EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND LUXEMBOURG

Scheduled for a Hearing
Before the
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

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JOINT COMMITTEE ON TAXATION

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CONTENTS

INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, describes the proposed protocol to the present income tax treaty between the United States and Luxembourg (the "proposed protocol"). The proposed protocol was signed on May 20, 2009 and is accompanied by official understandings implemented by an exchange of diplomatic notes (collectively, the "diplomatic notes" or "notes") carried out on that same day. The Senate Committee on Foreign Relations has scheduled a public hearing on the proposed protocol for June 7, 2011.[2]

Part I of the pamphlet provides a summary of the proposed protocol. Part II provides a brief overview of U.S. tax laws relating to international trade and investment and of U.S. income tax treaties in general. Part III contains a brief overview of Luxembourg tax laws. Part IV contains an article-by-article explanation of the proposed protocol. Part V contains a discussion of issues relating to the exchange of information under the modernized article in the proposed protocol, including the extent to which the proposed protocol is an adequate response to concerns about bank secrecy and the need for greater transparency for tax purposes.

[1] This pamphlet may be cited as follows: 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. References to "the Code" are to the U.S. Internal Revenue Code of 1986, as amended. This document can also be found on our website at www.jct.gov.

[2] For a copy of the proposed protocol, see Senate Treaty Doc. 111-08.

I. SUMMARY

The principal purposes of the present treaty between the United States and Luxembourg 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 present treaty also is intended to promote close economic cooperation between the two countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the two countries.

The proposed protocol modifies several provisions of the Convention between the United States of America and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital signed at Luxembourg on April 3, 1996 (the "present treaty"). The rules of the proposed protocol generally are similar to rules of recent U.S. income tax treaties, the 2006 U.S. model income tax treaty ("U.S. Model treaty"), and the 2010 model income tax treaty of the Organisation for Economic Co-operation and Development ("OECD Model treaty"). The present treaty, as amended by the proposed protocol, however, includes certain substantive deviations from these treaties and models. The deviations found in the articles modified by the proposed protocol are noted in the article-by-article explanation of the proposed protocol in Part IV of this pamphlet.

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

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

II. OVERVIEW OF U.S. TAXATION OF INTERNATIONAL TRADE AND INVESTMENT AND U.S. TAX TREATIES

This overview briefly describes certain U.S. tax rules relating to foreign income and foreign persons that apply in the absence of a U.S. tax treaty. This overview also discusses the general objectives of U.S. tax treaties and describes some of the modifications to U.S. tax rules made by treaties.

A. U.S. Tax Rules

The United States taxes U.S. citizens, residents, and corporations on their worldwide income, whether derived in the United States or abroad. The United States generally taxes nonresident alien individuals and foreign corporations on all their income that is effectively connected with the conduct of a trade or business in the United States (sometimes referred to as "effectively connected income"). The United States also taxes nonresident alien individuals and foreign corporations on certain U.S.-source income that is not effectively connected with a U.S. trade or business.

Income of a nonresident alien individual or foreign corporation that is effectively connected with the conduct of a trade or business in the United States generally is subject to U.S. tax in the same manner and at the same rates as income of a U.S. person. Deductions are allowed to the extent that they are related to effectively connected income. A foreign corporation also is subject to a flat 30-percent branch profits tax on its "dividend equivalent amount," which is a measure of the effectively connected earnings and profits of the corporation that are removed in any year from the conduct of its U.S. trade or business. In addition, a foreign corporation is subject to a flat 30-percent branch-level excess interest tax on the excess of the amount of interest that is deducted by the foreign corporation in computing its effectively connected income over the amount of interest that is paid by its U.S. trade or business.

U.S.-source fixed or determinable annual or periodical income of a nonresident alien individual or foreign corporation (including, for example, interest, dividends, rents, royalties, salaries, and annuities) that is not effectively connected with the conduct of a U.S. trade or business is subject to U.S. tax at a rate of 30 percent of the gross amount paid. Certain insurance premiums earned by a nonresident alien individual or foreign corporation are subject to U.S. tax at a rate of one or four percent of the premiums. These taxes generally are collected by means of withholding. Certain payments of U.S.-source income paid to foreign financial institutions and other foreign entities are also subject to withholding tax at a rate of 30 percent unless the foreign financial institution or other foreign entity is compliant with specific reporting requirements.

Specific statutory exemptions from the 30-percent withholding tax are provided. For example, certain original issue discount and certain interest on deposits with banks or savings institutions are exempt from the 30-percent withholding tax. An exemption also is provided for certain interest paid on portfolio debt obligations. In addition, income of a foreign government or international organization from investments in U.S. securities is exempt from U.S. tax.

U.S.-source capital gains of a nonresident alien individual or a foreign corporation that are not effectively connected with a U.S. trade or business generally are exempt from U.S. tax,

with two exceptions: (1) gains realized by a nonresident alien individual who is present in the United States for at least 183 days during the taxable year, and (2) certain gains from the disposition of interests in U.S. real property.

Rules are provided for the determination of the source of income. For example, interest and dividends paid by a U.S. resident or by a U.S. corporation generally are considered U.S.-source income. Conversely, dividends and interest paid by a foreign corporation generally are treated as foreign-source income. Notwithstanding this general rule that dividends and interest are sourced based upon the residence of the taxpayer making such a payment, special rules may apply in limited circumstances to treat as foreign source certain amounts paid by a U.S. resident taxpayer and treat as U.S. source certain amounts paid by a foreign resident taxpayer.[3] Rents and royalties paid for the use of property in the United States are considered U.S.-source income.

Because the United States taxes U.S. citizens, residents, and corporations on their worldwide income, double taxation of income can arise when income earned abroad by a U.S. person is taxed by the country in which the income is earned and also by the United States. The United States seeks to mitigate this double taxation generally by allowing U.S. persons to credit foreign income taxes paid against the U.S. tax imposed on their foreign-source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax liability on U.S.-source income. Therefore, the foreign tax credit provisions contain a limitation that ensures that the foreign tax credit offsets only the U.S. tax on foreign-source income. The foreign tax credit limitation generally is computed on a worldwide basis (as opposed to a "per-country" basis). The limitation is applied separately for certain classifications of income. In addition, a special limitation applies to credits for foreign taxes imposed on foreign oil and gas extraction income and foreign oil related income.

For foreign tax credit purposes, a U.S. corporation that owns 10 percent or more of the voting stock of a foreign corporation and receives a dividend from the foreign corporation (or is otherwise required to include in its income earnings of the foreign corporation) is deemed to have paid a portion of the foreign income taxes paid by the foreign corporation on its accumulated earnings. The taxes deemed paid by the U.S. corporation are included in its total foreign taxes paid and its foreign tax credit limitation calculations for the year in which the dividend is received.

[3] For tax years beginning before January 1, 2011, all (or a portion) of a payment of interest by a resident alien individual or domestic corporation was treated as foreign source if such individual or corporation met an 80-percent foreign business requirement. Although this provision was generally repealed for tax years beginning after December 31, 2010, other rules still apply to treat certain payments of interest by a foreign bank branch or foreign thrift branch of a domestic corporation or partnership as foreign source. Similarly, several rules apply to treat as U.S.-source certain payments made by a foreign resident. For example, certain interest paid by a foreign corporation that is engaged in a U.S. trade or business at any time during its taxable year or has income deemed effectively connected with a U.S. trade or business during such year is treated as U.S. source.

B. U.S. Tax Treaties

The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion. Another related objective of U.S. tax treaties is the removal of the barriers to trade, capital flows, and commercial travel that may be caused by overlapping tax jurisdictions and by the burdens of complying with the tax laws of a jurisdiction when a person's contacts with, and income derived from, that jurisdiction are minimal. To a large extent, the treaty provisions designed to carry out these objectives supplement U.S. tax law provisions having the same objectives; treaty provisions modify the generally applicable statutory rules with provisions that take into account the particular tax system of the treaty partner.

The objective of limiting double taxation generally is accomplished in treaties through the agreement of each country to limit, in specified situations, its right to tax income earned within its territory by residents of the other country. For the most part, the various rate reductions and exemptions agreed to by the country in which income is derived (the "source country") in treaties are premised on the assumption that the country of residence of the taxpayer deriving the income (the "residence country") may tax the income at levels comparable to those imposed by the source country on its residents. Treaties also provide for the elimination of double taxation by requiring the residence country to allow a credit for taxes that the source country retains the right to impose under the treaty. In addition, in the case of certain types of income, treaties may provide for exemption by the residence country of income taxed by the source country.

