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***EXCHANGE OF INFORMATION 2006
AND RELATED ISSUES***

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I. THE BAHAMAS TAX INFORMATION AGREEMENT NOW

A. The Treaty is currently in effect now.

1. Criminal Matters January 1, 2004
2. Civil Matters January 1, 2006
3. Bahamas Reward
 - a. The extension of the convention deduction to the Bahamas.
 - b. This means U.S. taxpayers may deduct the costs of attendance at a conference or convention held in the Bahamas. Bahamas TIEA, Art. 5. The Treaty language differs from the statute in allowing “seminars” and “similar meetings” IRC § 274(h)(6). However, this difference should not have any substitutive effect.
 - c. Qualified intermediary.
4. The clause in the TIEA relating to the most favored nation status has not apparently been invoked even though some of the treaties relating to other countries are not yet in force. Bahamas TIEA Art. 7.5.
5. There is an OECD Model Treaty and there are certain differences. However, there are no negotiations pending because differences are not glaring. Bahamas TIEA Art. 7.6.
6. Any information relating to criminal matters turned over by the government prior to January 1, 2006 may not be used in any other matter without consent of the Bahamas government. After that, upon notice to the Competent Authority in the Bahamas, information obtained under the TIEA, may be used in connection with “a type of United States federal tax matter other than that for which it was requested.” Bahamas TIEA, Art. 3.4.

B. The Result

1. Information with respect to “all federal taxes in the United States” is now subject to exchange under the Treaty.
2. To be subject to exchange of information, a civil matter must be pending at the time of the information request and must relate to a taxable period commencing on or after January 1, 2006. This information is available only with respect to returns due in March 15, 2007, in the case of

corporations, and in April 15, 2007, in respect to other taxpayers subject to extensions in each case.

3. Procedural Protections

Any information request with respect to a matter (other than a criminal matter) must be accompanied by a certification by a senior officer of the United States Treasury that the request is foreseeably relevant or material to the determination of the federal income tax liability of a taxpayer of the United States or to the criminal liability of a person under the federal tax laws of the United States. Where the matter relates to a non-resident of the United States, the senior official must certify that such request is foreseeably relevant or material to the determination of the federal tax liability of a taxpayer of the United States or to the criminal liability of a person under the federal tax laws of the United States. In addition, it must also be established to the satisfaction of the Minister, that such information is foreseeably relevant or material to the administration and enforcement of the federal tax laws of the United States. Bahamas TIEA, Art. 2.5; Implementation Act §5 (3)(4).

An indication as to the meaning of what is foreseeably relevant or material in the Bahamas TIEA can be found in the commentaries to the OECD Agreement on Exchange of Information on Tax Matters. There, it is stated:

“The standard of foreseeable relevance is intended to provide for exchange of information in tax matters to the widest possible extent and at the same time to clarify that the Contracting Parties are not at liberty to engage in fishing expeditions or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer.” Comm. 3.

Thus, the foreseeably relevant standard is designed to insure against fishing expeditions and to make sure that the requests are designed to determine the tax liability of a particular taxpayer of the United States or the criminal liability of a person under the federal tax laws of the United States. The insertion of the phrase “or material” is probably to avoid issues of the technicalities of the evidentiary rules, which might relate to what is relevant.

The Government of the Bahamas is not obliged, in connection with the rendition of information, to carry out administrative measures at variance with the laws and administrative practices of the Bahamas or to supply particular items of information which is not obtainable under the laws or in the normal course of administration of the Bahamas, nor to supply

information that would disclose any trade, business, industrial, commercial or professional secret or trade process, or to supply information, the disclosure of which, in the judgment of the government of the Bahamas, would be contrary to national security or public policy. Bahamas TIEA §2.7. *See, also* Implementation Act §3(4). The Bahamas TIEA also states:

“Nothing in this Agreement shall be construed to permit the Government of the United States to share information received pursuant to this Agreement with an agency or employee of any other government.” Bahamas TIEA, Art. 3.3

The Bahamas Agreement states that the Article relating to provisions of information “. . . shall not apply to the extent that the requested information:

- a. relates to a matter under United States federal tax law that is barred by the applicable statute of limitations; or
- b. constitutes or would reveal a privileged communication.”

