment, including a multilateral approach for the exchange of information.

Against the backdrop of the Global Forum and the G20 process, the proposed Protocol to the Multilateral Convention was adopted on May 27, 2010. The Multilateral Convention is an instrument that obligates its signatories to exchange information for tax purposes. However, because it was concluded in 1988, some of its provisions are now out of date and do not conform to the current international standards for transparency and exchange of information. In addition, the 1998 Convention is open only to member countries of either the Council of Europe or the OECD. The proposed Protocol to the Multilateral Convention conforms the existing agreement to the current international standards for exchange of information, and opens the agreement for signature and ratification by any country, provided that the Parties have provided unanimous consent. This important agreement is therefore a centerpiece to the global effort to improve transparency and foster full exchange of information between tax authorities.

ENSURING THE PROTECTION AND CONFIDENTIALITY OF INFORMATION EXCHANGED WITH OUR TREATY PARTNERS

As we modernize existing exchange of information relationships and establish new relationships, the administration is also strongly committed to ensuring that information that we provide our treaty partners will be strictly protected and treated as confidential. One of the critical principles under today's existing international standards for information exchange upon request is that the country receiving information must ensure that exchanged information is kept confidential and only used for legitimate tax administration purposes. Consistent with this standard, the United States will not enter into an information exchange agreement unless the Treasury Department and the IRS are satisfied that the foreign government has strict confidentiality protections. Specifically, prior to entering into an information exchange agreement with another jurisdiction, the Treasury Department and the IRS closely review the foreign jurisdiction's legal framework for maintaining the confidentiality of taxpayer information. Before entering into an agreement, the Treasury Department and the IRS must be satisfied that the foreign jurisdiction has the necessary legal safeguards in place to protect exchanged information and that adequate penalties apply to any breach of that confidentiality.

Even if an information exchange agreement is in effect, the IRS will not exchange information with a country if the IRS determines that the country is not complying with its obligations under the agreement to protect the confidentiality of information and to use the information solely for collecting and enforcing taxes covered by the agreement. The IRS also will not exchange any return information with a country that does not impose tax on the income being reported, because the information could not be used for the enforcement of taxes laws within that country.

With respect to the Multilateral Convention, a Coordinating Body, on which the United States sits, has been established for the express purpose of evaluating the domestic legal framework of countries that request to join the agreement to ensure that new parties will provide confidential treatment to information received under the agreement. Countries that do not have sufficient domestic laws or legal framework to guarantee the confidentiality of taxpayer information are not permitted to sign the proposed protocol to the Multilateral Convention.

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 to seek input regarding the areas on which we should focus our treaty network expansion and improve efforts, as well as regarding practical problems encountered under particular treaties or particular tax regimes.

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 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 laws, 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 tax 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 tax 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 the Treasury Department's bilateral dealing with countries around the world, we commonly conclude that the right result may be no tax treaty at all. With certain 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 unresolved double taxation of cross-border income, given the fact that the United States provides foreign tax credits to its residents regardless of the existence of an income tax treaty. Under such circumstances, it would not be appropriate to enter into a bilateral tax treaty, because doing so would result in a unilateral concession of taxing rights by the United States. When instances of unrelieved double taxation cannot be identified with respect to a country, an agreement that focuses exclusively on the exchange of tax information (so-called "tax information exchange agreements" or "TIEAs") may be the more fitting agreement to conclude.

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 conclude 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.

EXPANDING THE U.S. TAX TREATY NETWORK

While much of the Treasury Department's tax treaty negotiations involve modernizing existing agreements with key trading partners to close loopholes or improve the level of benefits to U.S. investors, we also engage with countries such as Chile to negotiate new tax treaties. The Treasury Department actively pursues opportunities to establish new tax treaty relationships with countries in which U.S. businesses encounter unrelieved double taxation with respect to their investments. The Treasury Department is aware of the keen interest of both the business community and the Senate to conclude income tax treaties with South American countries that provide meaningful benefits to cross-border investors. If approved by the Senate and the Chilean Congress, the tax treaty with Chile would be the second U.S. tax treaty in force in South America: therefore, the proposed tax treaty with Chile represents a significant inroad into the South American region. In addition, the Treasury Department is engaged in bilateral tax treaty negotiations with Colombia.

The Treasury Department is also developing new tax treaty relationships in other regions of the world. For example, we have held several rounds of negotiations with Vietnam, a country that U.S. businesses have listed as a priority because they have experienced unrelieved double taxation. We hope to conclude a tax treaty, which would be the first agreement of its kind between the United States and Vietnam, in the near future.

DISCUSSION OF PROPOSED TREATIES

I now would like to discuss the five tax treaties that have been transmitted for the Senate's consideration. The five 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 treaties, the treaties contain some minor variations that reflect particular aspects of the treaty policies and partner countries' domestic laws and 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.

Chile

The proposed Chile tax treaty is generally consistent with U.S. tax treaty policy as reflected in the United States Model Income Tax Convention of November 15, 2006 (the "U.S. Model"). There are, as with all bilateral tax treaties, some variations from these norms. In the proposed treaty, these variations from the U.S. Model reflect particular aspects of the Chilean tax system and treaty policy, the interaction of U.S. and Chilean law, and U.S.-Chile economic relations.

The proposed treaty provides for reduced source-country taxation of dividends distributed by a company resident in one country to a resident of the other country. The proposed treaty 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 treaty provides for an exemption from withholding tax on certain cross-border dividend payments to pension funds. In recognition of unique aspects of Chile's domestic tax system, the withholding rate reductions on dividend payments from Chile will generally not apply to Chile unless Chile makes certain modifications to its corporate tax system in the future.

Consistent with the U.S. Model, the proposed treaty contains special rules for dividends paid by U.S. regulated investment companies and real estate investment trusts to prevent the use of structures designed to inappropriately avoid U.S. tax.

The proposed treaty provides a limit of 4 percent on source-country withholding taxes on cross-border interest payments to banks, insurance companies and certain other financial enterprises. For the first 5 years following entry into force, the proposed treaty provides a limit of 15 percent on all other cross-border interest payments. After the initial 5-year period, the 15-percent limit is reduced to 10 percent for all other cross-border interest payments. In addition, consistent with the U.S. Model, source-country tax may be imposed on certain contingent interest and payments from a U.S. real estate mortgage investment conduit. The proposed treaty also permits the United States to impose its branch-level interest tax according to the applicable withholding rate reductions for cross-border interest payments.

The proposed treaty provides a limit of 2 percent on source-country withholding taxes on cross-border royalty payments that constitute a rental payment for the use of industrial, commercial or scientific equipment, and a limit of 10 percent on all other cross-border royalty payments.

The taxation of capital gains under the proposed treaty generally follows the format of the U.S. Model, with some departures in recognition of unique aspects of Chile's domestic tax system. Similar to the U.S. Model, gains derived from the sale of real property and real property interests may be taxed by the country in which the property is located. Likewise, gains from the sale of personal property forming part of a permanent establishment situated in a country may be taxed in that country. Gains from the alienation of shares or other rights or interests in a company may either be taxed at a maximum rate of 16 percent by the country in which the company is a resident, or in certain circumstances in accordance with that country's domestic law. However, the proposed treaty recognizes a unique aspect of Chile's domestic law and provides that these gains shall be taxable only in the country of residence of the seller if Chile makes certain modifications to its corporate tax system in the future. Certain other gains from the alienation of shares of a company are taxable only in the country of residence of the seller, such as gains derived by a pension fund. Furthermore, gains from the alienation of ships, boats, aircraft and containers used in international traffic, as well as gains from the alienation of any property not specifically addressed by the proposed treaty's article on capital gains, are taxable only in the country of residence of the seller.

The proposed treaty permits source-country taxation of business profits only if the business profits are attributable to a permanent establishment located in that country. The proposed treaty generally defines a "permanent establishment" in a way consistent with the U.S. Model. One Model departure that is also found in a number of other U.S. tax treaties with developing countries, deems an enterprise to have a permanent establishment in a country if the enterprise has performed services in that country for at least 183 days in a 12-month period.

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

The proposed treaty provides that an individual resident in one country and performing services in the other country will become taxable in the other country only if the individual has a fixed place of business (a so-called "fixed base"). The proposed treaty generally defines "fixed base" in a way consistent with the U.S. Model, with a departure also found in a number of U.S. tax treaties with developing countries which deems an individual to have a fixed base if he has performed services in that country for at least 183 days in the taxable year concerned.

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

The proposed treaty permits both the residence country and source country to tax pension payments, although the source country's taxation right is limited to 15 percent of the gross amount of the pension. Consistent with current U.S. tax treaty policy, the proposed treaty permits the deductibility of certain cross-border contributions to pension plans. Also consistent with current U.S. tax treaty policy, the proposed treaty provides for exclusive source-country taxation of social security payments.

The proposed treaty contains a comprehensive "limitation on benefits" article designed to address "treaty shopping," which is the inappropriate use of a tax treaty by residents of a third country. The limitation on benefits article is consistent with current U.S. tax treaty policy, although it contains a special rule for so-called "headquarters companies" that is also found in a number of other U.S. tax treaties.

The proposed treaty incorporates 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 Chilean tax rules to address the "mark-to-market" provisions enacted by the United States in 2007, which apply to individuals who relinquish U.S. citizenship or terminate long-term residency.

Consistent with the OECD and U.S. Models, the proposed treaty provides for the exchange between the competent authorities of each country of information that is foreseeably relevant to carrying out the provisions of the proposed treaty or enforcing the domestic tax laws of either country. The proposed treaty allows the United States to obtain information from Chile, including from Chilean financial institutions, regardless of whether Chile needs the information for its own tax purposes.

The proposed treaty will enter into force when the United States and Chile have notified each other that they have completed all of the necessary procedures required for entry into force. With respect to taxes withheld at source, the treaty will have effect for amounts paid or credited on or after the first day of the second month following the date of entry into force. With respect to other taxes, the treaty will have effect for taxable years beginning on or after the first day of January next following the date of entry into force.

Hungary

The proposed tax treaty and related agreement, which will be effected by exchange of notes with Hungary, were negotiated to bring tax treaty relations based on the existing tax treaty into closer conformity with current U.S. tax treaty policy. Entering into a new agreement has been a top tax treaty priority for the Treasury Department because the existing tax treaty with Hungary, signed in 1979, does not contain treaty shopping protections and, as a result, has been used inappropriately by third-country investors in recent years.

The proposed treaty contains a comprehensive "limitation on benefits" article designed to address treaty shopping. 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 includes a provision granting so-called "derivative benefits." The new limitation on benefits article also contains a special rule for so-called "headquarters companies" that is also found in a number of other U.S. tax treaties.

The proposed treaty incorporates updated rules providing 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 the United States enacted in 2007, which apply to individuals who relinquish U.S. citizenship or terminate long-term residency.

The withholding rates on investment income in the proposed treaty are the same as or lower than those in the current treaty. The proposed treaty provides for reduced source-country taxation of dividends distributed by a company resident in one country to a resident of the other country. The proposed treaty 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 treaty provides for an exemption from withholding tax on certain cross-border dividend payments to pension funds.

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

Consistent with the existing treaty, the proposed treaty 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 treaty generally follows the format of the U.S. Model. Gains derived from the sale of real property and 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 country may be taxed in that country. All other gains, including gains from the alienation of ships, boats, aircraft and containers used in international traffic, as well as gains from the sale of stock in a corporation, are taxable only in the country of residence of the seller.

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

The proposed treaty would change the rules currently applied under the existing treaty 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 treaty are similar to those under the U.S. Model. The general rule is that employment income may be taxed in the country where the employment is exercised unless three conditions constituting a safe harbor are satisfied.

The proposed treaty preserves the current treaty'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 and U.S. Models, the proposed treaty provides for the exchange between the tax authorities of each country of information relevant to carrying out the provisions of the proposed treaty or the domestic tax laws of either country. The proposed treaty 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 treaty would enter into force on the date of the exchange of instruments of ratification. With respect to taxes withheld at source, the treaty will have effect for amounts paid or credited on or after the first day of the second month following the date of entry into force. With respect to other taxes, the treaty will have effect for taxable years beginning on or after the first day of January next following the date of entry into force. The existing treaty will, with respect to any tax, cease to have effect as of the date on which the proposed treaty has effect with respect to such tax.

Luxembourg

The proposed protocol to amend the existing tax treaty 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 treaty's information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the current international standards for exchange of information. The proposed protocol allows the tax authorities of each country to exchange information 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. In addition, the proposed protocol 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. The agreed understandings include 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. The agreed understandings also provide that information shall be exchanged without regard to whether the conduct being investigated would be a crime under the laws of the requested country.

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 proposed protocol on that date.

Switzerland

The proposed protocol to amend the existing tax treaty with Switzerland and related agreement effected by exchange of notes were negotiated to bring the existing treaty, 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 they generally follow the OECD standard for exchange of information.

The proposed protocol replaces the existing treaty's information exchange provisions with updated rules that are consistent with current U.S. tax treaty practice and the current international standards for exchange of information. 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 treaty by incorporating procedural rules to govern requests for information and an agreement between 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 treaty with respect to the mutual agreement procedure by incorporating mandatory 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.

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

The proposed protocol would enter into force when the United States and Switzerland 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 information exchange, the proposed protocol would have effect with respect to requests for bank information that relate to any date beginning on or after the date the proposed protocol is signed. With respect to all other cases, the proposed protocol 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 proposed protocol enters into force and to cases that come under consideration after that date.

Protocol to the Multilateral Convention

On January 25, 1988, the OECD and the Council of Europe jointly opened for signature the Multilateral Convention, which the United States signed in 1989 and entered into force for the United States in 1995. The proposed protocol to the Multilateral Convention was negotiated to bring the Multilateral Convention into conformity with current international standards regarding exchange of information for tax purposes.

Although the Multilateral Convention contains broad provisions for the exchange of information, it predates the current internationally agreed standards on exchange of information. Thus, the obligations contained in the Multilateral Convention are subject to certain domestic law limitations that could impede full exchange of information. In particular, the Multilateral Convention does not require the exchange of bank information on request, nor does it override domestic tax interest requirements. In contrast, the current internationally agreed standards on transparency and exchange of information provide for full exchange of information upon request in all tax matters without regard to a domestic tax interest requirement or bank secrecy laws. The proposed protocol amends the Multilateral Convention in order to bring it into conformity with these internationally agreed standards, which are also reflected in the OECD's Model Tax Convention on Income and Capital and the U.S. Model tax treaty. In addition, the proposed protocol brings the confidentiality rules of the Multilateral Convention regarding exchanged information and the limitations regarding the use of such information into conformity with the OECD and U.S. Models.

The Multilateral Convention specifies information the applicant country is to provide the requested country when making a request. In some situations, the name of the person under examination is not known to the applicant country, but there is other information sufficient to identify the person. The proposed protocol amends the Multilateral Convention by providing that a request for assistance is adequate even if the name of the person(s) under examination is not known, provided that the request contains sufficient information to identify the person or ascertainable group or category of persons.

The original Multilateral Convention was open for signature and ratification only by countries which are members of the Council of Europe, the OECD, or both. The proposed protocol amends the Multilateral Convention by allowing any country to become a party thereto. However, countries which are not members of the OECD or of the Council of Europe may only become a party to the amended Convention subject to unanimous consent of the parties to the amended Convention.

The Multilateral Convention as amended by the proposed protocol entered into force on June 1, 2011, for countries that signed and ratified it prior to that date. For countries that ratify subsequent to that date, the Multilateral Convention as amended by the proposed protocol will enter into force on the first day of the month following the expiration of a period of three months after the date of deposit of the instrument of ratification with one of the Depositaries.

Any Member State of the Council of Europe or of the OECD that is not yet a party to the Multilateral Convention will become a party to the Multilateral Convention as amended by the proposed protocol upon ratification of the Convention as amended by the proposed protocol by that Member State, unless it explicitly expresses the will to adhere exclusively to the unamended Convention. Any country that is not a member of the OECD or the Council of Europe that subsequently becomes a party to the Convention as amended by the proposed protocol shall be a party to the Convention as amended by the proposed protocol.

The amendments shall have effect for administrative assistance related to taxable periods beginning on or after January 1 of the year following the year in which the Convention as amended by the proposed protocol, entered into force in respect of a party. Where there is no taxable period, the amendments shall have effect for administrative assistance related to charges to tax arising on or after January 1 of the year following the year in which the Convention as amended by the proposed protocol entered into force in respect of a party. Any two or more parties may mutually agree that the Convention as amended by the proposed protocol may have effect for administrative assistance related to earlier taxable periods or charges to tax. However, for criminal tax matters, the proposed protocol provides that the Convention as amended by the proposed protocol shall have effect for any earlier taxable period or charge to tax from the date of entry into force in respect of a party. A party may nevertheless take a reservation according to which the provisions of the Convention as amended by the proposed protocol would have effect for administrative assistance related to criminal tax matters, only as related to taxable periods beginning from the third year prior to the year in which the Convention as amended by the proposed protocol entered into force in respect of that party. The administration is not recommending that the United States take such a reservation [because?...].

TREATY PROGRAM PRIORITIES

In addition to our work described above to expand the U.S. tax treaty network, the Treasury Department also maintains an active negotiating calendar aimed at modernizing existing tax treaties with many of our key trading partners. In this regard, our recent efforts have borne much fruit. In 2013, we concluded protocols with Spain and Japan that make extensive changes to our bilateral tax treaties with those countries. Revising the Spain treaty has been a top priority of U.S. businesses, because the existing treaty does not reflect the current tax treaty practices of either Spain or the United States. The new Japan protocol makes several key amendments to the existing tax treaty, including an exemption from source country withholding of all payments of interest, mandatory binding arbitration provisions, and rules that will allow the United States to request assistance from the Japanese revenue authorities in the collection of U.S. taxes.