Treaties define the term "resident" so that an individual or corporation generally will not be subject to tax as a resident by both of the countries. Treaties generally provide that neither country may tax business income derived by residents of the other country unless the business activities in the taxing jurisdiction are substantial enough to constitute a permanent establishment or fixed base in that jurisdiction. Treaties also contain commercial visitation exemptions under which individual residents of one country performing personal services in the other are not required to pay tax in that other country unless their contacts exceed certain specified minimums (for example, presence for a set number of days or earnings in excess of a specified amount). Treaties address the taxation of passive income such as dividends, interest, and royalties from sources within one country derived by residents of the other country either by providing that the income is taxed only in the recipient's country of residence or by reducing the rate of the source country's withholding tax imposed on the income. In this regard, the United States agrees in its tax treaties to reduce its 30-percent withholding tax (or, in the case of some income, to eliminate it entirely) in return for reciprocal treatment by its treaty partner. In particular, under the U.S. Model treaty and many U.S. tax treaties, source-country taxation of most payments of interest and royalties is eliminated, and, although not provided for in the U.S. Model treaty, many recent U.S. treaties forbid the source country from imposing withholding tax on dividends paid by an 80-percent owned subsidiary to a parent corporation organized in the other treaty country.

In its treaties, the United States, as a matter of policy, generally retains the right to tax its citizens and residents on their worldwide income as if the treaty had not come into effect. The United States also provides in its treaties that it allows a credit against U.S. tax for income taxes paid to the treaty partners, subject to the various limitations of U.S. law.

The objective of preventing tax avoidance and evasion generally is accomplished in treaties by the agreement of each country to exchange tax-related information. Treaties generally provide for the exchange of information between the tax authorities of the two countries when the information is necessary for carrying out provisions of the treaty or of their domestic tax laws. The obligation to exchange information under the treaties typically does not require either country to carry out measures contrary to its laws or administrative practices or to supply information that is not obtainable under its laws or in the normal course of its administration or that would reveal trade secrets or other information the disclosure of which would be contrary to public policy. Several recent treaties and protocols provide that notwithstanding the general treaty principle that treaty countries are not required to take any actions at variance with their domestic laws, a treaty country may not refuse to provide information requested by the other treaty country simply because the requested information is maintained by a financial institution, nominee, or person acting in an agency or fiduciary capacity. This provision thus explicitly overrides bank secrecy rules of the requested treaty country. The Internal Revenue Service (the "IRS"), and the treaty partner's tax authorities, also can request specific tax information from a treaty partner. These requests can include information to be used in criminal investigations or prosecutions.

Administrative cooperation between countries is enhanced further under treaties by the inclusion of a "competent authority" mechanism to resolve double taxation problems arising in individual cases and, more generally, to facilitate consultation between tax officials of the two governments. Several recent treaties also provide for mandatory arbitration of disputes that the competent authorities are unable to resolve by mutual agreement.

Treaties generally provide that neither country may subject nationals of the other country (or permanent establishments of enterprises of the other country) to taxation more burdensome than the tax it imposes on its own nationals (or on its own enterprises). Similarly, in general, neither treaty country may discriminate against enterprises owned by residents of the other country.

At times, residents of countries that do not have income tax treaties with the United States attempt to use a treaty between the United States and another country to avoid U.S. tax. To prevent third-country residents from obtaining treaty benefits intended for treaty country residents only, treaties generally contain "anti-treaty shopping" provisions designed to limit treaty benefits to bona fide residents of the two countries.

III. OVERVIEW OF TAXATION IN LUXEMBOURG[4]

A. National Income Taxes

Overview

The Grand Duchy of Luxembourg is a constitutional monarchy divided into three districts, which are further subdivided into cantons. Individual income taxes are levied at the national level, while corporate income taxes are levied at both the national and cantonal levels. Both individual and corporate residents are generally subject to tax on their worldwide net incomes. Luxembourg provides a participation exemption regime for certain foreign source income. The definition of income subject to tax is expansive and includes capital gains; it is, however, based on an enumerated list of sources of income that are subject to taxation.[5] Individual income taxes are levied by way of annual assessments (tax returns must be filed by March 31st of the following year) and withholding. While corporate income taxes are also levied by way of assessments (corporate tax returns for corporations operating on the calendar year need to be filed by May 31st of the following year), there is also a system of quarterly prepayments. Both residents and nonresidents are generally subject to the same tax rules and rates on Luxembourg-source income.

Individuals

Individual Luxembourg residents are subject to tax on their worldwide income. An individual is considered a resident of Luxembourg if his domicile or customary place of abode is in Luxembourg. Joint returns are permitted, and the taxable unit is the household. There are three classes of taxpayers: (i) Class 1 consists of single individuals not falling within Class 1a or 2; (ii) Class 1a consists of taxpayers who are widowed or aged over 64, or individuals with decedents in their household not falling within Class 2; and, (iii) Class 2 consists of jointly assessed spouses, civil partnerships (same-sex and opposite-sex couples), and taxpayers of the same sex married according to foreign law. There are eight sources of income for individual income tax purposes: (i) trade or business;[6] (ii) agriculture and forestry; (iii) independent

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[4] The information in this section relates to foreign law and is primarily based on the Joint Committee staff's review of publicly available sources, including the principal Luxembourg Federal income tax statute, the Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu, as amended as of January 1, 2011, available at http://www.impotsdirects.public.lu/legislation (in French)], the Unofficial Summary of Direct Taxes Levied (Legislation as of 1st January 2011), Grand Duchy of Luxembourg - Tax Administration, available at http://www.impotsdirects.public.lu, Business Operations in Luxembourg, Tax Management Portfolio No. 971-3rd, available at http://taxandaccounting.bna.com/btac/; IBFD Regional Analysis, Luxembourg, available at http://checkpoint.riag.com ;Tax Notes International - Luxembourg (January 17, 2011), available at http://www.taxanalysts.com; and International Tax and Business Guide - Luxembourg (2010), Deloitte LLP, available at http://www.deloitte.com. The description is intended to serve as a broad overview of Luxembourg law and does not purport to contain an exhaustive analysis; many details have been omitted and simplifying generalizations made.

[5] For example, gains from lotteries are not taxed because they fall outside enumerated sources.

[6] Individuals operating a business are also generally subject to cantonal tax.

personal services; (iv) employment; (v) pensions and annuities; (vi) capital investment; (vii) letting and leasing; and (viii) miscellaneous services and capital gains on private assets. Income falling outside those sources is exempt from income tax. Salaries and pensions, among other sources of income, are subject to withholding tax.

Luxembourg subjects individuals to progressive income tax rates. Pursuant to recent amendments that took effect on January 1, 2011, the highest income tax rate was increased by 1 percent to 39 percent; income tax rates now range from zero percent to 39 percent. Income below certain thresholds is exempt. The following threshold amounts apply in 2011: (i) €11,265 ($15,027)[7] for Class 1; (ii) €22,530 ($30,053) for Class 1a; and, (iii) €22,530 ($30,053) for Class 2. In 2011, the 39 percent marginal tax rate will apply to taxable income exceeding €41,793 ($55,749) for Class 1, €33,978 ($45,324) for Class 1a and €83,586 ($111,498) for Class 2.

Individuals are also subject to an unemployment fund contribution which is assessed as a percentage of the income tax payable. Pursuant to recent amendments, the contribution rate increased from two and one-half percent to four percent. In some cases, the rate is six percent. Assuming a four percent contribution rate, the top individual marginal rate is 40.56 percent for 2011.

In calculating net income, individual taxpayers may claim certain allowances, deductions and credits. Expenses incurred to earn taxable income are deductible. Individuals benefit from various credits, including child and employee tax credits.

Net losses incurred by individual taxpayers may be used to offset taxable income. Losses from business, agriculture and forestry activities or from independent personal services may be carried forward indefinitely, but not carried back. On the other hand, losses from capital investment and miscellaneous income may only be used to offset taxable income from the same categories. Losses incurred from letting and leasing may be offset against any other taxable income, but only in the year the losses were incurred.

Dividends paid to individuals from resident corporations are subject to a 15 percent withholding rate, which can be credited against individual income tax. Interest income received from a resident borrower may benefit from preferential tax treatment. Such interest income is subject to a 10-percent withholding tax, but is not included in the individual's taxable income. Moreover, interest received from a foreign borrower residing in EU/EEA Member States and certain other territories may also benefit from this tax treatment if the resident taxpayer pays the 10 percent withholding tax. Income derived from certain intellectual property rights is 80 percent exempt. The exemption generally applies to acquired or self-developed copyrights on software, trademarks, patents, designs and models, and domain names that have been acquired or

[7] U.S. dollar equivalents were calculated using the currency rate for January 1, 2011, according to OANDA's FX Converter, available at http://www.oanda.com.

registered after January 1, 2008.[8] Intellectual property acquired from related persons, however, does not benefit from the 80 percent exemption.

