

## INTRA-EUROPE EXCHANGE OF DIRECT TAX INFORMATION: THE DIRECTIVE ON MUTUAL ASSISTANCE 25 YEARS ON

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Tax harmonisation in the EU has proceeded at less than a snail's pace in the direct taxation field. Many proposals have been made by the Commission and have sat on the shelf for decades. Apart from the three measures enacted in 1992 (Directive on the common system of taxation applicable to mergers, divisions, transfer of assets, and exchanges of shares concerning companies of different Member States (90/434)); Directive on the common system of taxation applicable in the cases of parent companies and subsidiaries of different Member States (90/435), and the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436)), in the course of the introduction of the single market, no Community legislation exists harmonising direct taxation. The requirement for unanimity amongst Member States in order to adopt tax measures makes agreement extremely difficult even in areas that might be regarded as somewhat uncontroversial.

The Directive on Mutual Assistance by competent authorities of Member States by exchange of information is the oldest direct tax measure. Enacted in 1977, it predates the harmonisation measures by some 15 years. Where Member States have been lacking in agreement on a common approach to substantive tax issues, a community of interest was clearly established at an early stage in assisting one another in relation to cross-border compliance by exchanging information.

The legal basis for the Directive is Article 100 EC (now Article 94 in accordance with the Treaty of Amsterdam). This deals with the approximation of laws, regulations and administrative provisions of Member States as 'directly affect the establishment or

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functioning of the common market'. The first preamble to the Directive indicates that cross-border tax evasion and tax avoidance lead to budgetary losses and violations of the principle of fair taxation, and are liable to bring about distortions of capital movements and of conditions of competition, and accordingly affect the operation of the common market. Neither evasion nor avoidance are defined.

#### **Exchange of Information and Discriminatory Taxation**

The exchange of information between Member States and, in particular, the role of the Directive have featured in the decisions of the European Court relating to discriminatory taxation. In *Finanzamt Köln v Schumacker*<sup>2</sup> the German tax administration argued that it was not discriminatory to ignore the personal and family circumstances of a non-resident worker *inter alia* because there were administrative difficulties preventing the state of employment from ascertaining the income of non-residents working in its territory received in their state of residence. The Court refused to uphold this argument. It stated that the Directive on Mutual Assistance provides for ways of obtaining information comparable to those existing between tax authorities at national level. There is, thus, no administrative obstacle to account being taken in the state of employment of a non-resident's personal and family circumstances. Likewise, in *Wielockx v Inspecteur der Directe Belastingen*<sup>3</sup> the Court accepted arguments from the Commission that tax authorities may always collect all necessary information pursuant to the Directive and consequently the lack of information about the circumstances of a taxpayer could not be invoked to justify discriminatory taxation.

Similarly, in the corporate context, the Court has ruled that legal measures cannot be justified on the basis of the absence of information. Thus, for example, in *Futura Participations SA and another v Administrations des Contributions*<sup>4</sup> the requirement to keep accounts in a Member State where a branch was located was held to be discriminatory. The Court ruled this discrimination could not be justified by the lack of access to the company's accounts, since information was available by virtue of the Directive on Mutual Assistance. Given the extensive legal framework for the exchange of information, it is somewhat surprising that in the late 1990's, Member States were arguing that a lack of information about taxpayers outside their own jurisdictions was a ground for discrimination. This may suggest that tax administrations had not, even at that stage, taken full advantage of the legal mechanisms available to them.

<sup>2</sup> (Case C-279/73) [1995] STC 306 (ECJ).

<sup>3</sup> (Case C-80/94) [1995] STC 876 (ECJ).

<sup>4</sup> (Case C-250/95) [1997] STC 1301 (ECJ).

### **Other Exchange of Information Initiative**

The late 1990's saw the quest for cross-border exchange of information given new impetus, both inside and outside the EU. In recent times, the OECD campaign against harmful tax practices which started with a lengthy list of perceived harmful practices has now focussed almost exclusively on exchange of information and transparency. More than half of OECD members are EU Member States. The debate on the prevention of tax evasion in the context of cross-border savings within the EU pitted arguments in favour of a general European withholding tax on interest against enhanced exchange of information arrangements. The proposed Savings Directive in its current form has, largely at the insistence of the UK, adopted exchange of information coupled with obligations on Member States to obtain the necessary information. During the life of the Directive, other OECD programmes have been aimed at improving administrative practices in this area, such as the recommendation concerning a standardised form of automatic exchange of information under international agreements<sup>5</sup> and the recommendation concerning a standard magnetic format for automatic exchange of tax information<sup>6</sup>.