Another 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 treaty shopping. I am pleased to report that in this regard we have made significant progress. In addition to the proposed tax treaty with Hungary, we have also concluded negotiations of new tax treaties with Poland, Norway, and Romania, all of which contain comprehensive limitation on benefits provisions. We signed the new treaty with Poland on February 15, 2013, and we hope to transmit it to the Senate for its advice and consent soon. We are preparing the new Norway and Romania treaties for signature in the near future.

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. In this regard, we are in active negotiations with Austria to make a number of key amendments to the existing bilateral tax treaty to including modern provisions for full exchange of information.

CONCLUSION

Mr. Chairman and Ranking Member Barrasso, let me conclude by thanking you for the opportunity to appear before the committee to discuss the administration's efforts with respect to the five 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 for your testimony, and thank you for your work, and we do appreciate the work of your people and your agencies in negotiating these agreements.

I want to ask the first question related to Mr. Barthold's point to Mr. Stack, and that is the Multilateral Convention opens up dramatically the number of countries, potential countries, that we will be exchanging information with. As you point out, it is very clear that we need to make sure that those countries can protect the privacy of information that is being made available.

Knowing how international agreements are negotiated and the politics involved, the United States will normally play a lead role in determining whether a country would be permitted to join the convention. Treasury has a lot of work to do. This is an important protection of privacy information. Many countries do not have the type of reputation and stability that would give us comfort that that information would be kept confidential.

How would you plan to move forward and would you be able to assure the American people that any country that we do business with under the Multilateral Convention indeed does have adequate protections for the information that is being shared?

Mr. STACK. Thank you, Senator.

Consistent with our other information exchange arrangements, the Multilateral Convention, I would suggest, has three aspects to ensuring the confidentiality and appropriate use of the information.

First, before a country is permitted to become a signatory to the Multilateral Convention, the parties to the convention consist of a coordinating body that examines the laws and practices of the jurisdiction in order to be sure that it is able to enter into and fulfill its obligations under the Multilateral Convention.

Senator CARDIN. Can you give us examples of countries that are not in the OECD and not in the Council of Europe that are signatories or likely to become signatories?

Mr. STACK. Yes, if you give me a moment, I can. Singapore would be one.

Senator CARDIN. Others?

Mr. STACK. I have a list here. Among signatories that neither a treaty nor a—Albania, Andorra, Croatia, Ghana, Nigeria, Saudi Arabia, and Singapore.

Senator CARDIN. So you have already made those judgments that those countries have adequate protocols in place to protect privacy?

Mr. STACK. Yes, Senator.

I should say, Senator, in the Multilateral Convention where the United States plays a lead role in the coordinating body, it is the coordinating body of the OECD that makes the determination that these members can become signatories to the Convention.

Senator CARDIN. But we are talking about U.S. entities and our information.

Mr. STACK. Yes.

Senator CARDIN. So you have a responsibility to assure us that the privacy protocols are adequate in the countries that are signatories.

Mr. STACK. Yes.

Senator CARDIN. And you have that assurance to us?

Mr. STACK. Yes, Senator. The other two ways we do it is, once they become a signatory, they are required to participate and abide by the confidentiality rules. But also, quite importantly, the IRS, on an ongoing basis, through the office of competent authority, monitors the experience with these jurisdictions, so that if there is ever word or we learn that there has a been a breach of this confidentiality, the IRS does, and has in the past, held the exchanges of information pending resolution of any issue that we hear arises with respect to a foreign jurisdiction.

Senator CARDIN. How frequently does that occur?

Mr. STACK. I know from talking to the IRS that that has occurred a variety of times over the past several years. It is generally not public, but it does arise from time to time.

Senator CARDIN. My only reason for asking this is that, obviously, we want to make sure that if a country is admitted to this Convention, that it has the protocols in place.

Obviously, disputes arise, and we have to have enforcement, if problems develop. But we want to make the first cut right, and that is not enter into the Convention with those countries that do not have protocols to protect privacy.

Let me raise a second question, if I might, and that is, in two cases, we are amending treaties that, as I understand it, really protects us more, particularly in regards to Hungary, because there are no exceptions now. And we are narrowing the exception category, so they cannot treaty shop. In two, we are setting up new treaties.

Can you just give me some concrete examples of how these treaties help American entities? The more specific you can be as related to doing either business in another country or complying with our tax laws, how do these treaties help us?

Mr. STACK. Sure. You know, I began this discussion by just mentioning that the treaty issues begin to arise when a company begins to conduct business in two jurisdictions, a typical cross-border, which, as we all know, is growing.

Senator CARDIN. Do we have specific companies that are concerned that we do not have today treaties in the two countries that are moving forward? Is that preventing them from doing business? Or hurting them from advancing?

Mr. STACK. Certainly, in the absence of, let us take Chile where it is a brand-new treaty, companies would be subject to double taxation, if we do not have the treaty. And indeed, one of our criteria for entering into a double tax treaty negotiation is that we see, and companies demonstrate to us, that there is unrelieved double taxation going on between us and that country.

And so the treaty sets the rules of the road. So the first thing it does is it helps companies understand, well, under what circumstances when I do business in that other country will my presence be such that I will be subject to tax in that jurisdiction? And those are called our permanent establishment rules.

The second thing it does is it can moderate, via the treaty, certain withholding taxes. You may know that very typically, when one company does business in another country, interest, dividends, and royalties that it receives back are often subject to withholding taxes as high as 30 percent. And what the treaties do, is they typically moderate those withholding amounts, so that they can reallocate the tax between source and residence and reduce the incidence of double taxation.

Third, there are specific provisions that once the two treaty parties come together, once the two treaty partners decide on the allocation of income in the treaty, there are also provisions that say, oh, and everything we talked about in this treaty will get some kind of relief from double taxation through a foreign tax credit.

But most importantly for our companies, they are very interested in what we call the mutual agreement procedures in our treaties. That is to say, once the treaty is ratified, if a dispute arises between that company and let us say that country, there is a procedure under the treaty to help get resolution of that dispute between the competent authorities.

And this might be a time to add that in the Swiss protocol, for example, under certain circumstances, we are adding in a binding arbitration provision into the mutual agreement to provide further possibilities of settling cases and further incentives for these countries to settle cases.

Senator CARDIN. One final question, and then I will yield to Senator Barrasso, we had our share of differences with Switzerland on sharing information. With the ratification of this treaty, how far will it go to resolve those types of disagreements?

Mr. STACK. I think, Senator, it goes very far, because it brings the United States and Switzerland up to the international standard on exchange of information. And in February 2011, Switzerland put out a statement to the effect that they recognize these international standards as applying to their treaty exchange relationships.

So we are optimistic about the advances with Switzerland.

Senator CARDIN. Thank you. Thank you very much.

Senator Barrasso.

Senator BARRASSO. Thank you, Mr. Chairman.

Mr. Stack, maybe from just a little different angle, I am concerned about foreign governments publicly disclosing sensitive personal information of U.S. taxpayers, or using that information for unauthorized purposes. I am just kind of curious about what penalties would be for unauthorized disclosure by a foreign government of U.S. taxpayer information. Are there penalties there? How does that all work?

Mr. STACK. Sure, Senator. The first thing I want to point out, and sometimes this information exchange business gets very confusing, but in both automatic exchange and in information exchange upon request, the foreign government is requesting information about its citizens or residents in the United States in connection with a tax matter that arises in its jurisdiction. That does not mean there are not situations in which there is a U.S. person.

Because these are international agreements, when we hear of any kind of a breach—once we have these agreements in place, the IRS works with these countries to understand their systems, processes, and procedures. And in the event those systems, processes, and procedures were to break down and there would be a release, our recourse is to hold further provision of information pending resolution of that. Because these are foreign governments and foreign countries, it is not so much a question as, let us say, a penalty under one of our statutes as it is the international relations.

Senator BARRASSO. In the unlikely event that this happens, is the U.S. taxpayer notified about the leak and the unauthorized use of the information? Is that something you are aware of?

Mr. STACK. Not that I am aware of, Senator.

Senator BARRASSO. Do you know how many of these unauthorized public disclosures maybe have been made by foreign governments recently or in a recent time period?

Mr. STACK. I would say, in my preparatory conversations with IRS, that there have been several, but maybe going back over several years.

But let me make a point about this. All these disclosures may not be what we typically think of as the malevolent, unauthorized disclosure. It could be a case that there is some kind of accident or leak. It could be a case that a court case in the foreign jurisdiction has already hinted that information that is collected in this process should or could be made public.

So, in both categories, any time there is a situation in which information can get out to the public, the IRS pays attention, contacts the country, has a discussion, and does not move forward until it is convinced that the situation has been resolved.

Senator BARRASSO. To move to a little bit different topic, we seem to have a patchwork of international agreements dealing with the sharing of tax information. We currently have 65 ratified bilateral treaties, tax treaties. In addition, we enter into tax information exchange agreements with other foreign countries. The United States has started to enter into numerous intergovernmental agreements under the Foreign Account Tax Compliance Act.

So I am just wondering whether you can talk a little about the differences in the scope of information and in the process of receiving information exchanged under, say, a tax treaty and then the tax information exchange agreement and intergovernmental agreements, just how that all works, if you would not mind?

Mr. STACK. I appreciate the question, Senator.

First, it is a good time to explain that we only enter into double tax treaties—double tax treaties contain their own tax information sharing provision, typically in article 26. And we only enter into those agreements when there is unrelieved double taxation between us and the other jurisdiction, because we are typically, A, willing to give up some of our taxing rights; they give up some of their taxing rights. And we are really trying to relieve double taxation.

When we negotiate a double tax agreement, as I mentioned, inside that agreement is also one of these tax information exchange agreements.

In many other cases, where we do not have a double tax treaty, because there is no unrelieved double taxation, we simply enter in a stand-alone tax information exchange agreement.

And so we go around the world with jurisdictions where we would like to have those kinds of agreements, which, again, are modeled on the treaty and provide for information exchange upon request. One jurisdiction is doing an audit and it comes to us to get information, and various other kinds of information exchange.

The intergovernmental agreements are a narrower subset, I would say, because we have entered into the intergovernmental agreements in order to facilitate the enforcement of FATCA, the Foreign Account Tax Compliance Act. In those agreements, if I can take a minute to just give you the two flavors, we have two types of these IGAs.

In the first type of IGA, the financial institutions in the jurisdiction, rather than giving information directly to the IRS—I am sorry, let me back up.

The first kind of IGA is what we call nonreciprocal. And what nonreciprocal means is we are going to receive information about the U.S. accountholders in the foreign financial institutions in that jurisdiction, but we are not going to give that jurisdiction back any U.S. information.

We need the IGA because, under the laws of some foreign jurisdictions, their financial institutions may not have been permitted to give information to a third party like the IRS. And so the IGA, in the nonreciprocal case, takes care of that situation. And we receive the information for FATCA compliance.

We also have what is called a reciprocal intergovernmental agreement. And under the reciprocal intergovernmental agreement, I think there is one important thing to understand. We only enter into a reciprocal where we are going to give information if we have a preexisting double tax agreement or TIEA already in place with the country, so we have already done our homework to understand that we are going to exchange information with them. That could apply to people or signatories under the Multilateral Convention.

And then we only give the other jurisdiction what we collect from financial institutions in this country about their residents.

So double tax treaty is very broad, including TIEA; TIEA where we do not do a double tax treaty; IGA is to enforce FATCA.

Senator BARRASSO. Just two more questions, Mr. Chairman.

There have been some concerns raised that the exchange of information provisions in these tax treaties could possibly lead to fishing expeditions that could undermine the privacy rights of Americans. Could you talk a little bit about how the exchange of information request process works? How the government decides whether to make a request for exchange, just a little bit of an overview on that?

Mr. STACK. Yes, Senator.

So for here, I would break this down into—this puts us back into the category of what we call information exchange on request. That is a situation in which another jurisdiction asks the IRS to get information for it because it is “foreseeably relevant” or may be relevant to an actual ongoing tax audit or investigation in that country.

When the IRS receives that request, it is very important that it understand, and will often have contact back with the foreign government, to understand that there is an ongoing audit, there are specific issues being looked at, and, indeed, that it is not a fishing expedition on which the OECD is kind of giving guidance for when you know there is a specific audit of a particular person or group of persons and crossing the line into a fishing expedition. If the IRS office in charge of this determines that there is a fishing expedition, they will simply decline to honor the request for information.

Senator BARRASSO. Obviously, there is a great deal of information that can be shared between foreign governments about an individual’s tax information. The United States currently has international tax treaties with Venezuela, with Russia, with China, and I just want to make sure that there are safeguards in place. Maybe you can describe some of those to assure that we as a Government are not sharing information with other foreign governments that may use this information in ways that we would never want it to be used—human rights violations against their own people or against U.S. taxpayers.

Mr. STACK. Senator, first, I will say we are not currently sharing information with Venezuela. No. 2, let me talk a little bit about the China and Russia issues or any other country in connection with the FATCA IGA, because that is the most recent work we have been doing.

So before we determine that we will do a reciprocal exchange, we are going through a process of consultation with the State Department and Justice Department to ask very narrowly, very specifically, about our Government’s experience with confidentiality and use for intended purposes with these other countries.

This tax area is not the first situation in which we share information with other countries.

Second, however, in all of our IGAs that we are doing FATCA with, we will not exchange information until the IRS actually does an on-the-ground visit with these jurisdictions to look at their systems, procedures, and policies, to be sure that the information will be kept confidential, and, indeed, that they have sanctions in place in the event that they violate it.

And only once we become comfortable after kicking the tires will we proceed under FATCA and the IGAs to the automatic exchange of information with countries like that.

Senator BARRASSO. Thank you.

Thank you, Mr. Chairman.

Senator CARDIN. I just want to clarify one point from Senator Barrasso’s questioning, and that is, you indicated earlier that these requests, generally, are for information about an entity that is located in the country that is requesting the information, about their activities in our country.

But is it not also applicable to U.S. entities that we would have to make information available to other countries?

Mr. STACK. It depends. The paradigmatic case is their resident who might have some assets in this country.

Senator CARDIN. I understand that.

Mr. STACK. In the business context, I think it can be much broader. For example, their parent company might have a subsidiary in this country, so, yes, it is our country's taxpayer, but the foreign government might think that that subsidiary has information about the tax liability of its parent company back in the home jurisdiction.

So, in that circumstance, the IRS would be——

Senator CARDIN. Could not it be a U.S. parent company with operations in another country, that they want information about the U.S. company?

Mr. STACK. Yes, it could be, Senator.

Senator CARDIN. I just want to make sure that we have that clear.

Mr. STACK. Right.

Senator CARDIN. That is not the typical case.

Mr. STACK. Right.

Senator CARDIN. So we are talking about U.S. entities where—we have a responsibility to protect privacy of all our information.

Mr. STACK. Yes.

Senator CARDIN. But when we are dealing with a U.S. entity, to me, it is a much higher standard.

Mr. STACK. Yes, Senator. I agree.

Senator CARDIN. Thank you both very much.

Mr. Barthold, I hope you do not mind that we did not ask you any questions, but we know how to find you whenever we need to. [Laughter.]

Mr. BARTHOLD. Call whenever, Mr. Chairman.

Senator CARDIN. Thank you.

Thank you both very much for your testimony. Appreciate it.

We will now move to our second panel, which is the private sector panel. We welcome Mr. William Reinsch, president of the National Foreign Trade Council; Mr. Paul Nolan, the vice president, tax, McCormick & Company, one of the great Maryland companies, and I am personally pleased to have Mr. Nolan here; and Ms. Nancy McLernon, president and CEO of the Organization for International Investments.

Mr. Reinsch, we will start with you. You may proceed as you wish. Your entire statement will be made part of our record, as is the case with the other two witnesses.

STATEMENT OF WILLIAM A. REINSCH, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, WASHINGTON, DC

Mr. REINSCH. Thank you, Senator. It is a pleasure to be back at the committee again after having been here some years ago.

The National Foreign Trade Council is pleased to recommend ratification of the treaties and protocols that you are considering today. We appreciate the chairman's actions in scheduling the hearing, and we strongly urge the committee to reaffirm the United States historic opposition to double taxation by giving its full support as soon as possible to the pending treaties and protocols.

The NFTC, organized in 1914 and celebrating its centennial this year—that is the end of the commercial—is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. We seek to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena.

To achieve this goal, American businesses must be able to participate fully in business activities throughout the world through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad.

As global competition grows ever more intense, it is vital to the health of U.S. enterprises and to our continuing ability to contribute the U.S. economy that they be free from excessive foreign taxes or double taxation, an impediment to the flow of capital that can serve as barriers to full participation in the international marketplace.

Foreign trade is fundamental to U.S. economic growth. Ninety-five percent of the world's consumers are outside the United States. Tax treaties are a crucial component of the framework that is necessary to allow that growth.

This is why the NFTC has long supported the expansion and strengthening of the U.S. tax treaty network, and why we recommend ratification of the items before you today.

While we are not aware of any opposition to the treaties under consideration, the NFTC, as it has done in the past, as a general cautionary note, urges the committee to reject any opposition to the agreements based on the presence or absence of a single provision.