Although capital gains may be subject to preferential treatment in some cases, capital gains are generally taxable at ordinary rates. There is no specific capital gains tax. Capital gains are divided between speculative and non-speculative gains. Speculative gains are taxable at ordinary marginal tax rates, subject to certain allowances, and include gains from: (i) real property held for less than two years; (ii) movable property held for less than six months; and, (iii) sales preceding the purchase of the underlying property.

Non-speculative gains, on the other hand, receive preferential treatment. Non-speculative gains generally include gains realized from the sale of: (i) a taxpayer's primary residency, which are exempt from tax if the taxpayer has resided there since acquisition or at least 5 years before the sale, or if the taxpayer is required to move for professional or family reasons; (ii) real property held for at least two years; and, (iii) a "substantial" shareholding.[9] Gains that fall in categories (ii) and (iii) are taxed at half the otherwise applicable rate. Moreover, certain capital gains realized on business assets may be deferred if the asset sold is replaced within prescribed periods.

Corporations

Corporations resident in Luxembourg are generally subject to tax on a worldwide basis. A resident corporation is one which has its statutory seat or head office in Luxembourg. The following entities are generally subject to corporate income tax: public limited liability companies (SAs), private limited liability companies (S.à.r.l.s), partnerships limited by shares (SCAs), cooperative companies, agricultural associations, mutual insurance companies and estates. General or limited partnerships are not subject to corporate income tax and are considered flow-through entities. A certain level of consolidation is allowed among fully taxable resident companies or certain Luxembourg permanent establishments, provided that one resident company owns at least 95 percent of the share capital of the other resident company.

Corporations are subject to national and municipal corporate income taxes. The national rate is 21 percent.[10] As with individuals, corporations are subject to an unemployment fund contribution. Pursuant to recent amendments, the contribution rate increased from 4 percent to 5 percent. The effective national corporate rate is 22.05 percent.[11]

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[8] Note that intellectual property acquired from related persons does not benefit from the 80 percent exemption.

[9] Generally, a substantial shareholding is a ten-percent equity interest in a corporation.

[10] A 20 percent rate applies if the corporation's taxable income does not exceed €15,000 ($20,009).

[11] Note that the City of Luxembourg's municipal corporate tax rate is 6.75 percent.

Pursuant to recent amendments,[12] a minimum flat tax applies to certain types of corporations. A minimum annual €1,500 ($2,001) tax applies to enterprises for which fixed financial assets and highly liquid assets[13] make up more than 90 percent of their total assets and whose activities are not subject to ministerial or governmental approval. Taxable income generally consists of any income earned by corporations less allowable deductions incurred in earning such income. Certain capital assets may be depreciated. Resident corporations receive various tax incentives, including tax credits for new investments. Losses may be carried forward, but not carried back. Only to the company that incurred the loss may use it; for example, the resulting entity from a merger cannot use accumulated losses of the merged entities.

Capital gains are taxable at the ordinary rate, subject to preferential treatment in certain cases. For example, capital gains realized on the sale of certain shares are tax exempt. The exemption applies to fully taxable resident companies and to certain Luxembourg permanent establishments that sell shares of another fully taxable resident company, an entity covered by the Parent-Subsidiary Directive;[14] or, a nonresident subsidiary subject to comparable corporate tax rates. The selling parent must have owned, directly or indirectly, at least 10 percent of the subsidiary's equity, or the parent's acquisition cost must have been greater than or equal to €6 million ($8 million). A minimum twelve month holding period also applies. Certain capital gains realized on the sale of business assets held for the prescribed period may be rolled over provided the corporation reinvests in similar assets.

Dividends received by a resident corporation are exempt, provided the participation exemption applies. The participation exemption for such dividends is similar to the one applicable to capital gains realized on the sale of shares. The dividend recipient must be a (i) a fully taxable resident company, (ii) a Luxembourg permanent establishment of an entity covered by the Parent-Subsidiary Directive, (iii) a Luxembourg permanent establishment of a company resident in a country with which Luxembourg has a tax treaty, or (iv) a Luxembourg permanent establishment of a company resident in a EEA country. On the date the dividend is distributed, the recipient must have held a minimum participation of 10 percent for twelve consecutive months, or the acquisition price of its participation must have been at least €1.2 million ($1.6 million) in the capital of the subsidiary. Dividends not subject to the participation exemption and received from a taxable resident corporation benefit from a 50-percent exemption.

Qualifying intellectual property income and gains benefit from an 80 percent exemption. To qualify, the intellectual property must have been acquired or developed after December 31, 2007. Generally, income from software copyrights, patents, trademarks, service marks, domain names, designs or models benefit from the 80 percent exemption. There are exceptions for sales to related parties, which generally do not benefit from this exemption.

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[12] Bill 6166, approved on December 2, 2010.

[13] The financial and highly liquid assets subject to the minimum flat tax include longterm financial assets, securities and bank credits, postal checking accounts, checks, and cash.

[14] Entities subject to the Parent-Subsidiary Directive consist of collective entities under article 2 of the modified Council Directive of 23 July 1990 on the Common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

Generally, dividends and other profit distributions are subject to a 15-percent withholding tax. The withholding tax does not apply in certain situations, including where the dividend is paid to a recipient qualifying under the dividend participation exemption. There are no withholding taxes on royalty income paid by a resident company to any resident or nonresident company. Moreover, ordinary interest is not subject to withholding tax under Luxembourg law.

B. International Aspects of Taxation in Luxembourg

Introduction

Individuals resident in Luxembourg are subject to tax on their worldwide income, except for foreign source income derived through permanent establishments. Nonresidents are subject to Luxembourg tax on their Luxembourg-source income. Nonresident individuals are not entitled to claim all deductions available to residents and married nonresidents may not file joint returns unless an exception applies. Moreover, while ordinary individual tax rates apply, nonresidents are subject to a minimum 15-percent income tax.

Corporations resident in Luxembourg are generally subject to income tax on their worldwide income; however, certain foreign source income is exempt. Nonresident corporations are subject to Luxembourg corporate income tax on taxable income earned from Luxembourg sources. Nonresident corporations are subject to the same corporate income tax rate applicable to resident corporations, 22.05 percent.

Outbound taxation

Foreign source income is generally subject to Luxembourg tax. However, Luxembourg treaties generally exclude foreign source income attributable to a foreign permanent establishment from Luxembourg tax. Moreover, income earned from a branch operating in a non-treaty country may be exempt if the corporation establishes that the branch is subject to foreign tax comparable to Luxembourg tax. Dividend and capital gain participation exemption rules apply to income earned by foreign subsidiaries.

If the underlying foreign source income is not exempt, Luxembourg taxpayers may claim a foreign tax credit. Credits are limited to the amount of Luxembourg tax otherwise payable on the income in question. Any non-creditable portion may be deducted. Only direct foreign tax credits are allowable; foreign taxes paid by a foreign subsidiary cannot be credited against Luxembourg income tax. Foreign withholding taxes imposed on dividends qualifying for the participation exemption may not be credited. Subject to certain exceptions, a per country limitation applies to foreign tax credits. Luxembourg does not have a controlled foreign corporation regime.

Inbound taxation

Nonresident individuals and companies are subject to Luxembourg tax on their income from Luxembourg sources, including income generated through a branch operating in Luxembourg. Nonresident businesses may deduct all expenses related to Luxembourg source income, even if the expenses did not originate in Luxembourg. Similarly to resident corporations, foreign entities are generally subject to a 15 percent withholding tax on dividend distributions, unless the withholding rate is reduced by treaty. Nonresidents are also subject to tax on capital gains, subject to certain preferential tax treatment. There is no withholding tax on royalties.

While Luxembourg does not impose a withholding tax on interest, there is a withholding tax on interest paid to European Union resident individuals pursuant to the implementation of the

EU Savings Directive in Luxembourg law. The withholding rate is 20 percent, but will increase to 35 percent as of July 1, 2011. This withholding rate is not reduced under any tax treaty.

C. Other Taxes

Crisis tax

Pursuant to recently enacted legislation that took effect on January 1, 2011, resident and nonresident individuals are subject to a 0.8 percent crisis tax for tax years 2011 and 2012. The crisis tax applies to all individual taxable income, subject to allowances for low-income earners.

Net wealth tax

Resident and nonresident corporations are subject to an annual net wealth tax of 0.5 percent. Resident corporations are subject to tax on their worldwide wealth while nonresident corporations are only taxable on their Luxembourg wealth.

Inheritance and gift taxes

Luxembourg imposes an inheritance tax on the value of all assets of a deceased person if the person was a Luxembourg resident, irrespective of whether the heirs or legatees are residents of Luxembourg. If the deceased was not a resident, a transfer tax is levied on the market value of all inherited real property situated in Luxembourg. The inheritance and transfer tax rates vary depending on the inherited amount and the degree of kinship between the deceased and the beneficiary. Luxembourg also imposes a gift tax with rates that vary according to the relationship between the donor and donee. Gift tax is payable by the donee on the asset's market value.

