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BUREAU OF THE CONSULTATIVE COMMITTEE OF THE CONVENTION FOR THE PROTECTION OF INDIVIDUALS WITH REGARD TO AUTOMATIC PROCESSING OF PERSONAL DATA

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REPORT ON THE IMPLICATIONS FOR DATA PROTECTION OF THE GROWING USE OF MECHANISMS FOR AUTOMATIC INTER-STATE EXCHANGES OF PERSONAL DATA FOR ADMINISTRATIVE AND TAX PURPOSES, AS WELL AS IN CONNECTION WITH MONEY LAUNDERING, FINANCING OF TERRORISM AND CORRUPTION

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Introduction

Linkage between the automatic exchange of personal data between States for administrative and tax purposes and similar exchanges aimed at combating money laundering, the financing of terrorism and corruption might seem surprising at first.

Automatic processing carried out by state authorities for the ultimate purpose of levying tax on individuals' taxable incomes does not pursue the same goal as processes geared to exchanging intelligence for the purpose of combating money laundering, the financing of terrorism and corruption (LAB-FT).

In the first case, it is chiefly a national issue of filling state coffers whereas in the second case the intention is to strip organised crime of its means of action, often by freezing or confiscating its assets.

But two developments have substantially blurred the boundaries between taxation and the fight against money laundering.

Firstly, when revising its Recommendations in February 2012, the FATF decided to include "all serious offences" within the scope of AML/CFT, which encompass a large number of tax offences.

The term "serious offences" used here reflects a drive to criminalise as many offences as possible by correlating the scope of anti-money laundering with the penalty applicable to the predicate offence. Like a black hole, the LAB-FT accretion disk sucks in all the offences linked to FATF thresholds.

Secondly, it should be remembered that, in a 1998 report[1] prepared in order to "*develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases"*, the OECD determined four key factors[2] in identifying tax havens: no or only nominal taxes, lack of effective exchange of information, lack of transparency and no substantial activities.

Although tax havens have been heavily stigmatised in the political arena and in the media, it should be noted that the rudimentary aim of countering the distorting effects of international tax competition has now been transformed into a drive against fraud and tax evasion. Mistrust surrounding state practices in tax competition has now shifted to individuals. The exponential development of obligations and duties based on the notion of *"suspicion"* is remarkable in this connection.

So, as Europeans debate the issue of automatic inter-state exchanges of personal data for administrative and tax purposes, the imminent entry into force of Foreign Account Tax Compliant Act[3] (FATCA) in respect of a great many countries has expedited the use of automated personal data processing permitting automatic exchanges of tax information.

As a result, the automatic exchange of information is becoming the international norm, as pointed out by the Secretary General of the OECD, who declared his satisfaction that *"the political support for automatic exchange of information on investment income has never been greater. Luxembourg has changed its position and the US FATCA legislation is triggering rapid acceptance of automatic exchange and propelling European countries to adopt this approach amongst themselves. In response to the G20 mandate to make*

[1] *Harmful Tax Competition: An Emerging Global Issue*, 19 May 1998, OECD.

[2] Cf. note no. 1, box I, page 26.

[3] The Foreign Account Tax Compliance Act of 18 March 2010 (FATCA) enables the United States to levy tax, under their own taxation laws, on all accounts held abroad by individuals subject to taxation in the United States.

automatic exchange or information the new standard, the OECD is developing a standardised, secure and effective system of automatic exchange"[4].

Defining the automatic exchange of information

The Council of Europe[5] considers that *"Information which is exchanged automatically is typically bulk information comprising many individual cases of the same type, usually consisting of payments from and tax withheld in the supplying State, where such information is available periodically under that State's own system and can be transmitted automatically on a routine basis. By exchanging information in an automatic way, compliance is generally improved and fraud can be detected which otherwise would not have come to light. The aim of the Parties will be to exchange such information in the most efficient way possible having regard to its bulk character"*.

The OECD defines the automatic exchange of information[6] as follows:

"Automatic exchange of information (also called routine exchange by some countries) involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (eg dividends, interest, royalties, salaries, pensions etc)".

It further describes it[7] as *"the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (eg dividends, interest, royalties, salaries, pensions etc). It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum even where tax administrations have had no previous indications of non-compliance"*.

