

[JOINT COMMITTEE PRINT]

**EXPLANATION OF PROPOSED
ADDITIONAL PROTOCOL TO THE INCOME
TAX TREATY BETWEEN THE
UNITED STATES AND MEXICO**

SCHEDULED FOR A HEARING

BEFORE THE

**COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE**

ON MAY 25, 1995

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION



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INTRODUCTION

This pamphlet,¹ prepared by the staff of the Joint Committee on Taxation, describes the proposed additional (second) protocol ("proposed additional protocol") to the income tax treaty between the United States and the United Mexican States ("Mexico"). The proposed additional protocol was signed in Mexico City on September 8, 1994. The proposed additional protocol would amend the current U.S.-Mexico income tax treaty, as amended by the first protocol, both of which were signed in Washington, D.C. on September 18, 1992, and entered into force on December 28, 1993. A public hearing on the proposed additional protocol is scheduled on May 25, 1995, by the Senate Committee on Foreign Relations.

The reason for the negotiation of the proposed additional protocol was to broaden the scope of the current treaty's provisions relating to the exchange of information between the United States and Mexico. The proposed additional protocol's amendments to these rules would permit the exchange of information with respect to the administration and enforcement of taxes imposed by States, municipalities, or other political subdivisions or local authorities of the two countries.

Part I of the pamphlet is a summary of the principal provisions of the proposed additional protocol. Part II presents a discussion of the issues raised by the proposed additional protocol. For a copy of the proposed additional protocol, see Senate Treaty Doc. 103-31, September 19, 1994. For a detailed, article-by-article explanation of the proposed additional protocol, see the "Treasury Department Technical Explanation of the Additional Protocol Signed at Mexico City, on September 8, 1994, and Modifying the Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income Signed at Washington, D.C., on September 18, 1992," May 1995 (hereinafter "Technical Explanation").

¹This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Additional Protocol to the Income Tax Treaty Between the United States and Mexico* (JCS-9-95), May 22, 1995.

I. SUMMARY

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

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

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

II. ISSUE

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

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

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

The TIEA defines "information" for the purpose of information exchange as any fact or statement, in whatever form, that may be relevant or material to tax administration and enforcement, including (but not limited to) testimony of an individual, and documents, records or other personal property of a person or of one of the coun-

tries. Such information includes information to effect the determination, assessment, and collection of tax, the recovery and enforcement of tax claims, or the investigation or prosecution of tax crimes or crimes involving the contravention of tax administration. Under the TIEA, the competent authorities are to automatically transmit information to each other for this purpose, and are to determine the items of information to be exchanged and the procedures to be used.

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

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

Extension of coverage of exchange-of-information provisions to taxes imposed below the Federal level is unprecedented under U.S. income tax treaties and tax information exchange agreements currently in force. No other proposed treaty containing such a provision has ever come before the Committee for its consideration.² As described above, the exchange of information provisions place considerable levels of responsibility on the competent authority of each country to respond to requests for assistance by the other competent authority. The committee may desire some assurance that extension of information-exchange responsibilities in such a manner in this or other future treaties would not place an unmanage-

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

able administrative burden on the U.S. competent authority. However, the Treasury Technical Explanation of the TIEA protocol indicates that the competent authorities will develop mechanisms to ensure the effective and efficient administration of these exchange-of-information provisions.

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

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