Social security

Employers and employees contribute to the Luxembourg social security system. Social security contributions are calculated on gross salary and are withheld from the employee's wages by employers. The joint employer-employee contribution is 16 percent for pension insurance and 6.1 percent for health insurance with a maximum annual ceiling of €105,453 ($140,667) as of January 1, 2011. There is also a 1.4 percent contribution for dependency insurance. Social security contributions, except for dependency insurance, are deductible for income tax purposes.

Consumption taxes

Luxembourg imposes a value added tax ("VAT") on the consumption of goods and services. Although the VAT is levied at each stage of the economic chain, it is ultimately borne by the final customer. The standard VAT rate is 15 percent. Reduced rates of three, six, and twelve percent apply to certain goods or services, including essential goods. Certain goods and services are zero rated or exempt.

IV. EXPLANATION OF PROPOSED PROTOCOL

Article I. Exchange of Information and Administrative Assistance

The proposed protocol replaces Article 28 (Exchange of Information) in the present treaty with a new article that is substantially similar to Article 26 (Exchange of Information and Administrative Assistance) of the U.S. Model treaty. The scope of information exchange authorized between the treaty countries is expanded and grounds for refusal to exchange information based on domestic law are limited. A requested treaty country may no longer decline to provide information held by financial institutions, information that is not relevant to a domestic tax issue, or information about conduct that would not constitute a crime under domestic law. The description below explains the scope and operation of the individual paragraphs and identifies instances in which the article varies from the U.S. Model treaty.

The United States and Luxembourg agree to exchange such information as is foreseeably relevant in carrying out provisions of the present treaty as amended by the proposed protocol 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" indicates the breadth of the scope of the exchanges, in establishing the standard for determining whether or not information may be exchanged under the protocol. It is based on the OECD Model and is understood to conform to the standard used in Code section 7602, which is the principal source of authority for United States information gathering and examination of records. Under section 7602, the IRS may request to examine any books, records or other material that "may be relevant," as confirmed by the U.S. Supreme Court in a line of cases beginning with *United States v. Powell.*[15]

This exchange of information is not restricted by paragraph 1 of Article 1 (General Scope) or Article 2 (Taxes Covered). Consequently, information about persons who are not residents of Luxembourg or the United States may be requested and provided under this article. For example, a third-country resident who has a Luxembourg bank account that is reportable to the IRS may be the subject of a request by the U.S. competent authority for information from Luxembourg about the bank account. The proposed protocol provides that information may be exchanged to enable each treaty country to administer its own domestic law, to the extent that taxation under that law is not contrary to the treaty. The competent authorities may exchange information relating to, for example, U.S. estate and gift taxes, excise taxes, and Luxembourg value added taxes. Finally, the competent authorities may exchange information about collection cases, cases under civil examination or criminal investigation, and cases being prosecuted.

Any information exchanged under the proposed protocol is to be treated as secret in the same manner as information obtained under the domestic laws of the treaty country receiving the information. The exchanged information may be disclosed only to persons or authorities (including courts, administrative bodies and legislative bodies) involved in the administration, enforcement or oversight of the tax laws. Such functions include assessment, collection, civil and criminal prosecution, and the determination of appeals in relation to the taxes to which the

[15] 379 U.S. 48 (1964).

proposed protocol applies. The authority to disclose information to persons involved in oversight of taxes includes authority to disclose to persons or authorities such as the tax-writing committees of Congress and the Government Accountability Office. Such persons or authorities receiving the information may use the information only in the performance of their role in overseeing the administration of U.S. tax laws. Finally, exchanged information may be disclosed in public court proceedings or in judicial decisions.

As is true under the U.S. Model treaty and the OECD Model treaty, under the proposed protocol a treaty country is not required to carry out administrative measures at variance with the laws and administrative practice of either treaty country. Neither treaty country is required to supply information that is not obtainable under the laws or in the normal administrative practice of either treaty country. Furthermore, the treaty does not require exchange of 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.

If information is requested by a treaty country in accordance with this article, the proposed protocol provides that the requested treaty country must obtain the information in the same manner and to the same extent as if the tax of the requesting treaty country were the tax of the requested treaty country and were being imposed by that treaty country, notwithstanding that the requested treaty country may not need the information for purposes of administering its own tax rules. In providing that a lack of a domestic tax interest in the information will not support a refusal to exchange information, the protocol limits the ability of either country to refuse to provide information requested based on the lack of need for such information in a domestic tax investigation, or the expiration of the limitations period in the requested country.

The proposed protocol limits the ability of either country to posit that domestic secrecy laws preclude response to a request for information. The proposed protocol explicitly limits the scope of the general principle that a treaty is not intended to require any actions by a country at variance with its domestic law, by providing that a treaty country cannot refuse to respond to a request for information based on the fact that the information is in the possession of financial institutions, nominees, or persons acting in an agency or fiduciary capacity. Thus, a competent authority receiving a request for information from a financial institution may not decline the request based on an argument that domestic bank secrecy or similar rules override the treaty obligations and preclude honoring the request.

The proposed protocol also provides that the competent authorities may not refuse to exchange information because it relates to information concerning ownership interests in a "person." This requirement has the effect of requiring disclosure of the beneficial owner of bearer shares. However, because the language in the proposed protocol refers to "interests in a person" but not to interests in "instruments" it may not be sufficiently broad to require such exchanges with respect to bearer bonds.

The proposed protocol makes it possible for a treaty country to request that responsive information be provided in an authenticated form that will facilitate the use of that information in the administrative or judicial proceedings in the requesting country. It provides that, upon specific request by the competent authority of a treaty country, the other competent authority must provide information in the form of depositions of witnesses and authenticated copies of

unedited original documents (including books, papers, statements, records, accounts, and writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of the requested country with respect to its own taxes.

The protocol does not adopt paragraph 8 of Article 26 (Exchange of Information) in the U.S. Model treaty, which requires each treaty country to permit representatives of the other country to enter its territory for the purpose of conducting interviews of cooperative witnesses and examining their books and records, without regard to the consent of the person whose tax liability is under examination unless that person is the person to be interviewed or the owner of the books and records to be reviewed.

The proposed protocol includes a requirement to assist in collection. Such assistance in collection of taxes is limited to the extent necessary to ensure that treaty benefits are enjoyed only by persons entitled to those benefits under the terms of the present treaty is required.

Article II. Entry into Force

The proposed protocol provides that the proposed protocol is subject to ratification in accordance with the applicable procedures of each treaty country. Each treaty country is to notify the other in writing, through diplomatic channels, when it has completed the required procedures. The proposed protocol will enter into force on the date of the later of the notifications made through diplomatic channels regarding the completion of the required ratification procedures.

Under the proposed protocol, the revised article on exchange of information governs requests made after the entry into force, and only with respect to taxable years beginning on or after January 1, 2009.

V. BACKGROUND AND ISSUES IN EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

Tax treaties establish the scope of information that can be exchanged between treaty parties. Exchange of information provisions first appeared in the late 1930s,[16] 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, due in part to the global financial crisis and the general increase in globalization. As part of the efforts to restore integrity and stability to financial institutions, substantial efforts have been made by the United States and other G-20 jurisdictions to reconcile the conflicts between jurisdictions, particularly between jurisdictions with strict bank secrecy, such as Switzerland and Luxembourg, and those seeking information needed to enforce their own tax laws. Although they have had a bilateral income tax treaty in force at all times since 1962, the United States and Luxembourg have engaged in only limited exchange of information under the applicable tax treaty. The proposed protocol is thus a response to that history as well as part of the international trend in exchange of information. The following discussion describes the context in which the proposed protocol was negotiated as both the U.S. and Luxembourg attempted to address the issue of transparency, and the extent to which the proposed protocol may avoid future problems. The U.S. position on exchange of information in general, as reflected in the U.S. Model treaty, is discussed in the concluding section.

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

A. Background of U.S.-Luxembourg Exchanges

Article XVIII (Administrative Assistance) in the 1962 U.S.-Luxembourg income tax treaty permitted exchange of information only for the purpose of "prevention of fraud or the like." Because Luxembourg did not consider tax fraud to be within the purview of "fraud or the like," it would not exchange information to combat tax fraud. As a result, information was exchanged only with respect to non-tax crimes; information on civil or criminal tax cases was not available. The provision was substantially revised in the present treaty, signed in 1996. The present treaty broadened the circumstances under which tax authorities could exchange information by eliminating the reference to fraud, and permitting exchanges necessary to carryout purposes of the treaty or of domestic law with respect to taxes covered by the treaty. In practice, exchange remained limited because neither treaty country could be required to provide assistance contrary to its domestic laws. Such deference to the domestic law included the bank secrecy laws, effectively precluding access to financial information.