However, the notion of *"automatic exchange of information"* is not the same as the automated exchange of information. Even though the OECD manual in question[8] distinguishes exchanges on request and spontaneous exchanges from automatic exchanges, it stipulates that the latter may involve exchanges of physical media (tapes, diskettes, CD ROM, DVD, post etc) and electronic exchanges (e-mail attachment, electronic file transfer).

Furthermore, Directive 2011/16/EU[9] of 15 February 2011 on administrative cooperation in the field of taxation defines automatic exchange as *"the systematic communication of predefined information to another Member State, without prior request, at pre-established regular intervals. In the context of Article 8, available information refers to information in the tax files of the Member State communicating the information, which is retrievable in accordance with the procedures for gathering and processing information in that Member State"*.

In the light of these definitions and, in particular, the fact that these communications of personal data for administrative and tax purposes take place systematically and without

[4] http://www.oecd.org/fr/ctp/locde-annonce-de-nouvelles-evolutions-en-matiere-dechange-de-renseignements-fiscaux.htm

[5] Cf. Explanatory Report to the Convention on Mutual Administrative Assistance in Tax Matters, CETS no. 127, opened for signature by the member States on 25 January 1988, Article 6, point 63.

[6] Manual on the implementation of exchange of information provisions for tax purposes, approved by the OECD Committee on Fiscal Affairs on 23 January 2006, OECD, Module on automatic (or routine) exchange of information, p. 3.

[7] http://www.oecd.org/ctp/exchange-of-tax-information/automaticexchange.htm

[8] Cf. note no. 11: Appendix 1 - SEIT-OECD Standards for Exchange of Information in Taxation, p.80.

[9] Art. 3 – 9°) of Directive 2011/16/EU.

prior request, it is recommended that the States concerned take the greatest care in drafting legal instruments underpinning the automatic exchange of personal data and, specifically, define at the very least:

- the legal basis for automatic exchange;
- its scope (eg the taxes and persons concerned);
- terms which might otherwise have differing interpretations;
- an exhaustive list of the personal data subject to automatic exchange and the period for which the recipient State keeps them;
- the purpose(s) for which these data have been gathered and may validly be used;
- the authorities and services authorised to pass on the personal data concerned and those authorised to use the data passed on;
- the frequency with which information is communicated;
- the practical arrangements for automatic exchange.

The legal basis for automatic inter-state exchange of personal data for administrative and tax purposes

The main legal platform for the automatic exchange of information for administrative and tax purposes is a bilateral convention on income tax or a multilateral agreement on mutual assistance or information exchange.

Some examples are:

- bilateral tax conventions based on OECD or United Nations models, for example;
- the joint Council of Europe/OECD Convention[10] on mutual administrative assistance in tax matters[11];
- Council Directive 2011/16/EU[12] of 15 February 2011 on administrative cooperation in the field of taxation[13] and repealing Directive 77/799/EEC;
- Council Directive 2003/48/EC[14] of 3 June 2003 on taxation of savings income in the form of interest payments[15] ;
- Council Regulation (EC) No. 1798/2003[16] of 7 October 2003 on administrative cooperation in the field of value added tax and repealing Regulation (EEC) No 218/92;

[10] Cf. Art. 6 of the Convention on Mutual Administrative Assistance in Tax Matters, Strasbourg, 25.1.1988, ETS no. 127.

[11] The text was amended in accordance with the provisions of the Protocol amending the Convention on Mutual Administrative Assistance in Tax Matters, which entered into force on 1 June 2011.

[12] See also the Commission Implementing Regulation (EU) No. 1156/2012 of 6 December 2012 laying down detailed rules for implementing certain provisions of Council Directive 2011/16/EU on administrative cooperation in the field of taxation and the proposal for a Council directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, Brussels, 12 June 2013, COM(2013) 348 final, 2013/0188(CNS). The proposal aims to extend the automatic exchange of information to a complete range of incomes. Some commentators believe that the components targeted by the FATCA regulations could be included within the framework of a "European FATCA".

[13] Article 29 defers to 1 January 2015 the measures relating to the mandatory automatic exchange of information set out in Article 8, which covers: a) income from employment, b) director's fees, c) life insurance products not covered by other Union legal instruments on exchange of information and other similar measures, d) pensions, e) ownership of and income from immovable property.

[14] The automatic exchange of information is provided for in Article 9 of that directive.

[15] This relates to interest payments from debt claims. A proposal to amend the directive is being examined within the Council in follow-up to the conclusions adopted unanimously on 2 December 2008. It should come out in March 2014 according to a European Council communication of 20 December 2013.

