Exchange of Information: bumps in the road

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Increased focus on taxation of cross-border situations involving both individuals and companies is one of the key features of the post-BEPS international tax environment. One central aspect of this is increased administrative cooperation between tax administrations in exchange of information and assistance in recovery of taxes.

Territoriality principle

Recent UK decisions have emphasised the need for such activity to be authorised by treaty. In *Jimenez, R (oao) v FTT (Tax Chamber) [2017] EWHC 2585 (Admin)*, for example, the High Court ruled that HMRC has no power to require person outside the UK to provide information. Information notices under Finance Act 2008, Schedule 36 are subject to the international law territoriality principle.

The standard for authorising exchange of information under article 26(1) of the OECD Model Convention was changed in 2005 from "necessary" to "foreseeably relevant" to the administration or enforcement of the tax laws of contracting states. The meaning and application of this term has not however received judicial attention until recently.

Hanse v United States Case No. 17-cv-4573, 5 March 2018, a case where the French tax administration requested information be obtained by the United States Internal Revenue Service did not turn on the term although it raised similar issues. Information was requested in relation French wealth Tax on funds held in the United States on behalf of a French citizen. He argued that he was not French resident, and, therefore, the French tax authorities should resolve the residence question before IRS procured requested information on non-French assets. The case turned primarily on whether the requirements under US law had been met for the IRS information demand. The US District Court ruled accepted that the summons was issued pursuant to a proper request from France under the provisions of the France-US treaty, and that the request stated that it is in conformity with the laws and administrative practices of the French tax administration. The IRS was not required to look beyond that in order to act properly in demanding the information. This approach may be out of line with recent judicial decisions elsewhere which suggest scrutiny of the other state's request is necessary.

What is "forseeably relevant"?

In *Berlioz Investment Fund SA* (C-682/15) the CJEU endorsed the OECD Commentary explanation that the term is intended to provide for exchange of information in tax matters to the widest possible extent without permitting "fishing expeditions" or provision of information that is unlikely to be relevant to the tax affairs of a given taxpayer. The Court ruled that both the requesting and requested states must assess whether this standard is met.

The meaning and application the "foreseeably relevant" was also examined by the Swiss Federal Supreme Court in *decisions 2C_411/2016* and others on 13 February 2017 in a series of cases flowing from a French request to the Swiss tax administration for information in a transfer pricing investigation. The investigation related to a corporate group reorganisation of activities and transfer pricing policy which lead to a change in distribution profits within group. The French tax administration requested information on the Swiss tax treatment of Swiss companies in the group, their financial statements and certain details of the reorganisation. The Court ruled that "foreseeably relevant" requires presence of a reasonable possibility that the requested information is relevant at the time of the request. Such a request will only be denied if the link between the requested data and the investigation is improbable, which excludes fishing expeditions. This again is in line with the OECD Commentary. The standard is objective and not the subjective opinion of a tax administration.

The Swiss Federal Supreme Court ruled that the financial statements of the Swiss companies were foreseeably relevant. The analysis of the relevance of the Swiss tax position of the companies was more nuanced. Information on the Swiss tax treatment of Swiss group companies was foreseeably relevant because under French law the burden of proof in transfer pricing, which is normally on the tax administration, is reversed for companies who benefit from foreign tax privileges. Information on the reorganisation was foreseeably relevant despite the fact that this information was available to the French tax authorities in a transfer pricing study. In relation to the obligation of the requested state to test foreseeable relevance, the Court invoked the international law principle of good faith in Article 26 of the Vienna Convention on the Law of Treaties and mutual trust to permit the requested state to assume that the standard is met if the requesting state provides full motivation for the request. In such cases, specific, persuasive evidence is needed to rebut the presumption. The decision is consistent with the CJEU in Berlioz in that both states are required to test foreseeable relevance. The requested state may rely on the presumption of compliance of a fully supported request in the first instance.

Good faith

Good faith in international law also featured in the Swiss Federal Supreme Court decision 17 March 2017 (*2C_1000/2015)*. There the French tax authorities requested information from their Swiss counterparts on Swiss bank account of French residents. This request based on stolen information obtained by French tax authorities from a former employee of a Swiss bank. The Court declined to approve the request on the basis that the theft is a criminal offence under Swiss law. The principle of good faith requires that a request not be underpinned by criminal activity in the requested state. In addition French government had agreed with Swiss government not to use stolen data as the basis for an information request. This put the request itself in conflict with the International principle of good faith in connection with stolen data.

Returning to *Hanse v United States*, the taxpayer's argument on the treaty was that, under French law, the French tax authorities were not entitled to the information sought (OECD Model Article 26(3)(b)). This appeared to be on the basis of his assertion not to be French resident. Article 27 of the France-US treaty does not follow the OECD Model but requires information that "may be relevant". Arguably this is a lower threshold than "foreseeably relevant".

Regardless of whether the taxpayer's position was justified, it does represent a common difficulty that may give rise to frustration both for taxpayers and administrators. Where information is not presently relevant because some precondition to its relevance has not yet been satisfied, should the information be provided then or only once the precondition is satisfied?