In response to the difficulties in compelling production of information across borders, the United States has enacted a variety of statutory measures to require enhanced information reporting and encourage voluntary disclosure, at the risk of incurring penalties or adverse findings. These measures range from third-party information reporting and withholding at source rules, as well as enforcement measures such as specific authority for the Tax Court to order foreign entities invoking its jurisdiction to provide all relevant information[17] to a statutory exclusionary rule affecting admissibility of foreign-based documents that had not been provided to the government earlier in administrative or judicial proceedings.[18] Each is a valuable tool, but is limited to the situation in which an offshore transaction has been identified and selected for examination; they do not assist in identifying an offshore transaction. In the latter situation, the IRS may make use of its authority to issue so-called "John Doe" summonses, although recent experience has shown that enforcement of these summonses can be particularly difficult when the information sought is located in jurisdictions with restrictive bank secrecy laws.

1. The private banking scandals

The difficulties faced by the IRS and the Department of Justice ("DOJ") in obtaining information needed to enforce U.S. tax laws against U.S. persons who utilize foreign financial accounts or foreign entities have long concerned administrators and legislators alike. These difficulties were brought into focus by two scandals in 2008 involving private banking practices (i.e., wealth management services), one involving a Liechtenstein bank and the second, UBS AG, a Swiss financial institution. Both cases involved institutions that had entered into an agreement with the IRS to act as a qualified intermediary ("QI") for withholding with respect to U.S. source income earned by non-U.S. persons. A QI is defined as a foreign financial institution or a foreign clearing organization, other than a U.S. branch or U.S. office of such institution or organization, which has entered into a withholding and reporting agreement (a "QI

[17] Code sec. 7456(b).

[18] Code sec. 982.

agreement") with the IRS.[19] In exchange for entering into a QI agreement, the QI is able to shield the identities of its customers from the IRS and other intermediaries (for example, other financial institutions in the chain of payment that may be business competitors of the QI) in certain circumstances and is subject to reduced information reporting duties compared to those that apply in the absence of the QI agreement. The subsequent investigation and enforcement action against UBS shed light on the extent to which foreign financial institutions with QI agreements had assisted U.S. persons in evading or avoiding their U.S. taxes.[20]

2. Administrative response to the private banking scandals

Voluntary disclosure initiatives

On March 26, 2009, as part of its efforts to manage the use of enforcement resources on offshore banking cases, the Commissioner of the IRS announced a voluntary compliance initiative under the terms of which it proposed to waive a significant portion of penalties in return for voluntary disclosure of previously undisclosed offshore accounts.[21] This initiative was the second compliance initiative available to the population of U.S. taxpayers who used offshore accounts to avoid paying taxes. The IRS had first attempted such an initiative in 2003, under the Offshore Voluntary Compliance Initiative ("OVCI").[22] That program encouraged the voluntary disclosure of offshore accounts accessed through credit card or other financial arrangements similar to those targeted by an IRS enforcement program known as the Offshore Credit Card Program. It was not, however, limited to those who used credit cards; its terms were broad enough to extend the partial amnesty to clients of offshore private banking. Under the OVCI, the IRS waived the civil fraud penalty and certain penalties relating to failure to file information and other returns,[23] but taxpayers remained liable for back taxes, interest, and certain accuracy-related and delinquency penalties.[24]

Although the IRS reported that, as of July 31, 2003, it had received OVCI applications from 1,299 taxpayers who paid over $75 million in taxes and identified over 400 offshore

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[19] The definition also includes: a foreign branch or office of a U.S. financial institution or U.S. clearing organization; a foreign corporation for purposes of presenting income tax treaty claims on behalf of its shareholders; and any other person acceptable to the Internal Revenue Service. Treas. Reg. sec. 1.1441-1(e)(5)(ii).

[20] For a full description of the UBS controversy and the difficulties in obtaining information from the Swiss authorities, 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.

[21] *See* Kristen A. Parillo and Jeremiah Coder, "IRS Reduces Penalties on Voluntarily Disclosed Offshore Accounts," *Tax Notes Today* 57-02 (March 27, 2009), reporting the statement from IRS Commissioner Doug Shulman on offshore income and the release of several internal memoranda outlining the settlement conditions for those who voluntarily disclose.

[22] Rev. Proc. 2003-11, sec. 2.02, 2003-1 C.B. 311.

[23] News Release, Internal Revenue Service, IR-2003-48 (April 10, 2003). Taxpayers wishing to participate in the OVCI program were required to apply before April 15, 2003.

[24] Rev. Proc. 2003-11, *supra* ; News Release, Internal Revenue Service, IR-2003-5 (Jan. 14, 2003).

promoters of abusive credit card or other financial arrangements,[25] success of the initiative was difficult to measure. Then IRS Commissioner Mark Everson discussed the limited success of the OVCI initiative at a hearing on August 1, 2006, during which he stated, "In reality, we did not have a good idea of the potential universe of individuals covered by this initiative. As a result, the incentive for taxpayers to come forward and take advantage of this initiative was diminished due to the fact that we did not have the ability to identify immediately and begin examinations for all non-participating individuals."[26]

With the high-profile prosecution of UBS AG and the efforts to identify its clients, the risk that bank customers who did not participate in the second initiative would nonetheless be discovered by the IRS was greater. Under the terms of the guidance issued to field agents, no FBAR[27] penalty would be imposed on any delinquent FBAR filer who was otherwise in compliance with the tax laws. Those who were not in compliance with the tax laws but who voluntarily disclosed and submitted delinquent FBARs and other information returns by September 23, 2009, were subject to an "offshore penalty" in lieu of the otherwise applicable FBAR penalties. The offshore penalty equaled 20 percent of the aggregate account balances at their highest point in any of the six years covered by the voluntary disclosure. Taxpayers who made voluntary disclosures were required to make all delinquent filings (e.g., FBARs, or information or income tax returns), for the six years covered and to pay all back-taxes, interest, and an accuracy or delinquency penalty. The offshore penalty amount could be reduced to five percent if the taxpayer did not open the account, there was no account activity while the taxpayer controlled the account, and all taxes were paid on the account.[28]

The IRS recently announced the 2011 Offshore Voluntary Disclosure Initiative, under terms similar to, but less generous than, those under the 2009 initiative. The maximum offshore penalty is now 25 percent of the aggregate account balance at any time in the years 2003 through 2010. As before, the offshore penalty may be reduced under certain circumstances. In the new initiative, the reduced penalty may be reduced to five percent if the taxpayer did not open the account, there was no account activity while the taxpayer controlled the account, and all taxes were paid on the account. In addition, taxpayers whose accounts did not exceed $75,000 in any year may be eligible for a reduced offshore penalty of 12.5 percent. All participants must pay taxes, interest, and an accuracy or delinquency penalty for all eight years in that period. The deadline for taxpayers to participate in the initiative is August 31, 2011.[29]

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[25] News Release, Internal Revenue Service, IR-2003-95 (July 31, 2003).

[26] Written Testimony of Commissioner of Internal Revenue Mark Everson Before Senate Committee on Homeland Security and Governmental Affairs' Permanent Subcommittee on Investigations Hearing on Offshore Abuses: The Enablers, The Tools and Offshore Secrecy, 109th Cong., 2d Sess., August 1, 2006.

[27] FBAR refers to the form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts," required by the Bank Secrecy Act, 31 U.S.C. sec. 5311. Failure to file the form is subject to both civil and criminal penalties.

[28] For news coverage of the 2009 voluntary disclosure announcement, see Kristen A. Parillo and Jeremiah Coder, "IRS Reduces Penalties on Voluntarily Disclosed Offshore Accounts," *Tax Notes* (March 30, 2009), p. 1561.

[29] News Release, Internal Revenue Service, IR-2011-14 (February 8, 2011).

Expansion and modernization of the U.S. exchange of information network

In response to the private banking scandals, efforts were made to modernize the exchange of information articles in bilateral treaties to which the United States is a party to ensure that exchange of information was required without regard to countries' domestic bank secrecy laws and to expand the U.S. exchange of information network. The proposed protocol is illustrative of those efforts. In addition to the proposed protocol, the United States and Switzerland signed a protocol amending the U.S.-Switzerland income tax treaty to conform that treaty to the exchange of information article in the U.S. Model treaty, as part of its efforts to bring all treaties to which the United States is a party into accord with OECD standards.[30] Expansion of the exchange of information network was also accomplished by expanding the network of countries with which the United States has executive agreements known as Tax Information Exchange Agreements ("TIEAs").