- Council Regulation (EC) No. 2073/2004[17] of 16 November 2004 on administrative cooperation in the field of excise duties;

Given the great diversity of legal instruments that may serve as a basis for exchanging information, the question of overlapping of applicable norms might arise, although it is generally resolved within the instruments themselves[18].

Recent developments appear to suggest a preference for multilateral agreements over bilateral conventions in the interests of harmonisation and having the same rules applicable to all[19].

Accordingly, it is recommended, in order to clarify the legal framework for automated processing carried out in connection with automatic inter-state exchanges of information for administrative and tax purposes, that the competent authorities systematically determine which legal instrument they are taking as their basis.

The principle of the purpose of processing

Article 5 b) of the Convention[20] for the protection of individuals with regard to automatic processing of personal data, known as *"Convention 108"* focusing on the quality of data stipulates that personal data undergoing automatic processing shall be *"stored for specified and legitimate purposes and not used in a way incompatible with those purposes"*.

In this respect, while some of the signatory States to the Convention stipulate in their domestic law that automatic processing may be carried out for several different purposes, others have opted for the principle of unity of purpose.

Whatever the case, it is to be inferred *a minima* from the aforementioned Article 5 b) that automatic processing may not use personal data for purposes that are incompatible with one another[21].

What we are seeing now, though, is a tendency to approximate the concepts of combating money laundering, financing of terrorism and corruption, tax fraud and tax evasion.

In this connection, the preamble to the Convention[22] on mutual administrative assistance in tax matters states in its recitals that *"the development of international*

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[16] It provides in Article 17 for the "*automatic or structured automatic exchange [of] the information referred to in Article 1 (…)"*.

[17] It provides in Article 17 for the *"occasional automatic or regular automatic exchange"* of the information referred to in Article 1.

[18] See for example Art. 27 of the joint Council of Europe/OECD Convention on mutual administrative assistance in tax matters, Art. 12 of the OECD Model Agreement on the exchange of information on tax matters, or Art. 11 of Council directive 77/799/EEC[18], amended, of 19 December 1977.

[19] See the recent debates on the question of a "*level playing field*" within the framework of reviewing the directive on taxation of savings.

[20] Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, Council of Europe, CETS no. 108, 28 January 1981, Strasbourg, which entered into force on 1 October 1985.

[21] In a press release (EDPS/13/7, Brussels, 4 July 2013) the European Data Protection Supervisor (EDPS) pointed out, where the Commission's anti-money laundering proposals were concerned, that: "*The sole purpose of the processing must be the prevention of money laundering and terrorist financing and personal information should not be further processed for incompatible purposes"*.

[22] The Convention was drawn up by the Council of Europe and the OECD and opened to signature by the member countries of the two organisations on 25 January 1988. The text was amended in line with the

movement of persons, capital, goods and services – although highly beneficial in itself – has increased the possibilities of tax avoidance and evasion and therefore requires increasing cooperation among tax authorities".

It should be borne in mind that while tax fraud is an offence fully justifying reinforced cooperation between the tax authorities, tax evasion may be a legal manoeuvre resulting from skilled tax advice. Implementing identical procedures to tackle tax fraud and tax evasion issues would be tantamount to licensing reinforced cooperation between authorities, incorporating investigation and search tools that are particularly invasive of privacy, in situations that cannot be assimilated.

Furthermore, the updated version[23] of Article 26 of the OECD model tax convention is a striking illustration of the trend towards a decompartmentalisation of purposes: *"Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use"*.

This move might be seen as surprising since the OECD[24] considers where tax confidentiality provisions in treaties are concerned that *"information exchanged may only be used for certain specified purposes"* and *"only be disclosed to certain specified persons"*.

Similarly, the FATF's 3rd recommendation, in its February 2012 version, stipulates that *"countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences*".

It states in points 2 and 3 of the interpretative note to recommendation 3 that *"countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences. Predicate offences may be described by reference to all offences; or to a threshold linked either to a category of serious offences; or to the penalty of imprisonment applicable to the predicate offence (threshold approach); or to a list of predicate offences; or a combination of these approaches.*

Where countries apply a threshold approach, predicate offences should, at a minimum, comprise all offences that fall within the category of serious offences under their national law, or should include offences that are punishable by a maximum penalty of more than one year's imprisonment, or, for those countries that have a minimum threshold for offences in their legal system, predicate offences should comprise all offences that are punished by a minimum penalty of more than six months imprisonment".