Bahamas TIEA, Art. 2.4.

4. Examinations outside of the U.S.

The Bahamas TIEA contains no provision allowing United States Treasury or IRS officials to be present at interviews or investigations. It is my understanding that there is a longstanding governmental policy opposing the presence of foreign government officials in pursuance of their duty on the national territory of the Bahamas. Whether this will continue to be the case remains to be seen. The Bahamas Implementation Act makes no reference to the presence of United States officials in the Bahamas during investigations, interviews or for the examinations of records.

C. What does this all mean to Trustees

The Trustee of an express trust has a heavy burden with regard to tax information exchange, as well as other information exchanges. The settlor and the beneficiaries of the trust have a reasonable expectation of financial privacy which has suddenly been torn away as a matter of law, at least as far as United States and, in the future, perhaps other tax inquiries are concerned. All of the information which the Trustee must accumulate in order to conform to “know your customer” rules is necessarily available under exchange of information proceedings subject to the legal professional privilege. This is true not only with respect to mutual legal assistance treaties and, to a limited

extent, through letters rogatory proceedings, but also as regards provision of tax information subject to the limitations discussed above. The best way for a Trustee to protect his client is to protect himself. In making a full, fair and complete disclosure of the situation, the Trustee will make the client aware of exactly what his circumstances are and in a position to make his own judgments with regard to disclosures.

It is also imperative that Trustees review their agreements with their clients to make sure that these agreements exonerate the Trustee with regard to information disclosure under government fiat; but at the same time require the Trustee, where legally possible, to give the client or his representative (such as the protector of a trust) reasonable notice of the fact that a request for information has been made.

It will be noted in the Bahamas, that where the matter relates to an investigation under the Proceeds of Crime Act, 2000 (bribery, money laundering, certain Bahamian offenses and offenses that would be Bahamian offenses if committed in the Bahamas) then the Trustee's "tipping off" the customer may be a crime.¹ However, there normally should be no tipping off offense involved where a turnover notice has been served under the Bahamas Implementation Act. In fact, the Act seems to contemplate that the Trustee will do and perform his fiduciary duty and provide information to the customer. Thus, when a notice is served under the Act, the Minister must determine when the turnover should take place, which time shall not be more than twenty-eight days commencing from the date on which the notice was served. The Minister has the power to extend the return date, where he considers the circumstances warrant the same. The statute requires the Minister to obtain information involved and to require the custodian of the information to deliver the information to the Minister. However, the information is not required to be turned over to the United States Competent Authority for a further period of twenty days. The Minister may extend the time for a turnover in the event that a taxpayer or other interested person has objected to the Minister or otherwise sought judicial review or other lawful recourse against the turnover, pursuant to Section 12 of the Act. Section 12 is a very broad provision, which enables virtually any affected person to seek judicial review or other action as is lawfully available.

Thus, the law seems to contemplate that the Trustee may, in fact, inform the client or his protector, or other interested parties concerning the request for information. Presumably the act will be administered in such a way so that Trustees will be provided with reasonable time within which to contact their clients so that the client may instruct how and the Trustee may deal with the request.

¹ Dr. Peter D. Maynard Ch 10 "The Bahamas" in Butterworths International Guide to Money Laundering Law and Practice 2d Ed. (Toby Graham, Gen'l Editor, Butterworths Lexis Nexis) at ¶ 10.55 et seq. (Oct. 2002).

However, there may be circumstances where suspicious activity is or has been involved and there might be a danger of “tipping off”. Accordingly, the trust instrument or trustee service agreement should provide that the Trustee is not obligated to advise the client of any request for information, if so doing is contrary to law.