TIEAs are entered into by the Administration, without the advice and consent of the Senate. In contrast to the bilateral tax treaties, TIEAs are generally limited in scope to mutual exchange of information,[31] and are often entered into with countries that impose little or no income tax, or with which the United States has no tax treaty. The objective of a TIEA is to promote international cooperation in tax matters (civil and criminal) through exchange of information. A country must have adequate process for obtaining information; if the country is required to enact measures providing such process, then the entry into force of the TIEA may be delayed until such requirements have been met. The provisions of the TIEA generally require a country to override its domestic laws and practices pertaining to disclosure of information regarding taxes. The OECD adopted and published a model TIEA in 2002, with commentary. To date, the U.S. Treasury Department has not published its own model TIEA.

Since the 1980s, the United States has entered into over 20 such agreements. The recently intensified expansion efforts resulted in execution of a TIEA with Liechtenstein, signed on December 8, 2008, with Gibraltar, signed March 31, 2009, with Monaco, signed September 8, 2009 and with Panama, signed November 30, 2010.[32] The terms of the TIEAs generally conform to the OECD model TIEA.

3. Legislative response to private banking scandals - FATCA

Hearings before the Senate Permanent Subcommittee on Investigations, Senate Finance Committee, and House Committee on Ways and Means addressed the problem of the evasion of

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[30] Treasury Press Release TG-177 (June 19, 2009).

[31] Section 274(h)(6)(C); see also *Barquero vs. United States*, 18 F.3d 1311, 1314-15 (5th Cir. 1994); Congressional Research Service, "Treaties and Other International Agreements: the Role of the United States Senate, A Study Prepared for the Committee on Foreign Relations," United States Senate, Library of Congress (January 2001), S. Prt. 106-71.

[32] Each of these TIEAs has since entered into force on the following dates: Liechtenstein on December 4, 2009; Gibraltar on January 1, 2010 (except with respect to criminal matters, for which it was effective as of December 22, 2009); Monaco on March 11, 2010, and Panama on April 18, 2011.

U.S. income tax through the use of offshore accounts in the wake of the whistleblower disclosures and the UBS summons proceedings. Expanded reporting obligations were enacted in the Hiring Incentives to Restore Employment ("HIRE") Act in 2010.[33] Subtitle A of Title V of the HIRE Act, entitled "Foreign Account Tax Compliance," was based on legislative proposals in the Foreign Account Tax Compliance Act ("FATCA"), a bill introduced in both the House and Senate on October 27, 2009.[34]

The HIRE Act made a number of changes to U.S. tax law to improve tax compliance, including changes with respect to foreign accounts and cross-border transactions. The Act added new Chapter 4 to Subtitle A of the Code, a reporting and withholding regime. Chapter 4 requires reporting of specific information by third parties for certain U.S. accounts held in foreign financial institutions ("FFIs").[35] Information reporting is encouraged through the withholding of tax on payments to FFIs unless the FFI enters into and complies with an information reporting agreement with the Secretary of the Treasury.[36]

The HIRE Act repeals certain foreign exceptions to the registered bond requirements; treats certain dividend equivalent payments received by foreign persons as U.S. source dividends for withholding tax purposes, and modifies certain rules in respect of foreign trusts. In addition to the added responsibilities of foreign financial institutions, changes in the reporting required of taxpayers were also enacted. U.S. individuals and, to the extent required by regulations, any domestic entity availed of by such individuals must disclose on their federal income tax returns their foreign financial assets and foreign financial accounts if the aggregate value of such assets exceeds $50,000. Failure to do so results in both a failure to disclose penalty as well as an increase in the otherwise applicable accuracy-related penalty. In addition, the HIRE Act extends the statute of limitations for taxpayers who do not comply with foreign financial asset disclosure obligations or significantly under report income associated with foreign assets.

4. Multilateral efforts gain momentum

In addition to purely domestic measures such as FATCA, the United States is one of many jurisdictions seeking new ways to ensure that it has an adequate network of bilateral exchange of information agreements (whether by tax treaty or TIEA) and exploring multilateral programs to complement those domestic efforts. To the extent that there is less than near universal acceptance of any emerging norms on the desirability of greater exchange of information, countries that are implementing international standards on exchange of information

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[33] Pub. L. No. 111-147.

[34] H.R. 3933 and S. 1934, respectively.

[35] Under section 1471(c), an FFI must report (1) the name, address, and taxpayer identification number of each U.S. person or a foreign entity with one or more substantial U.S. owners holding an account, (2) the account number, (3) the account balance or value, and (4) except as provided by the Secretary, the gross receipts and gross withdrawals or payments from the account.

[36] The information reporting requirement under the HIRE Act generally applies to payments made after December 31, 2012.

are understandably concerned that capital for investment will flow to noncompliant jurisdictions. Since 2008, several jurisdictions previously reluctant to commit to OECD standards of transparency ("the OECD standards") have done so, suggesting that political tolerance for shielding tax avoidance from exposure has been exhausted.

The development of international norms in recent years owes a great deal to the work done on transparency and exchange of information by the OECD Global Forum on Transparency and Exchange of Information (the "Global Forum"), begun in 1996. The OECD standards require:

- Exchange of information where it is "foreseeably relevant" to the administration and enforcement of the domestic laws of a requesting State;
- No restrictions on exchange caused by bank secrecy or domestic tax interest requirements;
- Availability of reliable information and powers to obtain it;
- Respect for taxpayer rights; and
- Strict confidentiality of information exchanged.[37]

The OECD Standards have been endorsed by the G-20 Ministers of Finance. Also initiated in 1996 was the OECD's Harmful Tax Practices Project, which is carried out through the Forum on Harmful Tax Practices ("FHTP"). FHTP focuses on: (1) eliminating harmful tax practices of preferential tax regimes of OECD Member states; (2) identifying tax havens and pursuing their commitments to OECD Standards; and, (3) encouraging other non-OECD counties to associate themselves with FHTP work.[38] As of 2000, FHTP had identified more than 40 jurisdictions with harmful tax practices. By 2005, 35 of these had become "committed jurisdictions," that is, jurisdictions that formally documented their commitment to the OECD standards. While seven jurisdictions on the original list initially refused to become committed jurisdictions, by early 2009, the list of noncooperative jurisdictions was reduced to three: Andorra, Monaco, and Liechtenstein.

As a meeting of the G-20 to be held in London on April 2, 2009 approached, concerns arose that the list of noncooperative jurisdictions would be revisited and possibly expanded at that meeting, on the basis of a survey conducted by the OECD of 46 jurisdictions that had not yet made sufficient progress with respect to the exchange of information and banking secrecy, including Luxembourg and Switzerland.[39] When a progress report was published at the end of the London meeting, Switzerland and Luxembourg were listed as jurisdictions that recently

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[37] Overview of the OECD's Work on International Tax Evasion (A note by the OECD Secretariat), p. 3 (March 23, 2009) ("2009 OECD Overview").

[38] 2009 OECD Overview, pp.3-4.

[39] Randall Jackson, *Kristen A. Parillo, and David Stewart, "Tax Havens Agree to OECD Transparency Standards,"* 53 *Tax Notes Int'l* 1027 (Mar. 23, 2009).

committed to the OECD standards.[40] Both jurisdictions avoided inclusion on the final list of noncooperative jurisdictions by announcing less than a month earlier their intention to commit to the OECD standards, as did Austria, Belgium, and Liechtenstein.

At the conclusion of the 2009 G-8 Meeting, the Finance Ministers of the G-8 issued a statement[41] expressing support for efforts to improve tax information exchange and transparency. They endorsed efforts to expand the commitment to the implementation of the OECD standards. In addition, they committed to the development of an effective peer-review mechanism to assess compliance with the same standards, and proposed that responsibility for development and conduct of such a process be charged to the Global Forum.[42]

At the Global Forum meeting in Mexico City on September 1 and 2, 2009, the Global Forum began the process of establishing a Peer Review system. It formed a Peer Review Group and a Steering Group to develop the methodology and detailed terms of reference for a robust, transparent and accelerated process.[43] The methodology and terms subsequently developed by these groups and adopted by the Global Forum contemplate a peer review conducted in two phases. Phase I, which began in 2010, examines the legal and regulatory framework in each jurisdiction. The Global Forum anticipates that it will complete Phase I reviews of all member countries within the initial three-year mandate.[44] Phase II evaluates the implementation of standards in practice. The peer review of Luxembourg is scheduled to begin in the first half of 2011. Its Phase II peer review is scheduled for the second half of 2012.[45]

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[40] OECD, *A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard*, reprinted at 2009 TNT 62-65 (April 2, 2009).

[41] Statement of G-8 Finance Ministers, Lecce, Italy, June 13, 2009.

[42] *Ibid*.

[43] OECD Centre for Tax Policy, Summary of Outcomes of the Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes Held in Mexico on 1-2 September 2009, (September 2, 2009), available at http://www.oecd.org/dataoecd/44/39/43610626.pdf (last accessed March 1, 2011).

[44] The United States, as well as several other countries with robust exchange of information programs and demonstrated commitment to the standards, agreed to a review combining Phases I and II. The review was conducted in late 2010. A report has not yet been issued.