Technological change has had a profound impact on both the environment in which tax administration takes place generally and specifically in the context of exchange of information. Information exchanges in earlier years which were based entirely on paper were subject to significant limitations, not only on the volume of information that was exchanged. It was slow, cumbersome and the use to which information received might be put was limited. Modernisation of tax administration, through the use of information and communication technology, means that administrations are able to exchange and use vast quantities of data.

### **Directive v Bilateral Treaties**

The UK has bilateral tax treaties which provide for exchange of information with all Member States. One may question, therefore, the necessity for the Directive if a satisfactory legal framework for exchanging information with other Member States is already in place pursuant to bilateral treaties in the UK context. The UK bilateral tax treaties with other Member States include some of the oldest UK treaties and all contain provisions for the exchange of information. The facility for exchange of information has thus been in place for a very long time indeed. However, in 1977, the treaty network within the Community as between other Member States was not complete.

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<sup>5</sup> OECD Council Recommendation C(81)39 dated 5th May 1981.

<sup>6</sup> OECD Council Recommendation C(92)50 dated 23rd July 1992.

By accident or design, the Mutual Assistance Directive was enacted in the same year as the OECD Model Double Tax Convention, 1977. The Directive shares a number of core features with Article 26 of the Model Convention. The Directive contains explicit authority for the circumstances where information may be exchanged that are dealt with by way of explanation only in the Commentary to the OECD Model. These include exchange on request, automatic exchange and spontaneous exchange of information.

The Mutual Assistance Directive however goes beyond the typical terms of UK treaties. Firstly, Article 6 of the Directive authorises collaboration by officials of the Member States concerned, including authorising the presence of another state's tax officials in their territory.

Secondly, Member States may allow the information they supply to be used for purposes other than taxation, if under the legislation of the informing state, that information could in similar circumstances be used in the informing state for those purposes. UK domestic legislation authorises disclosure of information to a number of other government departments, particularly in the context of Social Security, and to the Police in the context of drug trafficking and terrorism.

Thirdly, Article 7(4) authorises the transmission of information received to the competent authorities of a third Member State with the agreement of the competent authority which supplied the information.

The Directive also establishes a framework for wider cooperation between tax administrations. Article 9 calls for consultation, both between particular Member States on bilateral issues, and among all Member States and the Commission on matters of collective interest for the purpose of implementation of the Directive. Similarly, Member States are enjoined to monitor cooperation procedures and to pool experience with a view to improving cooperation and, where appropriate, drawing up a body of rules in the fields concerned (Article 10).

### **Spontaneous Exchange of Information**

The European Court has only considered directly the text of the Directive in one case. The interpretation of Article 4(1) dealing with spontaneous exchanges of information was examined in *W.N. v Staatssecretaris van Financien*.<sup>7</sup> Article 4(1) requires Member States without prior request to forward information to the competent authority of another Member State where:

<sup>7</sup> (Case C-420/98) [2001] STC 974 (ECJ).

- (a) the informing state has 'grounds for supposing that there may be a loss of tax in the other Member State';
- (b) a person liable to tax obtains a reduction in or an exemption from tax in the one Member State which would give rise to an increase in tax or to a liability to tax in the other Member State;
- (c) business dealings between taxpayers in two Member States are conducted in such a way that a saving in tax may result in one or both Member States;
- (d) the competent authority of a Member State has grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises;
- (e) information forwarded to one Member State by another has enabled information to be obtained which may be relevant in assessing the liability to tax in the second Member State.

The Court was asked to consider, firstly, whether the expression 'a loss of tax' had to apply to a loss of tax covered by an express measure on the part of the receiving state. Secondly, the Dutch version of the Directive used the expression 'abnormale vrijstelling of vermindering' as the expression 'loss of tax' (this may be literally translated as 'abnormal exemption or reduction'). The interpretation of this expression was required. The Court was also asked whether if Article 4(1)(a) was inapplicable, Article 4(3) gave rise to an obligation to exchange information. Article 4(3) states that the competent authorities of Member States 'may forward to each other in any other case without prior request' the information referred to in Article 1(1) of which they have knowledge.

The Court held that Article 4(1)(a) obliges Member States to forward to another Member State information which may enable a correct assessment of taxes to be effected. It is sufficient for the loss of tax in question to be supposed and is not necessary for it to have been proven. This interpretation corresponds with the purpose of the Directive as set out in the preamble. In particular, it is unnecessary for the forwarding state to make any assessment of the tax liability in the receiving state.

Secondly, in order to interpret different language versions, they have to be interpreted by reference to the purpose and general scheme of the rules of which they form part. In the context of this Directive which is not only to combat evasion and avoidance, but also to enable a correct assessment of tax to be effected in different Member States, the Directive must be interpreted as meaning that a Member State is required without prior request to forward information to the tax authorities of another Member State where it has grounds for supposing that, without that information, an unjustified saving in tax might exist or be granted in that other state. Thus, the expression 'a loss of tax' refers

to an unjustified saving in tax in another Member State.