No process as complex as the negotiation of a full-scale tax treaty will be able to produce an agreement that will completely satisfy every possible constituency, and no such results should be expected.

Tax treaty relationships arise from difficult and sometimes delicate negotiations aimed at resolving conflicts between the tax laws and policies of the negotiating countries. The resulting compromises always reflect a series of concessions by both countries from their preferred positions.

Recognizing this, but also cognizant of the vital role tax treaties play in creating a level playing field for enterprises engaged in international commerce, the NFTC believes that treaties should be evaluated on the basis of their overall effect.

In other words, agreements should be judged on whether they encourage international flows of trade and investment between the United States and the other country. An agreement that meets this standard will provide the guidance enterprises need in planning for the future and provide nondiscriminatory treatment for U.S. traders and investors, as compared to those of other countries.

I want to emphasize how important treaties are in creating, implementing, and preserving an international consensus on the desirability of avoiding double taxation. The tax laws of most countries impose withholding taxes, frequently at high rates, on payments of dividends, interest, and royalties to foreigners. And treaties are the mechanism by which these taxes are lowered on a bilateral basis.

If U.S. enterprises cannot enjoy the reduced foreign withholding rates offered by a tax treaty, noncredible high levels of foreign withholding tax leave them at a competitive disadvantage relative to traders and investors from other countries. Tax treaties serve to prevent this barrier to U.S. participation in international commerce.

If U.S. businesses are going to maintain a competitive position around the world, treaty policy should prevent multiple or excessive levels of foreign tax on cross-border investments, particularly if their foreign competitors already enjoy that advantage.

The United States has lagged behind other developed countries in eliminating this withholding tax and leveling the playing field for cross-border investment. The European Union eliminated the tax on intra-EU parent-subsidiary dividends over a decade ago, and dozens of bilateral treaties between foreign countries also follow that route. The majority of OECD countries now have bilateral treaties in place that provide for a zero rate on parent-subsidiary dividends.

Tax treaties also provide other features that are vital to the competitive position of U.S. businesses. For example, by prescribing internationally agreed thresholds for the imposition of taxation by foreign countries on inbound investment, and by requiring foreign tax laws to be applied in a nondiscriminatory manner to U.S. enterprises, treaties offer a significant measure of certainty to potential investors.

Another extremely important benefit which is available exclusively under tax treaties is the mutual agreement procedure. This bilateral administrative mechanism avoids double taxation on cross-border transactions.

The Swiss and Luxembourg protocols that are before the committee today update agreements between the United States and these countries that were signed many years ago.

The Hungary tax treaty replaces the previous treaty, which was signed in 1979. The Chilean tax treaty is the first bilateral tax treaty between the United States and Chile. The Multilateral Convention has been signed by 61 countries.

The protocols improve conventions that have stimulated increased investment, greater transparency, and a stronger economic relationship between our countries. The Swiss and Luxembourg treaties strengthen the information exchange provisions to alleviate concerns that U.S. taxpayer information was not accessible by the IRS.

We are pleased that the Swiss protocol provides for mandatory arbitration. We thank the committee for its prior support of this evolution in U.S. tax treaty policy, and we strongly urge you to continue that support by approving all five of these treaties and protocols.

The NFTC supports the provision in the Swiss protocol that expands the prohibition on source-country taxation on dividends beneficially owned by pension or other retirement arrangements resident in the other treaty country.

Under the Swiss 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 treaty with Chile signed in 2010 would be our first with that country, and its ratification would present an important milestone lowering tax barriers to U.S. companies operating in Latin America where, as you know, we so far have few such agreements.

The Swiss and Luxembourg treaty protocols would, among other measures, update the current information exchange provisions with those countries to override their bank secrecy laws. The Swiss protocol would also unable the U.S. Government to collect tax revenues from hidden offshore accounts of U.S. tax evaders while specifically protecting against fishing expeditions by either country.

The Multilateral Convention was amended at the request of the G20 to align it to the international standard on exchange of information. The Convention is a multilateral agreement designed to facilitate international cooperation among tax authorities to improve their ability to tackle tax evasion and avoid avoidance, and to ensure full implementation of national tax laws while respecting the fundamental rights of taxpayers.

Additionally, important safeguards included in the Hungary tax treaty prevent treaty shopping, which you have already discussed with Mr. Stack a few minutes ago.

The Swiss protocol provides for mandatory arbitration of certain cases that cannot be resolved by the competent authorities within a specified period of time. Following the arbitration provisions already adopted in the Canadian, German, Belgium, and French treaties, the arbitration provision included in the Swiss protocol will help to resolve cases where the competent authorities are unable to reach agreement.

NFTC member countries use tax treaty arbitration as a tool to strengthen and not replace the existing treaty dispute resolution procedures conducted by the competent authorities. Although the existing procedures work well to resolve most of the disputes that arise in cases involving Switzerland and the United States, the inclusion of the arbitration provisions will expedite the resolution disputes in all competent authority cases.

The Swiss protocol has already been ratified by Switzerland, and its approval is essential in resolving hundreds of long-running U.S. tax investigations.

Finally, Mr. Chairman, let me express our gratitude to you and to members of the committee for giving international economic relations prominence in the committee's agenda, particularly when the demands upon the committee's time are so pressing. We would also like to express our appreciation for the efforts of both majority and minority staff, which have enabled this hearing to be held at this time.

We urge the committee to proceed with ratification of these agreements as expeditiously as possible. Thank you.

[The prepared statement of Mr. Reinsch follows:]

PREPARED STATEMENT OF WILLIAM A. REINSCH

Mr. Chairman and members of the committee, the National Foreign Trade Council (NFTC) is pleased to recommend ratification of the treaties and protocols under consideration by the committee today. We appreciate the chairman's actions in scheduling this hearing, and we strongly urge the committee to reaffirm the United

States historic opposition to double taxation by giving its full support as soon as possible to the pending tax treaty protocol agreements with Switzerland, and Luxembourg, the tax treaties with Hungary and Chile, and the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

The NFTC, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. As global competition grows ever more intense, it is vital to the health of U.S. enterprises and to their continuing ability to contribute to the U.S. economy that they be free from excessive foreign taxes or double taxation and impediments to the flow of capital that can serve as barriers to full participation in the international marketplace. Foreign trade is fundamental to the economic growth of U.S. companies. Ninety-five percent of the world's consumers are outside of the United States. Tax treaties are a crucial component of the framework that is necessary to allow that growth and balanced competition.

This is why the NFTC has long supported the expansion and strengthening of the U.S. tax treaty network and why we recommend ratification of the items before you today.

GENERAL COMMENTS ON TAX TREATY POLICY

While we are not aware of any opposition to the treaties under consideration, the NFTC, as it has done in the past as a general cautionary note, urges the committee to reject any opposition to the agreements based on the presence or absence of a single provision. No process as complex as the negotiation of a full-scale tax treaty will be able to produce an agreement that will completely satisfy every possible constituency, and no such result should be expected. Tax treaty relationships arise from difficult and sometimes delicate negotiations aimed at resolving conflicts between the tax laws and policies of the negotiating countries. The resulting compromises always reflect a series of concessions by both countries from their preferred positions. Recognizing this, but also cognizant of the vital role tax treaties play in creating a level playing field for enterprises engaged in international commerce, the NFTC believes that treaties should be evaluated on the basis of their overall effect. In other words, agreements should be judged on whether they encourage international flows of trade and investment between the United States and the other country. An agreement that meets this standard will provide the guidance enterprises need in planning for the future, provide nondiscriminatory treatment for U.S. traders and investors as compared to those of other countries, and meet an appropriate level of acceptability in comparison with the preferred U.S. position and expressed goals of the business community.

The NFTC wishes to emphasize how important treaties are in creating, implementing, and preserving an international consensus on the desirability of avoiding double taxation, particularly with respect to transactions between related entities. The tax laws of most countries impose withholding taxes, frequently at high rates, on payments of dividends, interest, and royalties to foreigners, and treaties are the mechanism by which these taxes are lowered on a bilateral basis. If U.S. enterprises cannot enjoy the reduced foreign withholding rates offered by a tax treaty, noncreditable high levels of foreign withholding tax leave them at a competitive disadvantage relative to traders and investors from other countries that do enjoy the treaty benefits of reduced withholding taxes. Tax treaties serve to prevent this barrier to U.S. participation in international commerce.

If U.S. businesses are going to maintain a competitive position around the world, treaty policy should prevent multiple or excessive levels of foreign tax on cross-border investments, particularly if their foreign competitors already enjoy that advantage. The United States has lagged behind other developed countries in eliminating this withholding tax and leveling the playing field for cross-border investment. The European Union (EU) eliminated the tax on intra-EU, parent-subsidiary dividends over a decade ago, and dozens of bilateral treaties between foreign countries have also followed that route. The majority of OECD countries now have bilateral treaties in place that provide for a zero rate on parent-subsidiary dividends.

Tax treaties also provide other features that are vital to the competitive position of U.S. businesses. For example, by prescribing internationally agreed thresholds for the imposition of taxation by foreign countries on inbound investment, and by requiring foreign tax laws to be applied in a nondiscriminatory manner to U.S. enterprises, treaties offer a significant measure of certainty to potential investors. Another extremely important benefit which is available exclusively under tax treaties is the mutual agreement procedure. This bilateral administrative mechanism avoids double taxation on cross-border transactions.

The NFTC also wishes to reaffirm its support for the existing procedure by which Treasury consults on a regular basis with this committee, the tax-writing committees, and the appropriate congressional staffs concerning tax treaty issues and negotiations and the interaction between treaties and developing tax legislation. We encourage all participants in such consultations to give them a high priority. Doing so enables improvements in the treaty network to enter into effect as quickly as possible.

AGREEMENTS BEFORE THE COMMITTEE

The Swiss and Luxembourg protocols that are before the committee today update agreements between the United States and these countries that were signed many years ago. The Hungary tax treaty replaces the previous treaty which was signed in 1979. The Chilean tax treaty is the first bilateral tax treaty between the United States and Chile. The OECD Multilateral Convention has been signed by 61 countries. The protocols improve conventions that have stimulated increased investment, greater transparency, and a stronger economic relationship between our countries. The Swiss and Luxembourg treaties strengthen the information exchange provisions to alleviate concerns that U.S. taxpayer information was not accessible by the Internal Revenue Service. We are pleased that the Swiss protocol provides for mandatory arbitration. We thank the committee for its prior support of this evolution in U.S. tax treaty policy, and we strongly urge you to continue that support by approving all five of these tax treaties and protocols.

The NFTC supports the provision in the Swiss protocol that expands the prohibition on source-country taxation of dividends beneficially owned by pension or other retirement arrangements resident in the other treaty country. Under the Swiss 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 proposed tax treaty with Chile, signed in 2010, would be our first with that country, and its ratification would represent an important milestone in lowering tax barriers to U.S. companies operating in Latin America, where we have few such agreements. The proposed treaty would lower withholding taxes on a bilateral basis and protect the interests of U.S. taxpayers in that country.

The Swiss and Luxembourg treaty protocols, both signed in 2009, would among other measures update the current information exchange provisions with those countries to override their bank secrecy laws. The Swiss protocol would also enable the U.S. Government to collect U.S. tax revenues from hidden offshore accounts of U.S. tax evaders, while specifically protecting against "fishing expeditions" by either country.

The OECD Multilateral Convention was amended at the request of the G20 to align it to the international standard on exchange of information. The Convention is a multilateral agreement designed to facilitate international cooperation among tax authorities to improve their ability to tackle tax evasion and avoidance and to ensure full implementation of national tax laws, while respecting the fundamental rights of taxpayers.

Additionally, important safeguards included in the Hungary tax treaty prevent "treaty shopping." In order to qualify for the reduced rates specified by the treaties, companies must meet certain requirements so that foreigners whose governments have not negotiated a tax treaty with Hungary or the United States cannot free-ride on this treaty. Similarly, provisions in the sections on dividends, interest, and royalties prevent arrangements by which a U.S. company is used as a conduit to do the same. Extensive provisions in the treaties are intended to ensure that the benefits of the treaty accrue only to those for which they are intended.

The Swiss protocol provides for mandatory arbitration of certain cases that cannot be resolved by the competent authorities within a specified period of time. Following the arbitration provisions already adopted in the Canadian, German, Belgian and French tax treaties, the arbitration provision included in the Swiss protocol will help to resolve cases where the competent authorities are unable to reach agreement. NFTC member companies view tax treaty arbitration as a tool to strengthen, not replace, the existing treaty dispute resolution procedures conducted by the competent authorities. Although the existing mutual agreement procedures work well to resolve most of the disputes that arise in cases involving Switzerland and the United States, the inclusion of the arbitration provisions in the Swiss tax protocol will expedite the resolution of disputes in all competent authority cases. The Swiss protocol has been ratified by Switzerland, and its approval is essential to resolving hundreds of long-running U.S. tax investigations.

IN CONCLUSION

Finally, the NFTC is grateful to the chairman and the members of the committee for giving international economic relations prominence in the committee's agenda, particularly when the demands upon the committee's time are so pressing. We would also like to express our appreciation for the efforts of both majority and minority staff which have enabled this hearing to be held at this time.

We urge the committee to proceed with ratification of these important agreements as expeditiously as possible.

Senator CARDIN. Thank you very much for your testimony.

Mr. Nolan.

STATEMENT OF PAUL NOLAN, VICE PRESIDENT, TAX, McCORMICK & COMPANY, INC., SPARKS, MD

Mr. NOLAN. Good morning, Mr. Chairman, and thank you for that warm welcome. Good morning also Ranking Member Barrasso. I appreciate the opportunity to speak today and the invitation to be here. McCormick does not often testify in Washington, and it is a great opportunity to be here on an important topic such as this.

A little bit of background on McCormick. We know that the chairman knows, but just for the rest of the committee, we are a $4 billion company and we are growing. We manufacture, market, and distribute spices, flavors, condiments, and seasoning mixes in retail outlets, to food manufacturers, and to food companies around the world. We sell into about 125 countries currently.

Approximately 45 percent of our sales are to customers outside the United States, and that number is growing each year. We employ over 10,000 employees and approximately 2,000 of those are in Maryland.

Our heritage is Baltimore. We started on the Inner Harbor. A gentleman by the name of Willoughby McCormick started selling root beer mix in 1889, right at the harbor. And we have grown into the global enterprise that we are today.

We now have our global headquarters in Hunt Valley, MD, and we have most of our manufacturing for the United States there. And of the finished goods that we sell in the United States, more than 90 percent is manufactured somewhere in the United States.

In 2014, we are celebrating our 125th year with the theme of "A Flavor of Together."

We have grown through innovation. We have grown through a clear focus on employee engagement and product quality.

I am here today to testify in favor of the ratification of the treaties and protocols that are the subject of the hearing.

First of all, why do multinationals care about treaties? The question arose with the prior panel. There are three clear reasons that we identify when considering treaties.

First and foremost, tax treaties provide clear thresholds and triggers for taxation. In a jurisdiction where there is a tax, and this was covered by the prior panel I think pretty clearly, circumstances going into a country where there is not a treaty is effectively domestic tax law in that country for the U.S. company entering that jurisdiction. And whether the company is given equal treatment or is at a competitive disadvantage under domestic tax is an open question. A treaty provides rules of the road with respect to that, and a level playing field.

Secondly, the mutual agreement procedure, it provides for principle-based government-to-government resolution of the double tax issues that arise under the treaty. And we find those to be very important, and I will address later the modifications that are happening and the significance of that. This process is the tool for assuring no double taxation due to differences.

In the absence of a MAP procedure, a global U.S.-based multinational has limited resources in that circumstance to address the double taxation. And again, political interference and parochial circumstances can get in the way.

Finally, the third reason, principal reason, is the withholding structures with respect to intellectual property and interest payments. Capital crosses boarders from the United States, and it can be in the form of debt, it can be in the form of intellectual property. We want to make sure that the royalties are treated fairly.

In addition to those three benefits, there are two significant benefits to the U.S. economy that we can see as well. First, trade and outbound investment from the United States itself—headquarters activities in the United States spurs greater job growth and also helps the suppliers grow while the headquarters companies grow here. That means more Federal, State, and local revenues, in addition to the jobs that it creates, and it also just basically supports the economy.

Also, the lower trade restrictions that occur under a tax treaty help with fundamental trade.

And full disclosure, we are a member of the NFTC, a proud member of the NFTC, on the board. And we associate ourselves with their testimony.

The support for free trade is very important to the vibrant growth of the U.S.-based multinationals.

But secondly, also treaties provide for a great environment for inbound investment as well.

Non-U.S. investors have a better environment for investing in terms of making sure that their capital is protected and that they have rules of the road that are safe. So royalties paid back to foreign parents for intellectual property, dividends, et cetera, there are also clear rules of the road.

Just a few more observations about treaties, the exchange of information provisions, there has been some discussion about that. We think they strike a careful balance. There is never going to be a perfect world for that sort of information exchange. However, we think that the U.S. Treasury and the IRS, with their processes and procedures, is pretty safe, and that should preclude fishing expeditions.

Also, if you take notice of events outside the United States, in terms of tax developments, the rules of the road that the United States has through these treaties is good protection for U.S. companies as opposed to what can emerge outside of those rules. And so a lot of times these days, U.S. companies, not McCormick, are targets of these non-U.S. governments, so it is better to have rules than not have rules.

The broad network of tax treaties provides fair framework and reduced rates of withholding taxes, and then also limitation on benefits prevents treaty shopping, which, if you are a scrupulous taxpayer, you do not necessarily like unscrupulous taxpayers abusing the rules.