[45] OECD, Launch of a Peer Review Process, Schedule of Reviews (2010).

B. The Luxembourg Response and the Proposed Protocol

As discussed above, Luxembourg announced its commitment to OECD standards at a time when it appeared that it could be included in a list of jurisdictions considered by the G-20 to be noncooperative. In March 2009, it withdrew its reservation regarding Article 26 of the OECD Model treaty, thus adopting the OECD standards on administrative assistance in tax matters.[46] By July of that year, it had substantially implemented the OECD standards. It has consistently espoused use of the OECD Model as the sole model for agreements throughout Europe.

The proposed protocol, by replacing Article 28 (Exchange of Information and Administrative Assistance) of the 1996 Treaty, is consistent with both the OECD and U.S. Models. As a result, the proposed protocol may facilitate greater exchange of information than has occurred in the past, chiefly by eliminating bank secrecy or lack of a domestic interest in the requested information as possible grounds for refusing to provide requested information. Those were two of the justifications for refusal of a request for information often cited by authorities in jurisdictions with strict bank secrecy.

Nevertheless, 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 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.

1. Obligation to ensure tax authority access to beneficial ownership of juridical entities and financial institutions

The diplomatic notes require the parties to exchange information with respect to beneficial ownership of organizations in its jurisdiction and financial institutions and to ensure that taxing authorities have access to such information. To the extent that such information is neither maintained in the jurisdiction by government authorities at any level (e.g. Federal, state or local in the United States) nor by persons located within its territorial jurisdiction, the information need not be exchanged. Thus, the United States would not be required to seek local law changes to require authorities to maintain beneficial ownership data that they do not presently require, but to the extent that such information is maintained, or is in the possession of another party within the United States territory, attempts to secure and exchange the information

[46] OECD, *A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard*, reprinted at 2009 TNT 62-65 (April 2, 2009).

would be required. In Luxembourg, legal access to banking and financial information is required. The language in the article and in the diplomatic notes is paraphrased in the Technical Explanation with little elaboration. Because the issue of beneficial ownership information has been a recurring criticism of the United States at the European Union, as explained below, the extent to which the language may be relied upon to either require action by the United States or any State or to justify a refusal to honor a U.S. request is an area about which the Committee may wish to inquire. In addition, the Committee may wish to inquire about the extent to which Luxembourg currently has the requisite domestic authority to provide beneficial ownership information.

Within the European Union, Luxembourg is an exception to the automatic exchange of information agreed upon by the other members. In June 2003, the European Council issued a directive designed to ensure that all interest earned by a citizen of a member state from an account held in any other member state would be subject to a minimal direct tax ("Savings Directive").[47] The Savings Directive is intended to ensure that interest income earned by a citizen of one jurisdiction from an institution in another jurisdiction is subject to tax by the citizen's jurisdiction of residence by requiring both information reporting by the financial institution to the jurisdiction in which it is resident and automatic exchange of such information reports among the member states. Although member states were required to implement the directive by July 1, 2005, a special transition period was provided for the several member countries, such as Luxembourg, whose domestic laws had bank secrecy and did not permit exchange of information without a specific request for information on a specific taxpayer. Instead of agreeing to provide information under the automatic exchange of information, Luxembourg agreed to act as withholding agents with respect to accounts in their jurisdictions.[48] It collects and pays over tax to the home jurisdiction of the account holder without identifying that account holder. Although it does not provide information about account holders to other EU members, Luxembourg is entitled to receive information about its own citizens from the other states, without a specific request.[49] Subsequent amendments extended the transition period at least until the end of 2014.[50]

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[47] A directive is a non-self-executing resolution of the European Council that member states must implement, whether by national legislation or regulatory action. Maastricht Treaty, Article 249.

[48] During the transitional period, Luxembourg is required to impose a tax (currently 20 percent, increasing to 35 percent after June 2011) on interest payments made to EU residents unless the account holders agree to the exchange of information related to their accounts. A portion of the withheld tax is then paid over to the country in which the account holder resides. Similar rules applied under EU savings agreements with Andorra, Liechtenstein, San Marino, Monaco, and Switzerland and under bilateral agreements between individual EU states and the 10 dependent and associated territories of the United Kingdom and the Netherlands (Anguilla, Aruba, the British Virgin Islands, the Cayman Islands, Guernsey, the Isle of Man, Jersey, Montserrat, the Netherlands Antilles, and the Turks and Caicos Islands).

[49] Council Directive 2003/48/EC of 3 June 2003, OJ L 157 (26-6-2003).

[50] The transition period ends on the later of either the end of 2014, or the date that all member states and other identified jurisdictions, such as Hong Kong, Singapore, and the Channel Islands states, are in accord with OECD standards, or when the Council of the European Union unanimously concludes that the United States is committed to honor specific requests for exchange of information with respect to interest payments (within the

2. Extent to which taxpayer names will continue to be required

The need to identify the taxpayers to whom the request for information relates is subject to varying interpretations about the extent to which information provided by the requesting treaty country is sufficiently specific. 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 of the treaty, to require a treaty country to produce the names of members of an ascertainable class of persons.

The ultimately successful treaty request submitted under the terms of the August 2009 settlement with UBS, which led to production of the information and withdrawal of the John Doe summons, was not the first time that a treaty request was considered in that case. Enforcement of the summons was sought in 2009 only after the United States, through the U.S. Competent Authority, had requested the information, despite long experience with Switzerland suggesting that the request would be futile both because the United States could not supply the names of the taxpayers involved and because it did not yet have information sufficiently probative of tax fraud or fraudulent conduct.[51] The purpose of the request was to obtain those names. Only after enforcement proceedings were approaching a point at which Swiss courts would be asked to grant comity to a U.S. court order were the treaty countries able to agree that exchange of information was permissible under the U.S.-Swiss treaty. Use of the treaty request under the settlement agreement negotiated by the United States and Switzerland as well as the United States and UBS enabled the Swiss to preserve Swiss sovereignty while nevertheless providing the information needed by the United States.

The diplomatic notes do not elaborate on what is required, referring only to "identity." The Committee may wish to inquire about the nature and extent of assurances provided by Luxembourg about the interpretations of this requirement. Otherwise, the language may be susceptible to interpretations that would thwart future attempts to acquire information of the type received from Switzerland in resolving the UBS controversy. Although the Technical Explanation represents that a name will not be required so long as other information is sufficiently specific, it does not include mention of any representation to that effect from Luxembourg. We note that the Swiss tax authorities announced on February 15, 2011, that they would revise the Swiss position on the need for identity of the taxpayer and the person in possession of the requested information to state "Other means of identification should also be

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meaning of the Savings Directive) from all EU members who are in accord with OECD standards. To date, the Council of the European Union has not so concluded with respect to the United States.

[51] See Declaration of Barry B. Shott, submitted with petition to enforce the summons, *United States v. UBS AG*, 09-20423 mc-GOLD (S.D. Fl.) (February 19, 2009).

admissible in the future,"[52] in response, to negative comments received in the course of its Phase I Peer Review. The Committee may wish to inquire about the existence of any similarly authoritative statements from Luxembourg on this issue.

3. Standard of relevance for requests for exchange of information

The proposed protocol permits the competent authorities to exchange such information as is foreseeably relevant to the provisions of the treaty and the domestic tax laws of the two treaty countries. This standard is consistent with the standard of Code section 7602 as confirmed by the U.S. Supreme Court in a line of cases beginning with *United States v. Powell*,[53] under which information need only be shown to be potentially relevant to a legitimate purpose in order to be required to be produced. Nevertheless, without guidance in the proposed protocol or diplomatic notes as to whether the requested treaty country is permitted or even expected to evaluate the relevance of a request independently of the apparent conclusion by the Competent Authority in the requesting treaty country that the information is relevant to a legitimate purpose, there is fertile ground for new bases on which to refuse to comply with requests for information. Given the limited history of exchange of information with Luxembourg, the Committee may wish to inquire about the type of statement of purpose anticipated. We note that the domestic standard for relevance is lenient, recognizing the asymmetry of information held by taxpayers and available to the IRS. For example, in enacting John Doe summons authority, the House reported that it balanced the concerns about privacy and freedom from "fishing expeditions" against the need for the tax authorities to gain access to information for civil purposes, and concluded that "It is enough for the Service to reveal to the court evidence that a transaction has occurred, and that the transaction (in the context of such facts as may be known to the Service at that time) is of such a nature as to be reasonably suggestive of the possibility that the correct tax liability with respect to that transaction may not have been reported."[54]

4. Requirement that requesting treaty country exhausted other means of obtaining the information

The Committee may wish to inquire how a requesting treaty country is expected to demonstrate that it has no other practical access to the foreign-based documents that are the subject of the request for exchange of information. If the documents requested are reasonably thought to be available in the other jurisdiction or subject to the control of a person in that other jurisdiction, a treaty request should be an acceptable means of obtaining such information without requiring resort to futile measures or judicial process.