In reality, it is not the information that the Trustee needs to be concerned about, but the consequences of the turnover of the information. Where a trust or other entity (such as a foundation) is expected to be tax efficient, the Trustee should satisfy that the client has been adequately advised. He must, therefore, require that his clients be adequately advised at the outset and on an ongoing basis from a tax and a legal perspective, such that there need not be great anxiety concerning the release of information, because all matters have been properly handled in advance and the information cannot hurt the client. The Trustee need not look behind the advice, however, unless it is manifestly erroneous or the Trustee volunteers to give legal advice.

Where the settlor of a trust and the beneficiaries are in different jurisdictions, advice of counsel in all relevant jurisdictions must be sought.

Where the Trustee or the trust is a qualified intermediary, responsibilities of the Trustee in that regard must be taken into account. A Trustee must bear in mind that there are circumstances where the Trustee may have sole or joint and several liability for the tax or tax penalty involved.

Once it is determined that the tax plan on which the trust or foundation or other entity or plan is predicated is viable, the Trustee must take steps to preserve all factual information necessary to support counsel’s opinion from a tax point of view. Very often problems arise from having too little information rather than having too much.

It is imperative, moreover, that the Trustee appoint a Tax Compliance Officer, similar to the Money Laundering Reporting Officer currently required under the Financial Intelligence Unit Act. That officer must make sure that all receptionists, all mailroom personnel and all account executives understand that any information relating to taxes and emanating from the Ministry of Finance, the United States Internal Revenue Service or the United States Treasury or any other tax agency of any other country must immediately be turned over to the Tax Compliance Officer for further processing. Significant penalties and liabilities may arise where a Trustee has not provided the client with adequate notice because of a lack of sensitivity on the part of personnel to the necessity for reacting immediately on an emergency basis to these types of communications, rather than in the ordinary course of business. This is because of the tight timeframes and response time that may be imposed in connection with the administration of exchanges of information.

WHAT HAS HAPPENED TO THE LEVEL PLAYING FIELD?

- A. A recent meeting of the Global Forum in Melbourne Australia.
 - 1. The discussions go on. The OECD has no present intention to seek to impose sanctions on non-participants. Rather, efforts to achieve intensive dialogue are ongoing.
 - 2. Switzerland refuses to execute exchange of information, but has agreed to withholding tax on interest subject to the European Savings Directive.
- B. Isle of Man enters into an exchange of information agreement without a level playing field. Isle of Man goes zero tax.
 - 1. Exchange of Information Agreement with the Netherlands is based on rewards.
 - 2. Rewards
 - a. Enhanced participation exemption for Netherlands Parent Companies and Isle of Man subsidiaries. Without the Agreement, Netherlands now requires a minimum tax of 5% on profits. This is also a passive income test which continues to apply.
 - b. Tax Agreement relating to operating of ships and aircraft in international traffic.
 - c. Mutual procedures to effect arms length adjustment of profits and losses.
 - d. Political commitment to further negotiations within six months to alleviate undesired tax barriers and other obstacles of a discriminatory nature and within two years to evaluate results and consider further steps to be taken.
 - 3. The possibility of a participation exemption without a Treaty.
 - a. The Danish gambit.
 - 4. Attachments.
 - a. Mutual Understanding on the Application of the Participation Exemption.

- b. Agreement Between the Isle of Man and the Kingdom of the Netherlands for the Avoidance of Double Taxation with Respect to Enterprises Operating Ships or Aircraft in International Traffic.
- c. Agreement Between the Isle of Man and the Kingdom of the Netherlands on the Access to Mutual Agreements Procedures in Connection with the Adjustment of Profits of Associated Enterprises and the Application of the Netherlands Participation Exemption.
- d. Political Declaration.
- e. Progress Towards a Level Playing Field: Outcomes of the OECD Global Forum on Taxation, Melbourne, 15-16 November 2005.

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