The mutual agreement procedures, a significant point to make on that are the improvements in our treaties past generation of treaties with the baseball arbitration. The mere fact that two countries may need to submit their disagreement to an arbitrator who can make a final judgment is a great incentive for two countries to reach resolution without the need for actual arbitration. We support the expansion of baseball arbitration, and it is in one of these protocols.

Finally, my last thought before I say "thank you for your time" is that tax reform is on the horizon, and we are supportive of broad-based tax reform. But before it happens, as a residence-based country with residence-based worldwide taxation, it is more in the United States interest to have a better treaty network to prevent double taxation, particularly as other jurisdictions lower their rates, because there is more for the United States to pick up.

So the bottom line is, many of these countries, in a world gone territorial, they are very much about source taxation. We are about residence taxation. Our current treaty network protects the U.S. fisc in this environment in a very unique way, and a more important way every day.

So, Mr. Chairman, I know you have seen some of these treaties before and it is deja vu for you. We know you are a supporter, and we are preaching to the choir, but we want to completely support these treaties and advocate for their further action. Thank you.

[The prepared statement of Mr. Nolan follows:]

PREPARED STATEMENT OF PAUL B. NOLAN

Good morning Mr. Chairman, Ranking Member Barrasso, and members of the committee. Thank you for the opportunity to testify at today's hearing. My name is Paul Nolan and I am the Vice President, Tax, at McCormick & Company, Inc.

McCormick & Company, Incorporated, is a global leader in flavor with $4 billion in annual sales. McCormick manufactures, markets and distributes spices, seasoning mixes, condiments and other flavorful products to the entire food industry—retail outlets, food manufacturers, and foodservice businesses—in more than 125 countries and territories. Approximately 45 percent of our sales are to customers located outside the United States and that number is growing each year.

We employ more than 10,000 people in locations around the world, including approximately 2,000 in Maryland, where our company began at the foot of the Baltimore Harbor, 1889, and where our company has its global headquarters and most of its U.S. manufacturing and research and development. In 2014, we are celebrating our 125th year under the theme of "The Flavor of Together."

Since Willoughby M. McCormick founded the company selling root beer extract in 1889, McCormick has demonstrated a strong commitment to the communities in which it operates. Innovation in flavor and a clear focus on employee engagement and product quality has allowed McCormick to grow its business globally and become the flavor leader it is today.

I am here today to testify in favor of the ratification of the two treaties and the three protocols amending three other treaties that are the subject of this hearing.

Mr Chairman, Ranking Member Barrasso, and members of this committee, tax treaties benefit the U.S. economy and U.S.-based multinational companies (MNCs) that are globally engaged, such as McCormick, in three ways.

First, tax treaties provide clear thresholds and triggers for foreign taxation of global American companies' income generated from trading with foreign customers. Bilateral tax treaties allow global American companies to invest and compete abroad for foreign customers through: (i) greater certainty regarding future income tax costs and (ii) equal treatment among other non-U.S. competitors because there is no competitive disadvantage arising from higher local taxation of U.S. companies' investment vs. foreign business investment in the treaty country.

Second, Mutual Agreement Procedures (MAP) are a critically important tool to facilitate resolution of income tax disputes between governments. Tax treaties provide the two governments who are disputing the income tax liability of a single company to enter into a principle-based government-to-government negotiation that can resolve the disputed income tax liability. This process assures no double-taxation due to differences in taxation principles between countries.

In the absence of MAP procedures, globally engaged U.S. companies would have limited recourse in resolving tax issues on their own. In some countries, tax authorities or judiciaries can be hostile to U.S. investors in particular, or all foreign investors in general, subject to political interference, or motivated by domestic budget pressures.

As a result, foreign tax authorities operating without tax treaties might levy duplicative capital gains and withholding taxes on U.S. company investments unsupported by international tax policy norms. Tax treaties bring with them OECD principles on proper attribution of profits, rules on permanent establishment, and other broadly accepted principles.

Third, tax treaties provide for mutually agreed reduced rates of withholding taxes on royalty payments for U.S.-owned intellectual property and interest payments paid with respect to U.S. debt. Without tax treaties in force, U.S. companies pay higher taxes on the same types of business transactions as foreign MNCs with broader and more effective treaty networks. By avoiding higher or additional layers of income tax, tax treaties also increase the net return to U.S.-owned intellectual property which increases the incentive to develop and own intellectual property in the United States.

As you well know, Mr Chairman and Ranking Member Barrasso, expanding the network of tax treaties benefits the U.S. economy. Tax treaties improve the environment for international trade and outbound investment, with major benefits to U.S. companies, workers, consumers, and taxpayers.

The headquarters activity generated by globally engaged U.S. companies' investments abroad spurs greater job growth here at home and along their supply chains. This increases federal, state, and local tax revenues that are sustainable only in an environment which continues to support free trade in goods and services.

Increased restrictions on trade will disadvantage consumers by reducing consumer choice, increasing prices, and favoring local producers, which makes globally engaged American companies less able to compete in the provision of goods and services to consumers around the world. Reduced foreign tax burdens on royalties paid to the United States increases the incentive for investment in intangible property in the United States by increasing the expected return of U.S.-owned intellectual property. This results in more investment in intellectual property in the United States.

Tax treaties also improve the environment for inbound investment that benefits both consumers and taxpayers. U.S. affiliates of foreign MNCs pay royalties to their foreign parent companies for the use of the foreign-owned intellectual property in the United States. Tax treaties enhance the environment for certainty in business planning and potentially reducing U.S. tax costs on inbound investments. This results in increased investment in the United States, with associated benefits for employment, tax revenue, and consumer choice.

"Exchange of Information" provisions provide appropriate and limited tools to reduce tax evasion by U.S. businesses and individuals while precluding the use of these provisions for "fishing expeditions" on the part of foreign or U.S. tax authorities without evidence of such evasion.

In conclusion, we support as broad a network of tax treaties as possible that reduce rates of withholding taxes and nonresident capital gains taxes. We support "limitation on benefits" provisions consistent with the latest model U.S. tax treaty. They prevent "treaty shopping." Unilateral application of "generally antiavoidance rules (GAAR) should be avoided as they are arbitrary in their application and often result in double-taxation.

In the recent past, some of the government-to-government negotiations that are intended to resolve double-taxation for taxpayers have become bogged down when one party or the other refuses to work the differences over the amount of income to be taxed in each jurisdiction.

So-called "baseball" arbitration is a solution to this problem of deadlocked negotiations between competent authorities. Baseball arbitration requires each country seeking to tax the same income to submit a "last best offer." The arbitrator then selects one of the offers to resolve the dispute. While it is rarely invoked, it does provide an incentive for two disputing jurisdictions to come to a timely agreement that avoids double-taxation. Baseball arbitration does not create nowhere income—it ensures that a taxpayer is not subjected to double taxation.

Thank you once again for the opportunity to testify and I would be happy to answer any questions.

Senator CARDIN. Thank you very much, Mr. Nolan, for your testimony.

Ms. McLernon.

STATEMENT OF NANCY McLERNON, PRESIDENT AND CEO, ORGANIZATION FOR INTERNATIONAL INVESTMENT, WASHINGTON, DC

Ms. McLERNON. Good morning, Chairman Cardin and Ranking Member Barrasso and distinguished members of the committee. I thank you for the opportunity to testify this morning, and I applaud your leadership in holding this hearing.

I am here to talk about the flip side of most of what has been discussed this morning, sort of the opposite side of the investment coin, if you will.

I am president and CEO of the Organization for International Investment, and OFII is a business association exclusively comprised of U.S. subsidiaries of foreign companies. Our mission is to ensure that the United States remains the most attractive location for foreign investment.

OFII strongly supports our Nation's tax treaty network. These bilateral agreements provide a reliable tax environment for companies doing business in several jurisdictions, much of which we have already talked about this morning. Tax treaties prevent double taxation and provide important information-sharing between governments to ensure appropriate taxes are paid.

Although many focus on how tax treaties impact homegrown companies like McCormick, they are also extremely important in promoting a competitive environment for foreign investment in the United States.

Foreign investment is a catalyst for economic growth that fuels American manufacturing, innovation, trade, and overall job creation. U.S. subsidiaries employ 5.6 million workers in the United States, including 17 percent of the U.S. manufacturing workforce, and account for 6.3 percent of private sector GDP. In Maryland, U.S. subsidiaries employ over 105,000, and in Wyoming, over 8,400.

In a recent study, we found that insourcing companies, which is how we refer to them, outperformed the private sector average across a number of key economic indicators over the past decade.

For example, U.S. subsidiaries increased U.S. R&D funding at double the rate, and their contributions to U.S. GDP increased by over 25 percent, nearly double the private sector's 14 percent increase.

However, competition to attract and retain global investment has never been stronger. Over the last decade, the United States has seen its share of global investment dramatically decline from roughly 37 percent in 2000 to just over 17 percent in 2012. This is why it is critically important for the United States to implement policies that make us more attractive for global companies to invest and generate jobs here.

Tax treaties, while not as prominent as bilateral trade agreements, play an essential role in encouraging greater foreign investment in the U.S. economy.

Let me explain it pretty simply. We talked about it somewhat. So when companies operate in multiple tax jurisdictions, situations can occur when two countries both try to tax a single item of earned income that moves across borders. One country may tax the income because the corporation is a resident of that country, while the other country may tax the income because the activity generating the income occurred within its borders. This double taxation can be a clear barrier to foreign investment.

Tax treaties help ensure that businesses are not taxed twice on the same income while accounting for concerns of tax avoidance. This is done in part by reducing or eliminating withholding taxes on cross-border income flows between affiliated companies. By ensuring that common business expenses like royalty and interest payments are not subject to double taxation, tax treaties allow insourcing companies to invest more in the very business activities that drive economic growth in the United States.

In addition, tax treaties promote information-sharing between governments and lay the foundation for cooperative efforts between tax authorities to better administer and enforce tax laws. This, too, creates a more conducive environment for foreign investment, as it provides a company with greater certainty on the application of tax rules.

In these and other ways, tax treaties play a significant role in providing certainty to cross-border businesses while advancing economic interests of the United States

Likewise, the pending bilateral treaties and protocols before this committee today contain proinvestment measures and will help coordinate and enforce tax administration with important economic partners.

The protocols with Switzerland and Luxembourg modernize outdated information exchange capabilities between nations, which is critical for resolving cross-border investigations, protecting the integrity and fairness of the global tax system, and improving the legal and regulatory climates for multinational firms.

This will provide greater certainty to companies based in countries that rank as the sixth- and seventh-largest investors into the United States. That certainty will benefit not only the companies, but their American employees.

Switzerland- and Luxembourg-based companies have infused billions of dollars and hired tens of thousands of U.S. workers for decades. For example, Zurich Insurance Group recently celebrated 100 years in the State of Illinois. And Nestle USA has been an insourcing company for over 110 years. Swiss-based firms alone in the United States provide jobs for over 446,000 Americans.

Hungarian-based companies are also significant investors in the U.S. market with cumulative investment totaling over $20 billion.

Hungary ranked in the top 10 investing countries for the United States.

The second proposed treaty with Chile would be an important milestone as only the second tax treaty with a South American country. By reducing withholding taxes, this treaty can encourage greater investment from an important economic ally.

The failure of the Senate to ratify many of these agreements in the past few years has slowed the progress on tax treaties with other countries and sends a message to the international community that the United States may not be committed to maintaining these important adjuncts to international commerce.

The proposed treaties we are discussing today are not the only tax treaties that have been signed and are awaiting Senate ratification. Last year, the United States signed tax treaties or protocols with Japan, Poland, and Spain. In addition to that, the United States is negotiating with the U.K. and Vietnam.

The lingering ratification process also scares away potential new investors from firms based in those treaty countries.

In closing, bilateral tax treaties and protocols encourage the flow of cross-border investment and economic activity. The United States needs to restore life back into our tax treaty network. It needs to send a message around the world that the United States takes these treaties seriously and wants to encourage greater levels of foreign investment in the United States.

Approving the protocols with Switzerland and Luxembourg and the conventions with Chile and Hungary will accomplish these goals.

Thank you and I look forward to any questions.

[The prepared statement of Ms. McLernon follows:]

Prepared Statement of Nancy L. McLernon

INTRODUCTION

Good morning. Senator Cardin, Ranking Member Barrasso, and distinguished members of the committee, I thank you for the opportunity to testify this morning. I applaud your leadership in holding this hearing on tax treaties.

My name is Nancy McLernon and I am President and CEO of the Organization for International Investment (OFII). OFII is a business association exclusively comprised of U.S. subsidiaries of foreign companies. Our mission is to ensure that the United States remains the most attractive location for global investment. As such, we advocate for nondiscriminatory treatment in U.S. law and regulation for these firms and the millions of Americans they employ.

OVERVIEW

OFII and its member companies strongly support expansion and updating of our Nation's tax treaty network. These bilateral agreements provide a reliable tax environment for companies doing business in several jurisdictions. Tax treaties prevent double taxation and provide important sharing of information between governments to ensure appropriate taxes are paid. Although many proponents focus on how tax treaties impact home-grown companies, they are also extremely important in promoting a competitive environment for foreign investment in the United States.

FOREIGN DIRECT INVESTMENT IMPORTANT TO U.S. ECONOMY

Foreign direct investment is a catalyst for economic growth that fuels American manufacturing, innovation, trade, and overall job creation.

U.S. subsidiaries employ 5.6 million workers in the United States, including 17 percent of the U.S. manufacturing workforce, and account for 6.3 percent of private sector GDP. In addition, these companies engage in high levels of research and development, make extensive capital investments in new facilities and equipment, and produce a large share of U.S. exports to markets abroad. In a recent study, we found that insourcing companies outperformed the private sector average across a number of key economic indicators over the past decade. For example, U.S. subsidiaries increased research and development funding at double the rate and their contributions to U.S. GDP increased by over 25 percent, nearly double the private sector's 14-percent increase.

In every state and every industry sector, U.S. subsidiaries of global companies are important players in providing high-quality jobs and much-needed investment. Recent examples include: Denmark-based Novo Nordisk's $225 million redevelopment project and new headquarters opening in New Jersey; Sweden-based Electrolux's announcement to add 650 jobs at their plant in Tennessee within the next few years; British-based Balfour Beatty's new office in Baltimore and over $1.9 billion spent on construction projects in the State of Maryland; and Belgium-based Solvay's Soda Ash plant expansion in Wyoming to increase production by 12 percent.

As a business community, these insourcing companies generate precisely the types of high-value jobs and economic activities policymakers are working to bring to their states.

However, competition to attract and retain global investment has never been stronger, providing companies with an unprecedented array of options when looking to expand into new markets around the world. Over the last decade, the United States has seen its share of global investment dramatically decline, from roughly 37 percent in 2000 to just over 17 percent in 2012. This is why it is critically important for the United States to implement policies that make the United States more attractive for global companies to invest.

TAX TREATIES ENCOURAGE INCREASED FOREIGN DIRECT INVESTMENT IN THE UNITED STATES

Tax treaties, while not as prominent as bilateral trade agreements, play an essential role in encouraging greater foreign direct investment in the U.S. economy. This can be seen by the growth in investment flows from our treaty partners. For example, since the Protocol to the French Income Tax Treaty was ratified at the end of 2009, we have seen a 144-percent increase in FDI flows from France. In fact, French investment increased sevenfold between 2011 and 2012, reaching nearly $22 billion.

The reason for this is simple. When companies operate in multiple tax jurisdictions, situations can occur where two countries both try to tax a single item of earned income that moves across borders. One country may tax the income because the corporation is a resident in that country, while the other country may tax the income because the activity generating the income occurred within its borders. This double taxation can be a clear barrier to foreign direct investment.

Tax treaties help ensure that businesses are not taxed twice on the same income while accounting for concerns of tax avoidance. This is done, in part, by reducing or eliminating withholding taxes on cross border income flows between affiliated companies. By ensuring that common business expenses like royalty and interest payments are not subject to double taxation, tax treaties allow insourcing companies to invest more in the very business activities that drive economic growth, like expanding operations, purchasing new equipment, hiring more U.S. workers, and selling trademarked or licensed goods.

In addition, tax treaties promote information-sharing between governments and lay the foundation for cooperative efforts between tax authorities to better administer and enforce tax laws. This too creates a more conducive environment for foreign direct investment as it provides companies with greater certainty on the application of tax rules.

In these and other ways, the U.S. network of more than 60 bilateral income tax treaties plays a significant role in providing certainty to cross-border businesses while advancing the economic interests of the United States in the global economy.

Likewise, the pending bilateral treaties and protocols before the committee today contain pro-investment measures and will help coordinate and enforce tax administration with important economic partners.

Specifics on Pending Protocols & Tax Treaties: Switzerland, Luxembourg, Hungary & Chile

The protocols with Switzerland and Luxembourg modernize outdated information exchange capabilities between nations, which is critical to resolving cross-border investigations, protecting the integrity and fairness of the global tax system and improving the legal and regulatory climates for multinational firms. This will provide greater certainty to companies based in countries that rank as the sixth- and seventh-largest investors into the United States in developing their near- and medium-term investment plans. That certainty will benefit not only the companies, but their employees and the communities in which they are located as well.

Switzerland and Luxembourg based companies have infused billions of dollars and hired thousands of United States workers for decades. For example, Zurich Insurance Group recently celebrated 100 years in the State of Illinois and Nestle USA has been an insourcing company for over 110 years. Overall, foreign direct investment from Switzerland and Luxembourg stands at $204 billion and $202 billion respectively through the end of 2012. Swiss-based firms alone provide 446,300 American jobs. Collectively, these countries account for nearly 9 percent of all direct jobs from global investment in the United States.