Consequently, the offence of money laundering may be applied to certain tax offences.

However, the legal techniques used to include offences within the scope of action against laundering, financing of terrorism and corruption that are only very indirectly related to it are likely to clash with the principles of the aforementioned article 5 b) of Convention 108[25].

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provisions of the Protocol amending the Convention on Mutual Administrative Assistance in Tax Matters, which entered into force on 1 June 2011.

[23] Adopted by the OECD Council on 17 July 2012.

[24] Keeping it safe – The OECD Guide on the protection of confidentiality of information exchanged for tax purposes, OECD 2012, p.7.

[25] Under the French case-law of the Conseil d'Etat dated 23 July 2010 (6th and 1st sub-sections combined, no. 309993), it was reiterated that *"the applicant may not validly rely on the recommendations of the Financial Action Task Force on money laundering (FATF), where those acts, emanating from an intergovernmental coordination body, do not derive from an international convention and are devoid of legal effects within the country's domestic legal order"*. While the recognition of the FATF's recommendations by the international

Accordingly, the "s*erious offence"* criterion adopted by the FATF may be subject to interpretation, and the thresholds mentioned in the interpretative note do not clearly translate the criterion of seriousness applied.

Consequently, it is recommended that:

- the tax offences be duly defined and listed for the purposes, on the one hand, of demarcating the boundaries of the purpose[26] of processing deployed against these offences and, on the other hand, of defining with certainty the scope of the persons concerned;
- personal data which are automatically processed be recorded for specific and legitimate purposes and not used in a manner that is incompatible with those purposes;
- States ensure that the data gathered and exchanged are not exploited in other processing carried out by transmitting and sending authorities for purposes not provided for in the legal instrument governing that automatic exchange.

The persons concerned

Targeting of the persons concerned

In the sphere of both action against money laundering and taxation, there are areas of uncertainty as to exactly which categories of persons are concerned. This issue takes on particular significance where automatic exchanges of personal data take place between States.

In the framework of automatic exchanges of data for administrative and tax purposes, it is necessary to refer expressly to the legal instruments serving as the basis for the automatic processing used for these purposes, as it is ultimately the taxes and levies covered in their scope which will determine the categories of persons concerned.

This comment refers directly, therefore, to the previous recommendation on the need to systematically determine the legal instrument on which processing is based.

Rights of the persons concerned

It should be pointed out that the aforementioned Article 25 of Directive 2011/16/EU on data protection stipulates that "*all exchange of information pursuant to this Directive shall be subject to the provisions implementing Directive 95/46/EC. However, Member States shall, for the purpose of the correct application of this Directive, restrict the scope of the obligations and rights provided for in Article 10, Article 11(1), Articles 12 and 21 of Directive 95/46/EC to the extent required in order to safeguard the interests referred to in Article 13(1)(e) of that Directive*".

community lends them a quasi-normative dimension, they should be systematically transposed in States' domestic law in the light of existing data protection legislation.

[26] In this connection, the EDPS recommended that *"the sole purpose of the processing must be the prevention of money laundering and terrorist financing and personal information should not be further processed for incompatible purposes"*: Press release, *EDPS finds major deficiencies in anti-money laundering proposals*, EDPS/13/7, Brussels, 4 July 2013.

This text therefore has direct inferences as regards notification of the persons concerned, their right of access to data and the publicity given to processing[27].

Yet given its particularly intrusive nature, it would appear that the automatic processing of personal data implemented in the framework of automatic inter-state exchanges of personal data for administrative and tax purposes should comply with the respective domestic legislation on personal data protection of the States concerned as well as Council of Europe Convention 108.

To that end, it is recommended that such automatic processing conforms to domestic legislative provisions on data protection.

In addition:

- the competent authorities should provide only in exceptional cases and within very well-defined limits for the possibility of derogating from the rules governing the right to protection of personal data;
- any restriction of individuals' fundamental rights should be duly justified and subject to tightly controlled conditions and guarantees.

The information exploited

Within the framework of automatic inter-state exchanges of personal data for administrative and tax purposes, the principle of quality of data provided for in Article 5 of Convention 108[28] imposes control over dataflows.

In this respect, Article 26 of the OECD Model Tax Convention on income and on capital states that *"the competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention (…)"*.