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[52] Swiss Statement, available at http://www.efd.admin.ch/aktuell/medieninformation/00462/index.html?lang=en&msg-id=37645.

[53] 379 U.S. 48 (1964).

[54] H. Rep. No. 94-658, p. 311 (1975).

5. Other issues about scope of exchanges

The proposed protocol permits collection assistance necessary to ensure that treaty benefits are limited to those entitled to them. Unlike the present treaty, the proposed protocol does not require that a specific request for collection assistance be accompanied by a copy of a document certified by the requesting competent authority specifying that the sums referred for collection assistance are "finally due and enforceable." The Technical Explanation does not address the omission of references to specific requests for collection assistance. The Committee may wish to inquire whether it is intended that such assistance be available, and if so, whether the standard for requesting assistance is limited to taxes that are "finally due and enforceable," that is, all administrative and judicial rights of the taxpayer to restrain collection in the requesting treaty country have lapsed or been exhausted such that the requesting treaty country has the right under its internal law to collect the tax.

There is little publicly available about the experience of the United States with requests for information from Luxembourg. The Committee may wish to inquire about the existence and nature of any perceived deficiencies in the former information exchange program. To the extent there are such deficiencies, the Committee may seek reassurances that the deficiencies have been addressed and that recurrence is unlikely. In addition to disagreements about appropriate interpretations of the treaty provisions, administrative concerns about timeliness and the form in which information has been provided may be explored.

C. Effectiveness of the U.S. Model Treaty Article 26

In addition to the above issues specific to the agreement between United States and Luxembourg, there are several questions about the effectiveness and scope of provisions that conform to the U.S. Model treaty. As described above, there has been a developing international consensus around the issue of bank transparency for tax purposes. That developing consensus has resulted in increased attention to efforts to reconcile conflicts between jurisdictions, particularly between jurisdictions with strict bank secrecy laws and those seeking bank information to enforce their own tax laws.[55] 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.

The U.S. Model treaty conforms with the norms for transparency and effective exchange of information articulated by the OECD, which are in turn the standards by which the OECD determines whether a country is committed to transparency. Those standards require the existence of mechanisms for exchange of information upon request; the availability of exchange of information for purposes of both criminal and civil tax matters; absence of restrictions of information exchange caused by application of the dual criminality principle[56] or a domestic tax interest requirement; respect for safeguards and limitations; strict confidentiality rules for information exchanged; and availability of reliable information (in particular bank, ownership, identity, and accounting information) and powers to obtain and provide such information in response to a specific request.[57]

1. Methods of 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[58] –

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[55] 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.

[56] The principle of dual criminality derives from the law regarding extradition and grounds for refusal to grant a request. Extradition is generally permitted only if the crime for which a person is to be extradited is treated as a similarly serious offense in the state in which the fugitive has sought refuge. *Restatement (Third) of the Foreign Relations Law of the United States*, sec. 476 (1987). The principle is relevant to a request for exchange of tax information only if the treaty in question limits the scope of its permitted exchanges to criminal tax matters.

[57] OECD, *Tax Cooperation: Towards a Level Playing Field, 2008 Assessment by the Global Forum on Taxation*, p. 8.

[58] OECD, Commentary on the Model Treaty Article 26, par. 9.

routine, spontaneous,[59] or specific exchanges.[60] With regard to the latter type of exchange, 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[61] is a specific request within the meaning of the article, and whether protracted litigation similar to that which occurred in the UBS litigation[62] can be avoided or shortened.

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 jurisdiction and agree to share such information on an ongoing basis, without the need for a specific request. Information that is automatically shared under this authority may include information that is not taxpayer-specific, such as news about changes in domestic tax legislation, or it may comprise voluminous taxpayer filings, such as magnetic disks containing the information from IRS Form 1042-S, relating to U.S.-source fixed or determinable income paid to persons claiming to be residents of the treaty country receiving the forms. 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 Committee may wish to inquire about the existence of any practical impediments to effective automatic exchange of information under the proposed treaty and what steps are needed to remove the impediments. 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. Examples of practical hurdles that reportedly limited the value of information exchanged were the lack of timeliness of its production, lack of conformity in reporting periods, the need to

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

[60] 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.

[61] 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.

[62] 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.

translate the language of the documents and the currencies, and its voluminous nature.[63] To the extent that useful information can be gathered through exchange of information, the United States may be able to reduce its reliance upon self-reporting, that is, information provided by the taxpayer and, therefore, only available with respect to those in compliance with the tax laws.

Practical challenges with automatic exchanges are not exclusive to the United States. The OECD has developed standards for the electronic format of such exchanges, to enhance their utility to tax administration.[64] 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.[65] Ideally, the information received by the IRS should either include a TIN or be subject to a process referred to as "TIN perfection" to enable the IRS to correlate account data in the information received with a valid TIN in its taxpayer databases, although such an undertaking may be time-consuming and costly. Working Party 10 in the OECD continues work to standardize information production. As part of that effort, it recently surveyed countries about their experience, impediments to greater use of automatic exchanges, and preferences for improving such exchanges. The Committee may wish to inquire how the United States responded to the OECD inquiries, and the priority it places on such improvements. In particular, an understanding of how and to what extent the IRS is able to use any information currently provided would help to evaluate the exchange of information programs.

The Committee may also wish to inquire about recently proposed regulations that expand information reporting by U.S. financial institutions on interest paid to nonresident aliens. Such reporting is not currently required, except with respect to payments to residents of Canada.[66] The recently proposed regulations would expand such reporting to include payments to any nonresident alien. In support of the proposed 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."[67] The Committee may wish to explore the usability of the information exchanged with Canada under present regulations, its relationship to the exchange of information program with Canada, the extent to which expanded regulations would strengthen exchange of information under the

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[63] Letter from Commissioner, IRS, to Chairman, Senate Committee on Finance (June 12, 2006), 2006 *Tax Notes Today* 115-17.

[64] 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").

[65] 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).

[66] Treas. Reg. sec. 1.6049-4(b)(5).

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

pending protocol, as well as any additional attendant burdens that may arise as a result of these regulations.[68]

2. U.S. reciprocity in providing 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.[69] 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.[70]

3. Override of domestic law privileges or confidentiality

The scope and operation of the provision that overrides potential arguments based on bank secrecy law of the requested treaty country presents questions about its possible impact on other privileges. Under the proposed protocol as well as both the OECD Model treaty and U.S. Model treaty, a treaty country is generally not obligated to take any action at variance with its domestic law, including disclosure of professional or trade secrets. That principle is limited by a special rule, which provides that a treaty country may not decline to provide information on the ground that the information is held by a financial institution, nominee, or person acting in an agency or intermediary capacity. The Technical Explanations to the proposed protocol and to the U.S. Model treaty state that this rule overrides claims of bank secrecy, but do not address its potential intersection with the law of professional privileges. In contrast, the OECD explains the general principle and provides as an example of information that a requested treaty country could

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

[69] Financial Action Task Force, IMF, *Summary 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).

[70] For example, 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.

decline to obtain any information that would violate safeguards against self-incrimination.[71] The OECD further explains the abrogation of the general principle and clarifies that the provision may limit the use of certain claims of professional privilege, but only to the extent that the domestic law in question was so broad as to base its protection solely on the status of the person holding the information.[72] Under the OECD approach, a treaty country may refuse to supply information held by a bank, financial institution, agent, fiduciary, or nominee as long as the ground for refusal is not the mere fact of the custodian's status as a bank, financial institution, agent, fiduciary, or nominee. The OECD provides an example of a legal representative acting for a client in an agency capacity. To the extent that confidential communications between the legal representative and his or her client are protected under local law, the general rule against requiring a treaty country to violate its own law continues to apply, and the treaty country may decline the request to exchange information.

At least one recently concluded treaty, the Income Tax Treaty between the United States and Finland,[73] departs from the U.S. Model treaty and expressly provides that the override of domestic law is not intended to include the ability to obtain information that would reveal confidential communications between a client and an attorney, in cases in which the client seeks legal advice. The Committee may wish to inquire as to the intended scope of the provision of the proposed protocol and of the U.S. Model treaty, and the extent to which the provision may override any privilege or confidentiality law that may be available under a treaty country's domestic law, and the circumstances in which this provision is likely to be involved. The Committee may wish to specifically inquire about its effect on the attorney-client privilege in the United States.

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[71] OECD, "Commentary to the OECD Model Treaty Article 26," par. 15.2.

[72] OECD, "Commentary to the OECD Model Treaty Article 26," pars. 19.12, 19.14.

[73] Senate Treaty Doc. 109-18.