Hungarian-based companies are also significant investors in the U.S. market, with cumulative investment totaling over $20 billion. Hungary ranked in the top 10 investing countries for the United States for 2012.

The proposed treaty with Chile would be an important milestone as only the second tax treaty with a South American country. By reducing withholding taxes, this treaty could encourage greater investment from an important economic ally as well as providing greater protection to U.S. companies operating in that market.

Prompt Consideration Sends an Important Signal to the Business Community and Trading Partners and Gives U.S. Negotiators Greater Credibility

It is important to note that failure to act on these agreements in an expeditious manner has a number of negative consequences. The failure of the Senate to ratify many of these agreements in the past few years has slowed the progress on tax treaties with other countries and sends a message to the international community that the United States is not committed to maintaining these important adjuncts to international commerce.

The proposed treaties we are discussing today are not the only tax treaties that have been signed and are awaiting Senate ratification. Last year, the United States signed tax treaties or protocols with Japan, Poland, and Spain. In addition to that, the United States is negotiating with the United Kingdom and Vietnam. These are significant markets for the United States, considering that British and Japanese companies have invested $795 billion combined in the United States, making them the top two investing countries by cumulative stock.

The lingering ratification process also scares away potential new investment from firms, based in proposed treaty countries, which are evaluating investment locations around the world and making long-term strategic plans. It is difficult for these businesses to commit to U.S. investments unless they are confident a treaty will promptly come into force.

CONCLUSION

In closing, bilateral tax treaties and protocols encourage the flow of cross-border investment and economic activity.

The United States needs to restore life back into our tax treaty network. It needs to send a message to our negotiating partners and businesses around the world that the United States takes these treaties seriously and wants to encourage greater levels of foreign direct investment and the jobs it generates.

Approving the protocols with Switzerland and Luxembourg and the Conventions with Chile and Hungary will accomplish these important goals.

Senator CARDIN. Well, let me thank all three of you for your testimony. As I indicated in my opening comments, the hearing we held in 2011 did not include a private sector panel, so we very much appreciate having the private sector represented here.

Mr. Nolan, I thought the point that you made about tax reform, and the fact that the United States is based upon resident rather than based upon territory, is a very valid point as to whether tax treaties are mutually beneficial to both countries. There is a direct interest in the United States on getting information about our residents' activities and other countries. That may not be true with some of the other partners that we have.

And I noticed that Senator Barrasso and I both are strong supporters of trying to move forward with lower corporate tax rates. The fact is that we do have high corporate tax rates, and, therefore, there can be complications on us having compliance with our laws that require information from other countries.

So I think the point that you raised there is a very valid point, and I appreciate you bringing that to our attention.

The question I have for you and for the others, you talked about having proper tax administration, having rules that you can understand, and confidence in the procedures that are in these tax agreements and treaties. You heard the first panel. You heard the concerns that we have, particularly with the Multilateral Convention, that there are countries that we are going to be entrusting information to, that some do not have a long track record of protecting sensitive information.

How confident are you, that your company or the companies that you represent, about these protocols being ratified and protecting information that may be made available by the United States to the four treaty countries that are involved or the signatories to the Multilateral Convention?

Mr. NOLAN. Senator, that is an excellent question, and I can only speak for myself and actually hypothetically, because I have not seen this yet, but it would be the exact circumstance that you described in your question to Assistant Secretary Bob Stack, which was U.S. multinational with a non-U.S. affiliate in one of these countries, and suppose that information was requested.

My perspective is, first, that we have a subsidiary in that country, and it is being audited already, or it is already being looked at. So a lot of time, you are already subject to the rules with respect to confidentiality and disclosure, which are not what we are used to in the U.S. rules. Rules of privilege and other attorney work product things that we take for granted here in the United States may not even exist in that jurisdiction. So we may already with that subsidiary have to disclose a fair amount of information about that subsidiary.

And a lot of times there will be information about the overall business model that will implicate the U.S. parent in that disclosure. And in order to comply with the law there, and to reach a successful resolution, there may be substantial disclosures already.

This would be over and above that. And there certainly could be risks here, and I do not know how you could just say there would not be, but I think in a circumstance like this you would have to look to the procedure and to your home country, to the United States, to make sure that they are looking out for your interests as a U.S. parent company in that country.

So that is why I welcome this kind of engagement, because absent that, I do not know that I have a way to bring the Treasury or the IRS to the table with me in a nontreaty country when they are looking at my subsidiary.

Remember, the fact pattern here was this is someone who is not already part of a bilateral treaty, not part of a TIA. This is someone coming in through the OECD, the window, in effect. Well, without the Treasury at that window protecting me, I am up against the local jurisdiction, the local revenue authorities, and whatever they might demand.

So is it perfect? No, but it could actually be better than the fact pattern you have without that type of information exchange, because now the Treasury is involved, and the IRS is involved somehow in reviewing what they are seeing.

Senator CARDIN. Mr. Reinsch, how do you feel about the companies that you represent and protection of privacy?

Mr. REINSCH. I think most of them, if not all of them, will agree with Paul. We recognize there is always a level of risk. We are comfortable with the risk in this case, and we think the procedures that Mr. Stack described to mitigate that are fine.

The thing that I would add is the advantage of a multilateral convention in any context is that it is a good way of essentially raising the bar for everybody to bring people along whose standards and practices may not be up to what we would like to see in the beginning. But by making them part of an international process and exposing them to the higher standards of the other members and allowing organizations like the U.S. Treasury and counterpart institutions in other governments to work with them, and have the high standard of expectations of those countries, you bring them up to the standards that we are talking about.

And I really think that is the only way you can do that. If you keep them outside the multilateral framework, you make it much harder.

So for us, the Convention is an important development, and we welcome it.

Senator CARDIN. Ms. McLernon, you raised a point that I wanted to follow up on, and that is the slow pace of U.S. ratification of tax treaties has already had an impact. It has had an impact on further treaty negotiations, getting more countries involved in more uniform treatment of taxpayers and protocols, as well as investment here in the United States. Can you just elaborate a little bit more about what the signal has been here from the action or inaction in the Senate?

Ms. MCLERNON. Yes, as I mentioned, the United States really has lost precipitously the amount of global share of cross-border investment. The United States is still the top location, but we have lost a lot of share.

Part of that is because of the rapid increase of emerging markets. So the United States has to be able to have an impact on the things that we can control. Tax treaties become a very powerful competitive advantage that we have, because it ensures companies that they are going to be dealt with fairly.

My organization is devoted toward ensuring that foreign-based companies are dealt with on a level playing field and, as such, promote investment and job creation in the United States.

But lack of movement on tax treaties make our trading partners concerned about how they will be treated once they are here. And it is not just true for the countries that are involved in the pending agreements we have before us today. It hurts our hand when we go and try to negotiate with other countries.

I know that many of my companies, and some that are probably at NFTC, are very interested in a tax treaty with Brazil. There could be other countries that we do not have treaties with that do not feel that it is worth time and effort if the United States is not going to move on some of these treaties.

So we talk a lot about trade agreements, and tax treaties do not often get the same limelight, but they are an important fact. And even just ensuring that policies follow our tax treaties is almost a full-time job for my organization, because sometimes at the State level, policies do not follow our tax treaties.

So with the absence of tax treaties, it is going to be even harder and make it less competitive for us to attract.

Senator CARDIN. The one treaty here that is completely new is Chile. As has been pointed out, we do not have a lot of tax treaties in South America. I think you pointed out this is the second, if it is ratified by the Senate.

Is there potential for significant progress with bilateral treaties in South America?

Ms. MCLERNON. Well, I think it certainly would be an area that we would want to focus on. I think, in general, both trade agreements and tax treaties with folks down south can make us a more attractive location, not only for foreign investment to come here, but as an export platform for other places around the world.

Foreign companies in the United States already produce about 20 percent of our U.S. exports, but we hear from many that they do not choose the United States for a variety of reasons, one of which is because they are concerned about our international agreements, and is the United States falling behind other countries in pursuing these international agreements. Many of them would like to produce here to sell to markets outside of the United States, which I think, certainly, we would agree is desirable, but this lack of engaging with the global economy can hurt us.

Senator CARDIN. Senator Barrasso.

Senator BARRASSO. Thank you, Mr. Chairman.

Mr. Chairman, our colleague, Senator Lamar Alexander, often says, “Find the good and praise it.” And I would like to note that Mr. Stack is still here, and he is paying attention. And so frequently, Mr. Chairman, the administration—and this goes for both parties—comes, testifies, and leaves without paying attention, without listening, without hearing what the others have to say.

So I just appreciate your staying, and I think that sets a very good example for others, from this and other administrations.

So thank you, Mr. Chairman, to that.

I wanted to point out The Economist this past week had an article called, “Company headquarters: Here, there and everywhere.” It may be applicable. It said, “Why some businesses choose multiple corporate citizenships.”

They talk about Fiat, an Italian company for the last 115 years, the board recently voted to move their parent legal domicile to the Netherlands, the tax residence to Britain, and the stock market listing to New York City, so I mean, the challenges are going to continue to come into the future.

Just think about that and how the treaties play a role, the international community plays a role.

I wanted to ask you, Mr. Reinsch, specifically about this treaty with Hungary. It contains a “limitation of benefits” provision. It is intended, I understand to fix a loophole that was in the existing treaty that made Hungary a target for what they call treaty shopping.

Could you just please provide some examples of how third parties outside perhaps the United States and Hungary use that current treaty with Hungary to engage in treaty shopping? Are you familiar with this?

Mr. REINSCH. I cannot.

Senator BARRASSO. OK.

Mr. REINSCH. I will, for the record.

[The written answer from Mr. Reinsch to Senator Barrasso's question follows:]

If a foreign investor from a country with which the United States does not have an income tax treaty wishes to invest in the United States by, for instance, purchasing shares in and or making a loan to a U.S. company, that foreign investor will be subject to our statutory withholding rates of 30 percent on the U.S. source dividends and most interest that it receives.

The foreign investor could instead choose to establish a Hungarian company through which he would route his U.S. investments. The effect would be that the U.S. source dividends and interest would enjoy the reduced U.S. withholding provided in the U.S. Hungary tax treaty.

A typical limitation on benefits rule would deny benefits to a Hungarian company that was owned by third-country investors and did not have an active business in Hungary. Holding companies are often established by third-country investors to take advantage of better tax treaty benefits in countries without limitation on benefit provisions.

The existing Hungary tax treaty does not have any limitation on benefits, and thus there is no protection against this type of treaty shopping abuse by third-country investors.

The limitation on benefits provision in the pending U.S.-Hungarian tax treaty limits the benefits to real American and Hungarian investors. This provision would ensure that the treaty benefits are being realized by those companies to which they were intended, which protects the competitive position of U.S. companies doing business in Hungary.

Senator BARRASSO. We appreciate that.

Wondering about the arbitration in the Swiss protocol, if I could talk to you about that a little bit. The proposed Swiss protocol includes mandatory binding arbitration when the United States and Switzerland are unable to resolve disagreements. It appears to be consistent with other arbitration provisions in international tax treaties with Canada, with Germany, Belgium, France. Do you know if there has been any successful arbitration conducted under those treaties or other treaties?

Mr. REINSCH. I think what we have generally found is what Mr. Nolan alluded to, which is that the presence of the provision is an incentive for the competent authorities to reach agreement so it does not have to be employed.

Whether there actually has been a successful arbitration, I do not know. The reason we are for it is the reason I just stated. It is the 2 years that matters, because there is a tendency sometimes in these cases—we had this problem with the Canadians, before the provision was included in that treaty—for negotiations to drag on for years and years, and these cases were never resolved.

If you put in the deadline through the arbitration provision, it is the incentive to conclude these cases in a timely fashion.

Senator BARRASSO. OK. Maybe for all three of you, and I can start with you, Ms. McLernon, from a business perspective, what is the impact of the Senate not ratifying the international tax treaties that are currently being discussed today?

Ms. MCLERNON. Well, as I mentioned, it is not just the treaties that we are talking about now. It is potential updates and new treaties. So I think it is going to make the United States fall even further behind in being competitive in a very competitive global economy.

And I know that many of my companies that have been in the United States for decades and longer would see this as a step backward.

Senator BARRASSO. Mr. Nolan.

Mr. NOLAN. Yes, if I may echo that, these treaties do not happen overnight. They are negotiated by representatives from the U.S. Government and the other government over a long period of time. And then, of course, under the Constitution, we have the ratification procedure.

Treaties always seem important but not urgent, and that is really a challenge. Well, I think the delay here is making these treaties in particular important and urgent. And I think that the whole treaty pipeline that Nancy alluded to is becoming important and urgent for the reasons that she said.

It is basically a question of global reputation, global ability to deliver on what we promise as a sovereign.

And then also, the world is changing. I have alluded to it a couple times. There are activities happening in the OECD. Governments are acting on their own because of concern regarding revenue collection and multinationals with multiple headquarters, et cetera. The NGOs have stirred up a real political imperative out there amongst other countries.

It is better for the United States to work within the framework it has with these countries and ratify and have a strong treaty network going forward.

Senator BARRASSO. Mr. Reinsch.

Mr. REINSCH. I would echo both of those comments.

One, the world is not standing still. Other people are going ahead. And if we are not, we steadily lose ground simply by standing in the same place.

In addition, as Paul pointed out, these things are a process, and they take a long time to negotiate. They take a long time to work out. When they come up here, they take an even longer time.

Several things happen. One, the signal is sent to the Treasury Department that these things are not moving along. Mr. Stack can speak better than I can to others that are in the pipeline right now, which are not going to go forward until they see that the Senate is prepared to act on these, because there is not much point in presenting even more treaties. As the chairman pointed out, these have been around since 2011. If these do not move, why send up three or four more? And the result is that everything then begins to back up.

We do an annual survey of our members, the results of which we provide only to the Treasury Department, on where our members would like to see negotiations go forward, either with a new protocol or a treaty with a country where there is none. Brazil is, by the way, these days regularly at the top of the list.

But it is a long list. And we will have 15, 20 countries where various of our members would like to see some improvement in the bilateral tax relationship, either by an update, because some of these treaties are quite old when commerce was very different, or with countries that we do not have a treaty with now, but have substantial trade with.

All of that begins to slow down and grind to a halt pending Senate action on what is there right now.

Senator BARRASSO. Thank you.

Thank you, Mr. Chairman.

Senator CARDIN. Well, let me thank all three of our witnesses here and just make this observation, and that is I will certainly take back the message of the urgency that you have expressed to Senator Menendez and Senator Corker, the chair and ranking member of our committee, and also talk to Senator Reid and Senator McConnell, who have more to do with how the scheduling is done on the floor of the United States Senate.

There are a lot of treaties that are pending in the United States Senate, in addition to tax treaties. Some are more controversial than others, but any ratification process needs to be done in a thorough way, and it takes time before the United States Senate can schedule a vote. And of course, we have an extraordinary hurdle that needs to be passed as far as the number of votes to ratify a treaty.

So I would just urge you, individually and through your organizations, to stress the urgency of action here to the political leadership here in the United States Senate.

And I will do my share, and I now Senator Barrasso will be talking to his leadership, to see whether we can find an opportunity first to take these issues up in our committee, but then also to find floor time to consider tax treaties in this Congress. The calendar will move quickly, but we need your help in pointing out how important these treaties are. I thought your testimonies were particularly useful, the first panel, we went through a lot of the technical parts. But the second, the practical impact of failure to ratify backs up other potential treaties from being completed. And when companies have options, they go where they feel that they know what the rules are.

Obviously, they would like to be in the United States, but there are other factors that can sway investment decisions, as you pointed out. So I very much appreciate those observations.

The committee record will remain open until Friday for members to pose questions for the record.

Senator CARDIN. If you are the recipient of those types of questions, we would ask if you could respond as quickly as possible, we would appreciate that, because we need to get that completed before we could schedule committee action on these treaties.

So we will relay the message to the leadership of our committee.

And with that, the committee will stand adjourned. Thank you all.

[Whereupon, at 11:55 a.m, the hearing was adjourned.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF CREDIT SUISSE GROUP SUBMITTED BY SENATOR BENJAMIN L. CARDIN

Chairman Menendez, Ranking Member Corker, and members of the committee, Credit Suisse appreciates the opportunity to comment on the 2009 Protocol to the

Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income, and to urge swift approval of the 2009 Protocol by the committee.

The 2009 Protocol would eliminate barriers to resolving numerous, long-running criminal tax investigations involving much of the Swiss banking industry. Resolution of these cases would enable the U.S. Government to collect substantial U.S. tax revenues, based on the exchange of information related to offshore accounts of U.S. taxpayers who may have misused Swiss privacy laws. At the same time, the 2009 Protocol will continue to balance in an appropriate manner the personal privacy interests of U.S. and Swiss citizens.

The Protocol was signed in September 2009 and previously approved by the committee in July 2011. It has since awaited action by the U.S. Senate for more than 2 years, and we strongly endorse its swift approval by the committee and by the full Senate.

CREDIT SUISSE HAS BEEN A LEADER IN PROMOTING TRANSPARENCY OF TAX INFORMATION

Founded in 1856, Credit Suisse is a leading global private banking and wealth management firm based in Switzerland. Credit Suisse employs approximately 9,000 people in 19 U.S. locations and manages over $1.4 trillion in assets. Our shares are listed on both the New York Stock Exchange and the leading Swiss stock exchange. Our wealth management business serves over 2 million clients around the world through 330 offices in 42 countries.