### **Taxpayers' Rights**

The thrust of the Directive is to give powers to tax administrations to assist each other, rather than to confer rights on taxpayers. To what extent can it be said that the Directive confers rights on taxpayers?

In delimiting the scope of information exchange, clearly taxpayers are entitled to insist upon compliance with the terms of the Directive by the competent authorities concerned. For example, the Directive was given effect in the UK under Finance Act 1978. Section 77 authorises the disclosure of information by the Inland Revenue to the competent authorities of other Member States in compliance with the Directive. Thus, disclosure not in accordance with the Directive (or a bilateral treaty) would be illegal.

The provisions relating to secrecy in Article 7 would appear to be of direct effect in several respects. Firstly, information made known to a Member State under the Directive must be kept secret in that state in the same manner as information received under its domestic legislation. This would suggest that a breach of the domestic law would give rise to a concurrent breach of Community law. In addition, Article 7 lays down limits to the use of the information which apply regardless of the rules of domestic law:

- (1) Exchange of information may be made available only to persons directly involved in the assessment of the tax or in the administrative control of this assessment.
- (2) It may be made known only in connection with judicial or administrative proceedings involving sanctions undertaken with a view to or relating to the making or reviewing the tax assessment and only to persons who are directly involved in such proceedings. This information may be disclosed during public hearings or in judgments if the competent authority of the Member State supplying the information raises no objection.
- (3) It may not be used other than for taxation purposes or in connection with judicial proceedings or administrative proceedings involving sanctions undertaken with a view to or in relation to the making or reviewing of the tax assessment.

Notwithstanding these rules, information may be used for other purposes in certain circumstances. Article 7(3) permits information to be used for other purposes in the requesting state if, under the legislation of the informing state, the information could in

similar circumstances be used in the informing state for similar purposes. It is clear therefore that the standard imposed is that of the informing state. Thus, the Inland Revenue would only be authorised to exchange information with other government departments or agencies if this would be permitted under the law of the state supplying the information. Furthermore, Article 7(3) would suggest that this exception to the general rule will only apply where information is requested pursuant to Article 2 and not to automatic exchange under Article 3 or spontaneous exchange under Article 4. A similar obligation of secrecy is imposed under Article 8(2) where it would lead to the disclosure of a commercial, industrial or professional secret or of a commercial process or of information whose disclosure would be contrary to public policy. Again, it would appear that these provisions are of direct effect.

### **Remedies for Breach of Confidentiality**

UK procedures for exchange of information do not in general involve the taxpayer. No notice is required to be given to UK taxpayers. One exception may be where the Inland Revenue exercise their powers under section 20 of the Taxes Management Act 1970 to gather information on behalf of other Member States. Finance Act 1990 section 125 authorises the use of these information gathering powers where the taxes of other Member States are in issue. These powers may be exercised despite the fact that the UK has no interest in the information. In the absence of an opportunity, for example, in challenging measures taken pursuant to section 20 on the basis that the information to be provided is contrary to the terms of the Directive, judicial review of an unlawful exchange of information may be ineffective as a practical result because of the lack of transparency in the process. Such a failure would render the UK liable under Community law for the lack of an effective remedy. A breach of secrecy would also likely give rise to a breach of Article 8 of the European Convention on Human Rights, which in the UK will be a ground for the judicial remedies specified in section 8 of the Human Rights Act 1998.

### **The Next 25 Years**

The first 25 years of the Mutual Assistance Directive are likely to be viewed as the infancy of exchange of information in Europe. The 21st Century is already proving a turning point, both in technological terms so that the ability to gather information electronically, to exchange it electronically and make use of it will be via means undreamed of at the time the Directive was conceived.

Secondly, the political environment in which 21st Century information exchanges will take place is dramatically different. National boundaries are breaking down. Traditional attitudes towards secrecy and confidentiality are being eroded in a number of areas, only one of which is taxation. The proposed Savings Directive, for example,

provides a derogation to the exception for exchanging information to protect commercial, industrial or professional secrets, or for public policy reasons. The draft proposal similarly calls for minimum content of the information to be provided under the new system. In this respect, it has some similarity with the regime established for VAT under EC Regulation 218/92. No doubt, once information exchange has become routine and taxpayers assume that it will take place, much of the non-disclosure that it is aimed at will disappear. Problem areas are then more likely to exist where incorrect information is exchanged or information is exchanged improperly, and whether the Courts will grant relief for the consequences of incorrect or improperly exchanged information.