In the commentaries[29] on the aforementioned Article 26, it is explained in point 4.1 that "*the change from "necessary" to "foreseeably relevant" and the insertion of the words "to the administration or enforcement" in paragraph 1 were made to achieve consistency with the Model Agreement on Exchange of Information on Tax Matters and were not intended to alter the effect of the provision*". Point 5 states that *"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 Contracting States 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*".

It is undeniable that the interpretation of criteria such as "*foreseeable relevance*[30]" is likely to cause legal difficulties as they comprise a necessarily subjective dimension.

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[27] See however the judgment of the CJEU, 3rd chamber, 7 November 2013, IPI / Geoffrey E, Grégory F., which states that: *"Article 13(1) of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data must be interpreted as meaning that Member States have no obligation, but have the option, to transpose into their national law one or more of the exceptions which it lays down to the obligation to inform data subjects of the processing of their personal data"*.

[28] Cf. note no. 21.

[29] Model Tax Convention on income and on capital (full version), commentary on Article 26, p. 1.084 and following.

[30] This criterion also appears in the 9th recital of Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation[30] and repealing Directive 77/799/EEC: *"The standard of 'foreseeable relevance' is intended to provide for exchange of information in tax matters to the widest possible*

But those difficulties have immediate inferences[31] as regards the information gathered in the light of the aforementioned principle of quality of data within the meaning of Article 5-c), whereby the data automatically processed must be *"adequate, relevant and not excessive in relation to the purposes for which they are stored"*.

Consequently, and irrespective of the legal instrument on which the automatic exchange of information is based, it appears that preference must be given to a standardised and exhaustive approach in terms of lists of information transmitted.

Moreover, an approach of this kind would curb the risks of excessive zeal on the part of the authority upstream of the transmission of information or *"fishing expeditions"*, to use the popular expression, and would effectively pave the way for an *a posteriori* assessment of procedures allowing for a high degree of comparability.

The question of transfrontier dataflows

Given the multilateral nature of mechanisms for automatic inter-state exchanges of personal data for administrative and tax purposes, the question of adequate protection arises in all cases where the automatic exchange involves a country that does not have an adequate level of protection.

In this context, transfers of personal data must not infringe the provisions of Article 12 of Convention 108, Article 25 of directive 95/46/EC and the domestic legislation of the States concerned.

Where transfrontier dataflows are concerned, it is recommended that:

- the States concerned ensure, prior to implementing the relevant automated processing, that automatic inter-state exchanges of personal data for administrative and tax purposes may validly take place in the light of their domestic legislation, taking due account of the legislation of the destination country or countries, particularly as regards the possibility of subsequent re-use of the data for purposes other than those originally intended;
- provisions specifically relating to international transfers be incorporated in the legal instrument governing the automatic exchange in question, *"which also take into account the principle of proportionality, especially to avoid the mass transfer of personal and sensitive information"* [32] where data is transferred to countries without an adequate level of protection.

Data security

Whether in the exchange or processing of data, security of information is a critical issue, as demonstrated by the cases that punctuated the news in 2013 and highlighted the fragile nature of certain information systems as well as a number of abuses.

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extent and, at the same time, to clarify that Member States are not at liberty to engage in 'fishing expeditions' (…)".

[31] Cf. Report from the Commission to the European Parliament and the Council (COM(2012)168 final) of 11 April 2012, point 2.14 – Protection of Personal Data, pp.14 and 15: *"consideration could be given to fostering further interaction between AML regulators and data protection supervisory authorities to reach a balanced application of the rules"*.

[32] Cf. Press release op. cit. footnote 26.

The persons authorised to receive exchanged data or to access the data should be clearly identified.

Similarly, appropriate security measures, within the meaning of Article 7 of Convention 108 and Articles 16 and following of Directive 95/46/EC, should be systematically developed within the legal instruments governing automatic inter-state exchanges of personal data for administrative and tax purposes themselves, as well as within the framework of action against money laundering and financing of terrorism and corruption[33].

The confidential nature of the data that may be exchanged necessitates special precautions to ensure the protection of individuals whose integrity and privacy might be jeopardised were information relating to them to be communicated to people who had no business to know it.

Accordingly, it is recommended that States adopt adequate technical and organisational measures, including through the use of impact studies establishing the likely consequences of personal data violation for the physical individuals concerned and the identification of potential remedies in line with those consequences.

[33] See for example art. 9 of the Agreement of 6 May 2011 on operational and strategic cooperation between the government of H.R.H. the Sovereign Prince of Monaco and the European Police Office, Sovereign Ordinance no. 3.509 of 2 November 2011.