Credit Suisse fully supports the U.S. Government's efforts to combat U.S. tax evasion. Credit Suisse has been a leader among Swiss banks in working with government authorities to fully address the problem of U.S. taxpayers evading taxes through the misuse of undeclared Swiss bank accounts. In 2008, when the Senate Homeland Security and Government Affairs Committee's Permanent Subcommittee on Investigations issued a report on how UBS and other Swiss banks' offshore practices helped U.S. clients seeking to evade taxes through offshore accounts, Credit Suisse responded faster than any other bank in Switzerland. Credit Suisse swiftly imposed a block on transfers of undeclared U.S.-owned accounts from UBS. Credit Suisse rigorously examined all of its accounts in order to identify those held by U.S. taxpayers and to ensure that they were in compliance with all relevant U.S. laws and regulations. Credit Suisse has also continued to cooperate with U.S. law enforcement authorities in their investigation of U.S. taxpayers with undeclared accounts and, regrettably, individual bankers who may have violated firm policies and historical Swiss banking practices.

We have made full compliance with U.S. tax laws a top priority. Consistent with that priority, we have adopted robust reforms, including the following: Since 2008, we have adjusted our internal compliance and monitoring systems to enable us to monitor all types of accounts for evidence of direct or indirect U.S. ownership. Credit Suisse no longer accepts accounts in its Swiss bank of U.S. residents, other than in tightly defined circumstances. For nonresident U.S. taxpayers living abroad, Credit Suisse not only notifies all identified U.S. accountholders of their U.S. tax filing obligations, but also requires them to consent to disclosure of their identity and account information to the IRS in order to continue banking with Credit Suisse. Our company policies also now prohibit inflows of funds from Swiss banks of U.S. account holders who have failed to disclose their tax status to the IRS.

THE TREATIES BEFORE THE COMMITTEE, INCLUDING THE 2009 PROTOCOL, ARE CRITICAL TO U.S. BILATERAL TRADE AND INVESTMENT

The world's network of bilateral and multilateral tax treaties, including the U.S. network of over 60 tax treaties, plays a critical role in fostering global trade, investment, job creation, and economic growth. The U.S. tax treaty network, including the 1996 U.S.-Swiss Tax Treaty which would be updated by the 2009 Protocol, enhances the ability of U.S. businesses to compete abroad.

Tax treaties work by reducing cross-border taxation on a reciprocal basis. For example, the U.S.-Swiss Tax Treaty reduces or eliminates withholding taxes that Switzerland would otherwise impose on income earned by U.S. investors from Swiss securities. The treaty also restricts Switzerland's ability to tax income earned by U.S. businesses from activities in Switzerland that fall short of a specific threshold, set forth in the treaty (the "permanent establishment" threshold). In return, the United States provides similar benefits for Swiss businesses and individuals, thereby fostering bilateral trade and investment.

The information exchange provisions of modern tax treaties allow the two countries' tax administrators to discuss and to resolve specific cases where their businesses or citizens could otherwise face taxation of the same income in both countries (i.e., international double taxation). This dispute resolution process would not be possible without the two governments being able to share taxpayer information. As discussed below, information exchange provisions also help the two countries investigate and, where necessary, prosecute suspected cases of tax evasion.

Most of the technical provisions included in modern U.S. tax treaties is the product of years of dialogue among committee members, the Joint Committee on Taxation, the Treasury Department, and interested stakeholders in the United States and abroad. The 2009 Protocol is no different in this regard, and we welcome this ongoing dialogue. In part because this process has been so cooperative, tax treaties have long enjoyed broad bipartisan support in Congress and within the taxpayer community, including the many U.S. businesses and individuals who rely on U.S. tax treaties to reduce the risk of international double taxation.

Credit Suisse strongly supports the ratification of each of the treaties before the committee today because it views tax treaties as key to promoting economic growth and free trade by reducing barriers to trade and investment on a reciprocal basis.

ADOPTION OF THE 2009 PROTOCOL TO THE U.S.-SWITZERLAND TAX TREATY IS NEEDED TO ENABLE THE IMPROVED BILATERAL EXCHANGE OF INFORMATION AND TAX TRANSPARENCY

The 2009 Protocol makes several key improvements to the current 1996 U.S.-Swiss Tax Treaty, which would remain in force, subject to amendment by the Protocol.

First and foremost, approval of the 2009 Protocol is essential to resolving several long-running U.S. tax investigations involving Swiss banks on a basis most favorable to the United States. The Protocol would eliminate the requirement, found in the 1996 U.S.-Swiss Tax Treaty, that a request for information from the U.S. Government to the Swiss Government describe conduct of a U.S. taxpayer amounting to “tax fraud or the like” under Swiss law, and that the request be “necessary for carrying out the provisions” of the tax treaty. This strict language has repeatedly prevented U.S. law enforcement from obtaining the information it needs to investigate U.S. tax evasion through the use of undeclared Swiss bank accounts.

The 2009 Protocol would rectify this situation by permitting the exchange of “such information as may be relevant for carrying out the provisions” of the treaty or for the administration of U.S. domestic law, even when such information would not be sought by Switzerland for its own tax administration purposes. The Protocol thus ensures that subsequent amendments to Swiss domestic law would not prevent the U.S. Government from obtaining from Swiss banks the same type of tax information the U.S. Government obtains every year from U.S. banks. Only by eliminating outdated barriers to U.S.-Swiss information exchange can the ongoing U.S. tax investigation into Swiss banks be completed. Credit Suisse supports these changes, which will allow Swiss banks to close this chapter and move forward under a more transparent regime that satisfactorily guards against future U.S. tax evasion.

Once it enters into force, the 2009 Protocol will allow the U.S. Government to obtain from Switzerland as much information as it can obtain currently from any other U.S. trading partner—and, in fact, more because of the Protocol’s retroactive effective date to September 2009. This change should serve as a formidable deterrence against tax evasion while, in the meantime, bringing a substantial recovery of tax revenue to the U.S. Treasury. Although Credit Suisse is prepared to provide the historical information about U.S. account holders currently being requested by the U.S. authorities, it cannot do so under existing Swiss law until the United States adopts the 2009 Protocol—in effect agreeing to receive the information that U.S. law enforcement has requested, and that Credit Suisse is willing to provide.

THE 2009 PROTOCOL INCORPORATES STRONG PRIVACY PROTECTIONS

In implementing these necessary changes to the existing tax treaty, the Protocol takes a balanced approach of permitting relevant tax data to be collected while ensuring the confidentiality of that data. In substance, the 2009 Protocol affords the same privacy protections to U.S. citizens that they would have in the United States. Consistent with current Swiss law, the Protocol strictly prohibits the unauthorized use or disclosure of requested information. Each treaty partner may use the obtained information only for tax administration purposes and may disclose it only to persons or authorities (such as courts) involved in administering U.S. and Swiss tax laws. The Protocol specifies criteria that must be met for a request to be honored and explicitly bars “fishing expeditions” by either country. The 2009 Protocol thus allows the U.S. to combat offshore tax evasion while continuing to safeguard personal privacy.

SWITZERLAND HAS ALREADY RATIFIED THE 2009 PROTOCOL

The 2009 Protocol required significant and difficult changes to be made to Swiss law, and the United States and its taxpayers would be the greatest beneficiaries of those changes. Yet while the Swiss Parliament approved the 2009 Protocol on June 18, 2010, the U.S. Senate has failed to provide its advice and consent. We believe this inconsistency can and should be rectified by swift action on the part of the U.S. Senate.

CONCLUSION

Historically, the Senate has approved tax treaties on a bipartisan basis, routinely allowing for ratification of the treaties by unanimous consent. For all the reasons detailed above, this committee unanimously approved the Protocol in July 2011. However, because the Senate as a whole was not able to act upon it before the end of the 112th Congress, this committee must act again to reapprove the Protocol. Credit Suisse strongly urges the committee to do so.

RESPONSE OF WILLIAM A. REINSCH TO QUESTION
SUBMITTED BY SENATOR ROBERT MENENDEZ

Question. Your membership is clearly interested in making the United States more competitive in the global marketplace. How would the ratification of these treaties advance that goal?

Answer. In order for American companies to be competitive globally, tax and trade barriers should be eliminated. The tax treaties currently pending before the Senate Foreign Relations Committee will reduce tax barriers to companies by eliminating double taxation and provide certainty through clearer definitions and a more robust dispute resolution provision. The withholding rate changes in interest, dividends, and royalties alleviate double taxation, while the clear definition of business profits and permanent establishments provide the certainty business needs. The mandatory arbitration provision included in the Swiss treaty will help resolve cases more quickly by providing a backstop to the Competent Authority negotiations and will prevent long drawn out cases that cost companies millions of dollars that could be put to a more productive use in their businesses.

RESPONSES OF PAUL NOLAN TO QUESTIONS
SUBMITTED BY SENATOR ROBERT MENENDEZ

Question. Could you elaborate further on the importance of these pending treaties, or income tax treaties in general, to your business? In what ways would they help?

Answer. We identified in our testimony three specific benefits of tax treaties to the U.S. companies that engage in global business, (i) clear thresholds and "triggers" of taxation, (ii) the Mutual Agreement Procedure (or "MAP" as it is commonly called) and (iii) reduced rates of withholding tax on source-based income (i.e, the treaty partner's tax on income derived in the treaty partner's jurisdiction) from licenses to use U.S.-owned intellectual property or U.S. capital (i.e., loans), i.e., royalties and interest.

We, like other U.S. multinational businesses, see all three of these benefits as a consequence of our treaty network. The treaties and protocols that were the subject of the hearing represent a portion of the "pipeline" of treaty updates and new treaties that the U.S. Treasury, as the delegate of the executive branch's constitutional authority, has been negotiating on behalf of the United States.

To elaborate further on the importance of these treaties, we see the treaty network as an evolving and growing system that serves as a foundation for cross-border tax rules, with amendments to existing treaties to improve and "modernize" them and with new countries being brought into the treaty network. The continuation of this evolution and growth is important. As a followup response to provide elaboration that we hope will be helpful to the chairman and the Senate Foreign Relations Committee in its deliberation of these treaties and protocols, we would make the following points.

First, the main importance of these treaties and protocols at this particular time is to demonstrate that the U.S. ratification process continues to work as designed, with the due deliberation of "advice and consent" as provided under the Constitution by the U.S. Senate and subsequent ratification and coming into force. For U.S. companies, a series of treaties or protocols with a status of "pending ratification" through successive Congresses raises concern regarding whether the treaty network will cease to evolve and grow.

Given the current environment regarding global taxation, with so-called "BEPS (base erosion and profit shifting) Initiative" occurring under the direction of the G20 and with many U.S. trading partner countries adopting new rules to address perceived tax abuse, the value of the treaty network as a bedrock system of bilateral principles and understanding between the United States and each of its treaty partners becomes even more important so that U.S. businesses can plan, invest, and grow with relative certainty.

Second, ratification of these treaties sends a signal to other sovereign states that we continue to value the bilateral approach and will continue to amend where appropriate and to enter into treaties with new partners as appropriate. U.S. companies will benefit from such a signal because other sovereigns will need to be cognizant of the range of current U.S. tax treaty norms for purposes of amendment of existing treaty or purposes of entering into a first tax treaty with the United States. The support of these treaty norms could serve to prevent approaches to taxation that harm or place U.S. companies at a disadvantage.

Third, modernization of treaties through protocols or new treaties, bring about consistency in treatment of fundamental issues that assist U.S. companies that seek to comply fully with the applicable rules. Specifically, "limitation of benefits" and information-sharing provisions modernize treaties to provide avenues to address tax abuses in which compliant U.S. companies do not engage. For a U.S. company that follows the rules, tax abuse by so-called "treaty shopping," or other abuses that an exchange of information can provide tax authorities with the tools to address, not only can create a competitive disadvantage but can also create undue reputational harm due to public perceptions of wide-spread tax abuse in all cross-border business activity.

Question. Has a delay in the ratification of the treaties affected your business

Answer. In our view, the answer to this question is "yes."

A simple example is the treaty with Chile, without which any U.S. company engaging in business must analyze Chilean domestic tax law without any of the protections or benefits that a treaty would bring, i.e., reduced withholding rates, clear mutual agreement procedures, residency rules, etc. The treaty with Chile would be the U.S.'s second tax treaty with South America. U.S. companies have extensive business and growth opportunities in South America. A series of treaties in South America would benefit U.S. businesses and support the creation of U.S. jobs in the United States for U.S. headquartered companies.

In terms of treaty protocols that amend treaties to incorporate the latest limitations on benefits or information exchange provisions, delay means that those who benefit from the status quo that the protocols would impact can continue to engage in tax abuse with impunity. As described above, this delay hurts tax compliant U.S. businesses.

Finally, as we testified before the committee, the ratification of tax treaties can often seem "important but not urgent" as the other foreign policy priorities arise with an urgency driven by crisis and events in foreign affairs and U.S. diplomacy.

In our view, these treaties are "important and urgent" for this Congress to ratify for the reasons provided in our testimony and the elaboration provided above.

RESPONSES OF ROBERT STACK TO QUESTIONS
SUBMITTED BY SENATOR ROBERT MENENDEZ

Question. The existing treaty with Hungary is one of only seven U.S. income tax treaties that do not include any limitation-on-benefits rules, thereby necessitating this new protocol. Similarly, the new treaty with Poland, which addresses limitation-on-benefits, may be transmitted to the Senate in the near future.

- What are the Treasury Department's priorities in renegotiating other treaties to better incorporate current practice on limitation-on-benefits or other major provisions?

Answer. The Treasury Department's efforts to protect the U.S. tax treaty network from abuse have focused primarily on those tax treaties that contain a complete exemption from withholding taxes at source for deductible payments and also lack any antitreaty shopping protections. Three tax treaties fall into this category: the tax treaties with Iceland, Hungary, and Poland that were signed in 1975, 1979, and 1974 respectively. 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 new U.S.-Iceland tax treaty contains a comprehensive limitation on benefits provision. In addition, the United States and Poland signed a new tax treaty in February 2013, which similarly contains a comprehensive limitation on benefits provision. The administration hopes to transmit the new tax treaty with Poland to the Senate for its advice and consent soon.

With the conclusion of new tax treaties with Iceland, Hungary, and Poland, the Treasury Department is actively seeking to revise other existing tax treaties that provide for positive, but reduced rates of withholding on deductible payments, and therefore also present opportunities for base erosion and treaty shopping, although not to the extent of the Iceland, Hungary, and Poland tax treaties. For example, we are in the process of concluding negotiations of new tax treaties that would replace the existing tax treaties with Norway and Romania, which were signed in 1971 and 1973 respectively. The administration hopes to sign these two new treaties and transmit them to the Senate for its advice and consent in the near future.

Question. Please describe the confidentiality protections that are built into the agreements before us and what steps the U.S. Government takes to ensure that private information is not disclosed to the wrong parties. How do the treaties ensure that our treaty partners do not engage in "fishing expeditions?"

Answer. Confidentiality protections for information are central to establishing and maintaining an exchange relationship under a tax agreement. Provisions requiring such protection are included in all five tax treaties being considered by the Senate. Additionally, the United States has the authority, consistent with international law, not to exchange information in cases where a treaty partner does not protect the confidentiality of the information as required by the treaties.

Specifically, the four proposed bilateral tax treaties, as well as the proposed Protocol to the Multilateral Convention, before the Senate provide that information that is exchanged pursuant to such agreements shall be treated as secret in the same manner as information obtained under the domestic laws of the State that received the information and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment, collection or administration of, the enforcement or prosecution in respect of or the determination of appeals in relation to, taxes, or the oversight or supervision of such functions. A State may disclose the information received in public court proceedings or in judicial decisions. When negotiating a bilateral agreement, the Treasury Department, including the Internal Revenue Service (IRS), evaluates key aspects of the domestic law of the other country, including domestic laws that provide for the confidentiality of information exchanged pursuant to an international agreement. The Treasury Department will agree to conclude a bilateral tax treaty or tax information exchange agreement only if it is satisfied that the other country's confidentiality laws are sufficiently robust.

The Multilateral Convention contains the above described provisions concerning protecting the strict confidentiality of information that is exchanged. The Convention has established a Coordinating Body comprised of all countries that are Parties to the Multilateral Convention, the primary purpose of which is to evaluate requests by new non-OECD and non-Council of Europe countries to become parties to the Convention. The Coordinating Body closely evaluates the domestic laws of each such potential party to ensure that it has a sufficient legal framework to ensure the confidentiality of information that would be exchanged pursuant to the Convention. Requests from countries that are not members of the OECD or the Council of Europe to join the Multilateral Convention must be approved by unanimous consent of the Coordinating Body, which reviews the legal framework of each potential party to ensure the confidentiality of information that is exchanged pursuant to the Convention. If any member of the Coordinating Body, including the United States, is not satisfied with the legal framework of a country regarding confidentiality, that country will not be permitted to join the Multilateral Convention.

If an exchange of information partner, either under a bilateral tax treaty, the Multilateral Convention, or a tax information exchange agreement (TIEA), were to breach the relevant agreement's confidentiality provisions, which are central provisions reflecting a bedrock principle of these agreements, the United States would have the ability, consistent with international law, to not exchange information with that state pending resolution of the matter. The provisions in the proposed treaties are similar to those in Article 26 of the updated OECD Model Tax Convention. This international law principle is reflected in the 2012 OECD Update to Article 26 of the OECD Model Tax Convention and its Commentary, which was approved by the OECD Council (including the United States) on July 17, 2012, and which provides: "In situations in which the requested State determines that the requesting State does not comply with its duties regarding the confidentiality of the information exchanged under this Article, the requested State may suspend assistance under this Article until such time as proper assurance is given by the requesting State that those duties will indeed by respected."

Finally, the text of the five treaties provides that the information be for such information as "may be relevant" or that is "foreseeably relevant." This language is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that the Parties are not at liberty to engage in "fishing expeditions." The text of these treaties contains similar language to that in the OECD Model Tax Convention. The Commentary to the OECD Model Tax Convention was revised with the approval of the OECD Council (including the United States) on July 17, 2012, to provide clear guidance regarding what constitutes a valid request for information under the OECD Model income tax treaty. The Commentary provides that a tax treaty "does not obligate the requested State to provide information in response to requests that are 'fishing expeditions,' i.e., speculative requests that have no apparent nexus to an open inquiry or investigation." Similarly, the Explanatory Report to the Multilateral Convention, which was approved by the OECD's Committee on Fiscal Affairs (including by the U.S. representative on that Committee) provides that "The standard of "foreseeable relevance" in the Multilateral Convention is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that the Parties are not at liberty to engage in 'fishing expeditions'. . ." This interpretation is universally accepted, and thus we do not have concerns that our treaty partners will engage in fishing expeditions. In the event that the IRS received a request for information that rose to the level of a fishing expedition, there would be no obligation to provide assistance, because the request would not be within the scope of requests permitted under the treaties.

Question. From the standpoint of information exchange, the Swiss and Luxembourg protocols are very important, because we know that banks in those two countries have been used by some in the United States to evade their tax obligations. The new protocols will enhance the ability of U.S. authorities to investigate and prosecute tax criminals that have used banks in those countries. From a privacy standpoint, the U.S. Government is required to keep any information obtained confidential and use it only for legitimate purposes.

- Do we have serious concerns about Switzerland and Luxembourg making unauthorized or inappropriate use of U.S. taxpayer information?

Answer. The proposed Protocol to the Luxembourg tax treaty requires any information exchanged pursuant to the tax treaty to be used for tax administration purposes only. The terms of the proposed Protocol with Switzerland are consistent with those of the proposed Luxembourg Protocol, although it also permits the use of information that has been exchanged pursuant to the agreement to be used for nontax purposes, but only if the revenue authority of the country providing the information provides written consent. The Treasury Department Technical Explanation of the proposed Protocol with Switzerland provides that the competent authorities will only provide such written consent if the information could have been exchanged pursuant to the treaty on mutual legal assistance between the United States and Switzerland. We are confident that these tax treaty provisions with both Switzerland and Luxembourg adequately protect the confidentiality of exchanged information, and we do not have concerns that either country will use information exchanged with the United States in an inappropriate manner.

RESPONSE OF NANCY MCLERNON TO QUESTION
SUBMITTED BY SENATOR ROBERT MENENDEZ

Question. Your organization represents the U.S. operations of many global companies. Could you elaborate further on how these treaties will help your members? For instance, will these treaties lead to additional insourcing or investment in the United States, and if so, in what ways?

Answer. Bilateral tax treaties provide a reliable tax environment for companies doing business in several jurisdictions and help ensure that common business expenses are not subject to double taxation. This provides companies with greater certainty on the application of tax rules, and allows insourcing companies to invest more in the very business activities that drive economic growth, like expanding operations, purchasing new equipment, hiring more U.S. workers, and selling trademarked or licensed goods. The positive impact these agreements have on investment flows can be seen by the growth in investment from our treaty partners.

For example, since the Protocol to the French Income Tax Treaty was ratified at the end of 2009, we have seen a 144-percent increase in FDI flows from France.

As the Senate considers these agreements, it is important to keep in mind that global companies have an increasingly wide array of options when looking to invest, expand, or establish new operations around the globe, especially with the growth of emerging markets. Over the last decade, the United States has seen its share of global investment dramatically decline, from roughly 37 percent in 2000 to just over 17 percent in 2012. This is why it is critically important for the United States to implement policies that make the United States more attractive for global companies to invest, and implementing the outstanding tax treaties will do just that. As such, the Organization for International Investment and its member companies strongly support expansion and updating of our Nation's tax treaty network.

RESPONSES OF ROBERT STACK TO QUESTIONS
SUBMITTED BY SENATOR BENJAMIN L. CARDIN

Question. Three of the agreements being considered by the committee were voted out of committee during the last Congress and are back for reapproval. This has caused a delay in getting these agreements into force.

♦ What effect does not ratifying these treaties have on the United States ability to negotiate tax treaties in the future and in influencing the development of tax treaties worldwide, for example through the OECD?

Answer. The Treasury Department urges the Senate to provide its advice and consent to the five tax treaties as soon as possible. Both our existing and potential new treaty partners, as well as key policymaking multilateral institutions such as the OECD have noted with concern the Senate's recent inaction regarding approval of tax treaties. The Senate's resumption of the tax treaty approval process would be a critical component of the U.S. Government's collective desire to advance modern tax treaty policies that promote transparency and the economic interests of the United States. The harm to U.S. interests of failing to ratify these treaties in an expeditious manner was aptly summarized in the testimony of Ms. Nancy L. McLernon, president and CEO of the Organization for International Investment:

> "It is important to note that failure to act on these agreements in an expeditious manner has a number of negative consequences. The failure of the Senate to ratify many of these agreements in the past few years has slowed the progress on tax treaties with other countries and sends a message to the international community that the United States is not committed to maintaining these important adjuncts to international commerce.
>
> "The proposed treaties we are discussing today are not the only tax treaties that have been signed and are awaiting Senate ratification. Last year, the United States signed tax treaties or protocols with Japan, Poland, and Spain. In addition to that, the United States is negotiating with the United Kingdom and Vietnam. These are significant markets for the United States, considering that British and Japanese companies have invested $795 billion combined in the United States, making them the top two investing countries by cumulative stock.
>
> "The lingering ratification process also scares away potential new investment from firms, based in proposed treaty countries, which are evaluating investment locations around the world and making long-term strategic plans. It is difficult for these businesses to commit to U.S. investments unless they are confident a treaty will promptly come into force."

Question. The treaty with Chile, if ratified, will be only the second in-force U.S. income tax treaty with a South American country. How significant are cross-border investment flows between the United States and Chile? In your view, what role does the Chile treaty play in continuing to expand our treaty network in this region?

Answer. If approved by the Senate, the proposed Chile tax treaty would be only the second U.S. tax treaty in force with a South American country. Chile is a major destination for foreign direct investment (FDI) in the region, receiving $20.1 billion in FDI inflows in 2013, according to Commerce Department data sources. The United States is the second-largest source of FDI into Chile, accounting for an average of 10 percent of Chile's FDI inflows over the past 5 years.

The U.S. business community has long urged the Treasury Department and the Senate to expand the U.S. tax treaty network in South America to address unrelieved double taxation faced by U.S. investments in the region. The proposed tax treaty with Chile, if approved by the Senate and brought into force, would represent a significant step in this effort. In addition, the Treasury Department is in active tax treaty negotiations with Colombia, which we hope to conclude soon. The Treasury Department hopes that the conclusion of the Chile tax treaty and our opening of tax treaty negotiations with Colombia will lead to more tax treaty discussions with key trading partners in the South American region, such as Brazil and Argentina.

Question. The Protocol to the OECD Convention provides for spontaneous exchange of information and simultaneous tax examinations with other signatory countries. Over 60 countries have signed the Convention so far, and the number can be expected to grow. Although many of these countries are existing tax treaty partners, the Convention may eventually include countries with which it would not be in our interest to exchange information.

♦ What protections does the Protocol have to ensure that the United States will not be required to provide information to such countries?

Answer. The Treasury Department urges the Senate to provide its advice and consent to the proposed Protocol to the OECD Convention as soon as possible. The new information exchange relationships that the proposed Protocol would establish for the United States would be an effective tool for the IRS to use to counter tax evasion. Requests from countries that are not in the OECD or the Council of Europe to join the Multilateral Convention must be approved by unanimous consent of the Coordinating Body, which reviews the legal framework of each potential party to ensure the confidentiality of information that is exchanged pursuant to the Convention. If any member of the Coordinating Body, including the United States, is not satisfied with the legal framework of a country regarding confidentiality, that country will not be permitted to sign the Multilateral Convention.

In case, after joining the Convention, a State was not providing satisfactory protection of information as required by the Convention, which is a bedrock principle of the Convention, then the United States would have the ability, consistent with international law, not to exchange information with that State pending resolution of the matter. This international legal principle is reflected in the Revised Explanatory Report to the Convention on Mutual Administrative Assistance in Tax Matters, as Amended by the Protocol, approved in 2010 by the OECD Committee on Fiscal Affairs, with the concurrence of the United States representative on that Committee. It provides: "However, consistent with international law, in situations where the requested State determines that the applicant State does not comply with its duties regarding the confidentiality of the information exchanged under the Convention, the requested State may suspend assistance under the Convention until such time as proper assurance is given by the applicant State that those duties will indeed be respected."

Further, Article 21 in the proposed Protocol, which is before the Senate, further contains a "public policy" (ordre public) exception for compliance.

"Article 21 – Protection of persons and limits to the obligation to provide assistance

> "1. Nothing in this Convention shall affect the rights and safeguards secured to persons by the laws or administrative practice of the requested State.
>
> "2. Except in the case of Article 14, the provisions of this Convention shall not be construed so as to impose on the requested State the obligation:
>
> > "a. to carry out measures at variance with its own laws or administrative practice or the laws or administrative practice of the applicant State;
> >
> > "b. to carry out measures which would be contrary to public policy (ordre public);"

The Explanatory Report to the amendments to the OECD Convention on "public policy," provides some helpful guidance and helps to illuminate what the parties were thinking. In particular, it provides that:

> "It has been felt necessary also in subparagraph d to prescribe a limitation with regard to information which concerns the vital interests of the State itself. To this end, it is stipulated that Contracting States do not have to supply information the disclosure of which would be contrary to public policy (ordre public). However, this limitation should only become relevant in extreme cases. For instance, such a case could arise if a tax investigation in the applicant State were motivated by political, racial, or religious persecution. The limitation may also be invoked where the information constitutes a state secret, for instance sensitive information held by secret services the disclosure of which would be contrary to the vital interests of the 30 requested State. Thus, issues of public policy (ordre public) should rarely arise in the framework of the Convention."

Thus, concerns over certain behavior of the other party if contrary to U.S. public policy, could support not sharing information with them.

Finally, note that parties to the Multilateral Convention have the right to participate in an information on request relationship, subject to the normal restrictions that apply in that context (e.g., the foreseeably relevant standard). The proposed Protocol, however, does not guarantee a country that we will enter into a spontaneous or reciprocal automatic exchange relationship.

RESPONSES OF ROBERT STACK TO QUESTIONS
SUBMITTED BY SENATOR RAND PAUL

Question #1. Under what authority was the IGA to implement FATCA created, and where in the FATCA legislation was reciprocity by U.S. financial institutions authorized?

Answer. The United States relies, among other things, on the following authorities to enter into and implement the IGAs: Article II of the United States Constitution; 22 U.S.C. Section 2656; and Internal Revenue Code Sections 1471, 1474(f), 6011, and 6103(k)(4) and Subtitle F, Chapter 61, Subchapter A, Part III, Subpart B (Information Concerning Transactions with Other Persons).

Question #2. Where does the Department of the Treasury have authority under FATCA to waive the 30 percent withholding sanctions in exchange for reciprocity?

Answer. The IGAs do not waive the 30 percent FATCA withholding tax in exchange for reciprocity. Instead, the IGAs generally provide that the FATCA withholding tax will not apply to financial institutions and certain other entities located in the IGA jurisdiction ("FATCA partner jurisdiction") in circumstances where either (i) the terms of the IGA provide that the IRS will receive reporting on the United States accounts maintained by the financial institution or (ii) the entity otherwise poses a low risk of being used by U.S. persons for tax evasion. The Treasury Department has ample authority under section 1471 of the Internal Revenue Code to issue regulations that waive the FATCA withholding tax in these circumstances. Specifically, section 1471(b)(2) authorizes the Secretary of the Treasury to treat certain classes of financial institutions as "deemed compliant" with FATCA's requirements, and therefore as exempt from FATCA withholding, when (i) the Secretary determines that the application of FATCA with respect to the class is not necessary to carry out the purposes of FATCA or (ii) the institution complies with any procedures prescribed by the Secretary to ensure that it does not maintain United States accounts and complies with any prescribed procedures regarding accounts held by other foreign financial institutions. In addition, section 1471(f)(4) authorizes the Secretary to exempt from FATCA withholding any payment where the beneficial owner is a member of a class of persons that poses a low risk of tax evasion (referred to as exempt beneficial owners). See also section 1474(f), which provides authority to prescribe regulations or other guidance that may be necessary or appropriate to carry out the purposes of, and prevent the avoidance of FATCA.

Question #3. Does the Department of the Treasury intend to interpret the income tax treaties before the Senate as the legal authority to force U.S. financial institutions to comply with the bilateral agreements to implement FATCA?

Answer. U.S. financial institutions are not forced to comply with the bilateral agreements to implement FATCA. The United States Government must comply with its bilateral agreements, such as an IGA. As noted below, in answer to Questions 4 and 5, financial institutions already have statutory and regulatory obligations to report certain U.S.-source income information about nonresident accounts to the IRS, which exist independent of the IGAs. These obligations are not dependent on any interpretation of the tax treaties currently before the Senate. The reciprocal IGAs only obligate the IRS to exchange with a FATCA partner jurisdiction account information that the IRS already collects with respect to the tax residents of the FATCA partner country.

Question #4. Where specifically in the treaties does the United States agree to mandate U.S. financial institutions to collect and report account information on a blanket basis (as opposed to requests to "exchange" tax data on individuals)?

Answer. The U.S. treaties under consideration by the Senate do not mandate U.S. financial institutions to collect and report any account information on a blanket basis. Rather, under existing provisions of the Internal Revenue Code and the regulations thereunder, withholding agents, including U.S. financial institutions, have the obligation to report to the IRS information on certain amounts of U.S. source income paid to non-U.S. persons, as described in more detail in the response to question 5, below.

The United States has authority to exchange the information that it collects from financial institutions with other jurisdictions under the tax information exchange provisions of most of its tax treaties, which receive Senate advice and consent to ratification, as well as pursuant to the bilateral agreements relating to the exchange of tax information (referred to as tax information exchange agreements, or TIEAs). The United States only enters into reciprocal IGAs with jurisdictions with which we already have a tax treaty or TIEA, and all reciprocal IGAs provide that any information provided by the IRS will be exchanged pursuant to that preexisting agreement.

Question #5. Do you believe the Department of the Treasury already has sufficient statutory authority to issue regulations requiring U.S. financial institutions to collect and report the information described in the Inter Governmental Agreement to Implement FATCA; and if so, please cite and provide relevant text of the statues conferring such authority.

Answer. The information that the United States would agree to exchange under the reciprocal version of the IGA differs in scope from the information that foreign governments would agree to provide to the IRS. In fact, the information specified to be exchanged by the IRS under the IGA is limited to the U.S.-source income information that U.S. financial institutions are required under existing regulations to report to the IRS about nonresident accounts.

The reciprocal IGAs require the United States to collect and report the following with respect to financial accounts held by a resident of the IGA partner jurisdiction and maintained by a U.S. financial institution in the United States or by the U.S. branch of a foreign financial institution:

1. Identifying information for the account holder, including name, address, foreign taxpayer identifying number, and account number;
2. The gross amount of interest paid on an account that is a depository account held by an individual, provided that more than $10 of interest is paid to such account in any given calendar year;
3. The gross amount of U.S. source dividends paid or credited to the account;
4. The gross amount of other U.S. source income paid or credited to the account, to the extent such income is subject to reporting under chapter 3 of subtitle A or chapter 61 of subtitle F of the U.S. Internal Revenue Code.

All of the foregoing information is already required to be reported under existing statutory or regulatory provisions for nonresident accounts maintained in the United States. Financial institutions are required to collect information from nonresident alien account holders to establish the status of the account holder as a non-U.S. person under section 6049. This information is generally collected on a Form W–8BEN, which includes the name, address, country of tax residence of the account holder, and foreign taxpayer identifying number, if any. In addition, under sections 871(a) and 881(a), foreign persons are subject to a 30-percent tax on certain payments of U.S. source income, which includes, among other things, interest, dividends, and other similar types of investment income, unless the beneficial owner of the payment is entitled to a reduced rate of, or exemption from, withholding tax under domestic law, including an income tax treaty. This tax is collected by U.S. withholding agents (including financial institutions) under section 1441. Section 1461 and the regulations thereunder require withholding agents to report to the IRS any payments that are subject to withholding tax under section 1441, even if the tax is reduced or eliminated by another statutory provision or an income tax treaty. These amounts would include items 3 and 4 described above (U.S. source dividends, and other "amounts subject to reporting under chapter 3 of subtitle A").

With respect to amounts described in item 2 above, bank deposit interest paid to nonresidents that is not effectively connected with the conduct of business within the United States is generally exempt from the section 1441 withholding tax. However, there is separate statutory authority that allows the reporting of such interest. Section 6049(a) provides generally that every person who makes a payment of bank deposit interest aggregating $10 or more to any other person shall, unless an exception applies, report such payment to the IRS in accordance with the forms and regulations as prescribed by the Secretary of the Treasury. Section 6049(b)(2)(B)(ii) provides that the term "interest," for purposes of application of section 6049(a), does not include, *except to the extent otherwise provided in regulations,* any amount described in section 6049(b)(5), which applies to certain payments of interest on deposits made to nonresident aliens and foreign corporations that are not effectively connected with the conduct of business within the United States. Sections 6049(b)(2)(B) and (b)(5) thus provide express authority for Treasury and the IRS to issue regulations requiring the reporting of bank deposit interest paid to nonresidents. The regulations issued pursuant to this authority at Reg. 1.6049–5 and –8 require reporting with respect to amounts described in item 2, above.

RESPONSES OF THOMAS A. BARTHOLD TO QUESTIONS SUBMITTED BY SENATOR ROBERT MENENDEZ

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

MAR 1 8 2014

Honorable Robert Menendez
United States Senate
SH-528
Washington, D.C. 20510

Dear Senator Menendez:

This letter is in response to your questions submitted for the record during a hearing by the Senate Foreign Relations Committee on tax treaties on February 26, 2014. You have asked me to comment on the extent to which the information sharing provisions in the proposed protocols to the U.S. income tax treaties with Luxembourg (the "Luxembourg treaty, as amended") and Switzerland (the "Switzerland treaty, as amended") incorporate the standards described in the Commentaries to Article 26 of the OECD Model treaty ("OECD Model"). In particular, you have asked about the standard a treaty country must meet when making a group request to show that the request is not part of a "fishing expedition."

Standard for information exchange in the OECD Model

Under paragraph 1 of Article 26 of the OECD Model, the competent authorities of each treaty country are required to exchange such information as is "foreseeably relevant" to carrying out the provisions of the OECD Model or in carrying out the provisions of the domestic laws of the treaty countries concerning all taxes of any kind imposed by the treaty countries. The Commentaries on paragraph 1 of Article 26 of the OECD Model explain that the standard of "foreseeable relevance" is intended to allow for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that treaty countries are not at liberty to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. The Commentaries provide that the treaty countries may agree to an alternative formulation of the standard that is consistent with the scope of Article 26 (*e.g.* by replacing "foreseeably relevant" with "necessary" or "relevant").

Standard for information exchange in the Luxembourg treaty, as amended

Under the Luxembourg treaty, as amended, the United States and Luxembourg agree to exchange such information as is foreseeably relevant in carrying out provisions of the treaty, as amended, or in carrying out the provisions of the domestic laws of the two treaty countries concerning all taxes of any kind imposed by a treaty country. The use of the phrase "foreseeably relevant" incorporates the standards of the OECD model, which is intended to provide for exchange information in tax matters to the widest possible extent, and at the same time, to clarify that treaty countries are not at liberty to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. This standard is understood to conform to the standard used in Code section 7602, which authorizes the IRS to examine any books, records or other material that "may be relevant or material," as confirmed by the U.S. Supreme Court in a line of cases beginning with *United States v. Powell.*[1]

Since 2009, as Luxembourg has updated its information exchange provisions with treaty partners so that they conform to Article 26 of the OECD Model, it has typically exchanged notes with treaty partners defining what is meant by "foreseeably relevant," and has indicated that the definitions should be interpreted in light of the Commentaries on paragraph 1 of Article 26 of the OECD Model. Although Luxembourg has not exchanged such notes with the United States, the language of the information exchange provisions of the Luxembourg treaty, as amended, adopts the language contained in Article 26 of the OECD Model.

Standard for information exchange in the Switzerland treaty, as amended

Under the Switzerland treaty, as amended, the United States and Switzerland agree to exchange such information as "may be relevant" in carrying out the provisions of the treaty, as amended, or in carrying out the provisions of the domestic laws of the two treaty countries concerning taxes that are imposed by a treaty country and subject to the treaty. The Switzerland treaty, as amended, provides that the purpose of referring to information that may be relevant is intended to provide for exchange of information in tax matters to the widest possible extent without allowing the treaty countries to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. The Switzerland treaty, as amended, contains important procedural requirements that are intended to ensure that fishing expeditions do not occur. Nevertheless, the provisions are to be interpreted so that they do not frustrate the effective exchange of information. This standard is understood to conform to the standard used in Code section 7602, which authorizes the IRS to examine any books, records or other material that "may be relevant or material," as confirmed by the U.S. Supreme Court in a line of cases beginning with *United States v. Powell.*[2] The Switzerland treaty, as amended, provides that a request must include information sufficient to identify the person under examination or investigation. Typically, information sufficient to identify the person would

---

[1] 379 U.S. 48 (1964).

[2] 379 U.S. 48 (1964).

include a name, and to the extent known, an address, account number or similar identifying information. The United States and Switzerland agree that there may be circumstances in which there is information sufficient to identify the person under examination or investigation even though the requesting country cannot provide a name.

As described earlier, the Commentaries allows treaty countries to agree to an alternative formulation of the standard of "foreseeable relevance" that is consistent with the scope of the information exchange provisions in the OECD Model. Switzerland has agreed to the Commentaries on paragraph 1 of Article 26 of the OECD Model.[3] Therefore, even though the information exchange provisions of the Switzerland treaty, as amended, use the phrase "may be relevant," instead of "foreseeably relevant," the standard for information exchange in the Switzerland treaty, as amended, incorporates the standard described in the Commentaries of paragraph 1 of Article 26 of the OECD Model.

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold
Chief of Staff

[3] For background information, see Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), May 20, 2011, pp. 34-37.

RESPONSES OF THOMAS A. BARTHOLD TO QUESTIONS SUBMITTED BY SENATOR BENJAMIN L. CARDIN

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

MAR 1 8 2014

Honorable Benjamin L. Cardin
United States Senate
SH-509
Washington, D.C. 20510

Dear Senator Cardin:

This letter is in response to your questions submitted for the record during a hearing by the Senate Foreign Relations Committee on tax treaties on February 26, 2014. You have asked me to compare the information sharing provisions of the proposed protocol amending the Multilateral Convention On Mutual Administrative Assistance In Tax Matters (the "Multilateral Convention, as amended") with the information sharing provisions of the proposed protocols to the U.S. income tax treaties with Luxembourg and Switzerland (the "Luxembourg treaty, as amended" and the "Switzerland treaty, as amended"). You have also asked me to compare the information sharing provisions of the Multilateral Convention, as amended, with the information sharing provisions of bilateral income tax treaties entered into by countries around the world. And you have asked me whether, if the United States does not adopt the Multilateral Convention, as amended, and the Luxembourg and Switzerland treaties, as amended, the United States's information exchange abilities will be out of step with the abilities of other countries.

Comparison between the amended Multilateral Convention and the amended Luxembourg and Switzerland treaties

The information sharing provisions of the Luxembourg treaty, as amended, and the Switzerland treaty, as amended, are broadly consistent with the information sharing provisions of the Multilateral Convention, as amended. I will summarize that consistency and will also note one important difference.

The information exchange provisions of the Luxembourg and Swiss treaties, as amended, and the Multilateral Convention, as amended, share the following similarities, among others. These agreements –

1. require treaty countries to exchange information that may be relevant to administration or enforcement of the domestic tax laws of the treaty countries;[1]

[1] Article 28, paragraph 1 of the Luxembourg treaty, as amended; Article 26, paragraph 1 of the Switzerland treaty, as amended; Article 4, paragraph 1 of the Multilateral Convention, as amended.

2. require each treaty country to provide information requested by another treaty country even if the requested country has no need for the information for its own tax purposes (has no "domestic tax interest");[2]

3. forbid treaty countries from declining to supply information solely because the information is held by a bank or other financial institution or by a nominee or person acting in an agency or a fiduciary capacity or because the information relates to ownership interests in a person;[3]

4. permit a treaty country not to share information if sharing would necessitate (a) carrying out administrative measures at variance with its laws and administrative practices, (b) supplying information unobtainable under its laws or normal administration, or (c) supplying information that would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy;[4]

5. mandate that information that one treaty country receives from another treaty country be kept secret in the same manner as information obtained under the domestic law of the receiving country;[5] and

6. allow disclosure of information received by one treaty country from another treaty country only to persons involved in activities related to tax administration, collection,

---

[2] Article 28, paragraph 4 of the Luxembourg treaty, as amended; Article 26, paragraph 4 of the Switzerland treaty, as amended; Article 21, paragraph 3 of the Multilateral Convention, as amended.

[3] Article 28, paragraph 5 of the Luxembourg treaty, as amended; Article 26, paragraph 5 of the Switzerland treaty, as amended; Article 21, paragraph 4 of the Multilateral Convention, as amended.

[4] Article 28, paragraph 3 of the Luxembourg treaty, as amended; Article 26, paragraph 3 of the Switzerland treaty, as amended; Article 21, paragraph 2 of the Multilateral Convention, as amended.

[5] Article 28, paragraph 2 of the Luxembourg treaty, as amended; Article 26, paragraph 2 of the Switzerland treaty, as amended; Article 22, paragraph 1 of the Multilateral Convention, as amended.

> and enforcement, and permit those persons to use the information only for these administration-, collection- and enforcement-related purposes.[6]

The information exchange provisions of the Multilateral Convention, as amended, and those of the Luxembourg and Switzerland treaties, as amended, are also similar to one another in the methods of information exchange that they contemplate. These agreements all contemplate that treaty countries may engage in exchange of information on request, automatic exchange of information, and spontaneous exchange of information. The competent authorities of the particular countries under the three agreements have discretion to work with one another to address day-to-day practices involving how exactly information is shared.

The Luxembourg and Switzerland treaties, as amended, differ from the Multilateral Convention, as amended, in certain narrower respects. I note here one important difference. The Luxembourg and Switzerland treaties, as amended, require that, when a treaty country requests information from the other treaty country, the requesting country must provide, in the case of the Luxembourg treaty, as amended, "the identity of the person under examination or investigation" and, in the case of the Switzerland treaty, as amended, "information sufficient to identify the person under examination or investigation." As I noted in my testimony before your committee last month and as the Joint Committee staff has described previously in more detail, these provisions leave unclear the extent to which a request for information that satisfies the standards of a John Doe summons in the United States will be required to be honored.[7] By contrast, the

---

[6] Article 28, paragraph 2 of the Luxembourg treaty, as amended; Article 26, paragraph 2 of the Switzerland treaty, as amended; Article 22, paragraph 2 of the Multilateral Convention, as amended.

[7] The Joint Committee staff's explanations of the proposed protocols to the Luxembourg and Switzerland treaties included the following statement (identical in each explanation because the relevant provisions in the two treaties include nearly identical wording):

> The proposed protocol mandates exchange of information only if made pursuant to specific requests for exchange of information and only if the request contains information sufficient to identify the taxpayer. In the context of section 7609(f) and John Doe summonses in the United States, the persons whose tax data is sought must belong to an ascertainable class of persons who may have taken steps to avoid taxes. That standard was satisfied in the UBS controversy. It is not clear what information other than a name may be sufficient, within the meaning

Multilateral Convention, as amended, requires that a treaty country that requests information from another treaty country must indicate "where appropriate . . . the name, address, or any other particulars assisting in the identification of the person in respect of who the request is made," and the commentary to the convention clarifies (in paragraphs 50 and 167) that this requirement is satisfied if the request is for information related to an "ascertainable group" of persons, a standard similar to the standard of a John Doe summons.

More broadly, although the Luxembourg and Switzerland treaties, as amended, are more closely consistent with the Multilateral Convention, as amended, and with current global norms related to exchange of information than are the treaties now in force with Luxembourg and Switzerland, you may wish to consider a number of issues when you are assessing the likelihood that information exchange under the amended treaties will be effective. In the case of the Luxembourg treaty, as amended, these issues include (1) whether there may be treaty-based or domestic law impediments to effective exchange of information related to beneficial ownership of entities; (2) whether effective exchange may be hampered by restrictive interpretations of the requirement that requested information be "foreseeably relevant" for carrying out the treaty or the domestic laws of the treaty countries; and (3) whether requests for information may be defeated by the requirement (in paragraph 3(g) of the diplomatic notes accompanying the proposed protocol to the current Luxembourg treaty) that the requesting country has pursued all means available in its own territory to obtain the information. In the case of the Switzerland

---

of the treaty, to require a treaty country to produce the names of members of an ascertainable class of persons.

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, p. 28; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), May 20, 2011, p. 35. See also Joint Committee on Taxation, *Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaties with Chile and Hungary, the Proposed Tax Protocols with Luxembourg and Switzerland, and the Proposed Protocol Amending the Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (JCX-11-14), February 26, 2014, pp. 11-12 (among other things, identifying as potential concerns "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, in the case of the proposed Luxembourg protocol, "the requirement that all requests must provide the identity of the person under investigation").

treaty, as amended, these issues include (1) whether the explicit prohibition against "fishing expeditions" (in paragraph 10(b) of the proposed protocol to the current Switzerland treaty) will be used to frustrate information requests unreasonably, and (2) the extent to which the usefulness of information exchange may be affected by the restriction that a country that requests information may use the information only for matters related to taxes covered by the treaty (as opposed to, for example, taxes of all kinds) unless a different use would be permitted under the domestic laws of both countries and the competent authority of the country that is to provide the information consents to that use. The Joint Committee staff has described these issues related to the Luxembourg and Switzerland treaties, as amended, in more detail previously.[8]

Comparison between the amended Multilateral Convention and the OECD Model

You have asked me to compare the information exchange provisions of the Multilateral Convention, as amended, with the information exchange provisions of bilateral income tax treaties entered into by other countries. Bilateral income tax treaties entered into by many industrialized countries often closely follow the Organisation for Economic Co-operation and Development Model Tax Convention on Income and Capital (the "OECD Model"). Consequently, I will restrict my comparison to one between the information sharing provisions of the Multilateral Convention, as amended, and the information sharing provisions of the OECD Model. If you would like a comparison between the information exchange provisions of the Multilateral Convention, as amended, and those of a particular bilateral income tax treaty or treaties, I will be happy to provide that comparison in subsequent correspondence.

The information exchange provisions of the Multilateral Convention, as amended, closely follow the information exchange provisions of the OECD Model. In particular, the OECD Model includes the same six information exchange provisions described above in my comparison between the information exchange rules of the Multilateral Convention, as amended, and those of the Luxembourg and Switzerland treaties, as amended. As a prominent example, just as the OECD Model information exchange provisions were amended in 2005 to clarify that a treaty

[8] 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, pp. 26-30; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), May 20, 2011, pp. 34-38.

country must provide information requested by another treaty country even if the country to which the request is made has no domestic tax interest to which the information relates, so the 2010 proposed protocol amending the Multilateral Convention clarifies that a treaty country may not use its lack of a domestic tax interest as a reason for declining to supply requested information.

Like the Multilateral Convention, as amended, the OECD Model contemplates (in paragraph 9 of the commentary on the exchange of information rules) that information may be exchanged on request, automatically, or spontaneously.

U.S. adoption of proposed protocols

You asked me whether if the United States does not adopt the Multilateral Convention, as amended, and the Luxembourg and Switzerland treaties, as amended, the United States's information exchange abilities will be out of step with the abilities of other countries.

Adoption of the Luxembourg and Switzerland treaties, as amended, would bring those treaties closer to current global and U.S. norms concerning information exchange. The current Luxembourg and Switzerland treaties depart in a number of respects from current global information exchange norms as embodied in the OECD Model and from prevailing U.S. information exchange policies as represented in the U.S. Model Income Tax Convention of November 15, 2006 (the "U.S. Model"). For example, by contrast with the OECD Model, the U.S. Model, and many income tax treaties entered into by the United States and those entered into by other industrialized countries based on those models, both the current Luxembourg treaty and the current Switzerland treaty (1) generally require information exchange only when "necessary" for certain purposes such as carrying out the treaty (rather than, as under current norms, when "relevant"); (2) do not require a treaty country to exchange information when it has no domestic tax interest; and (3) do not forbid a treaty country to refuse to exchange information solely because the information is held by a bank or other financial institution. The current Switzerland treaty also (4) calls for information exchange when necessary to prevent tax fraud in relation to taxes covered by the treaty, a far narrower standard than the standard of many treaties that more closely conform to current norms.[9] The Luxembourg and Switzerland treaties, as amended, are closer to current global and U.S. norms because, among other things, they eliminate these four sources of divergence from those norms.

Adoption of the Multilateral Convention, as amended, would have two consequences related to the United States's information exchange abilities. Because the Multilateral Convention, as amended, conforms closely with information exchange norms embodied in the OECD Model and in many bilateral tax treaties based on that model, adoption would bring the United States's information exchange abilities with parties to the convention into conformity with those norms to the extent the United States does not now have information exchange relationships with those parties based on current norms. Likewise, if the United States adopts the Multilateral Convention, as amended, it will enter into information exchange programs with countries with which it has not previously had bilateral exchange relationships.[10] If the United States did not adopt Multilateral Convention, as amended, its information exchange abilities would be out of step with the abilities of other countries that are parties to the convention in the sense that those other countries would have information exchange relationships based on current norms that the United States may not have.

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold
Chief of Staff

---

[9] For discussions of the tax fraud requirement and its elimination in the Switzerland treaty, as amended, see Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), May 20, 2011, pp. 20-21, 23, 34-36.

[10] For a discussion of the expansion of information sharing to non-G20, non-OECD, and non-Council of Europe, see Joint Committee on Taxation, *Explanation of Proposed Protocol to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters*, (JCX-9-14), February 21, 2014, pp. 24-25.