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Exchange of tax information under DTAs: NZ case has wide import

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Exchange of information articles have been a feature of double tax agreements (***DTAs***) for many years and have been, and still are, in wide use by revenue authorities. Tax Information Exchange Agreements have also been around for some time. However, this modern world of tax transparency, featuring developments such as BEPS, multilateral information exchange agreements, and the general swapping of information between revenue authorities around the world, places the exchange of information in a whole new light. In this context, a recent NZ High Court decision deserves some attention.

The NZ High Court recently quashed the Commissioner of Inland Revenue's information notices issued to New Zealand tax agents, Chatfield & Co, requesting information for possible exchange under the NZ/Korea DTA: *Chatfield & Co Ltd v Commissioner of Inland Revenue* [2017] NZHC 3289 (Wylie J, 22 December 2017).

NZ and Korea have a DTA. Korea requested information from NZ under the "Exchange of information" article. The NZ Commissioner exchanged information she held. She exchanged information she obtained from public registers and sources. However, she thought it necessary to take further steps to respond to Korea's request. The NZ Commissioner issued notices to the tax agents. The power to issue information notices is similar to Australia's s 353-10 of Sch 1 to the TAA. The sole purpose in issuing the information notices was to obtain information requested by Korea "for possible exchange" under the DTA. (No NZ tax was in issue.)In its case, Chatfield ran evidence that was intended to show that:

- *the Korean authority may not have exhausted Korean sources of information*. A former associate of a taxpayer had received a Korean information notice. Meanwhile, the tax audit in Korea was 'suspended', whatever that meant;

- *the Korean authority may be out of time to amend taxes for some periods for which information was sought*. There was an outer limit of 10 years in Korea, and usually only 5 years;

- *information may have been sought for purposes beyond administration of the DTA's "taxes covered"*. One affidavit read by the applicants suggested that the Korean tax authority was investigating a named company "in relation to alleged exchange control

> breaches" involving other named companies, the latter companies being the subject of information notices: [51]. (I do not suggest any wrong-doing.)

The Commissioner eventually declined to run evidence providing specific background to the Korean request and the notices. (This important forensic decision is discussed below.)

Wylie J's decision, if unaltered on appeal, ***has seismic implications for the defence of information notices issued under this and like procedures***.

I provide detailed comment below.

Difficult litigation

The *Chatfield* litigation has been lengthy and difficult.

Two previous, preliminary decisions, about disclosure and about striking out the tax agent's pleadings, were noted at 2017 WTB 10 [299].

The tax agent did not get court ordered disclosure of documents held by the Commissioner, and had part of its pleadings struck out.

The tax agent exhausted its appeal rights concerning those interlocutory matters. (See 2017 WTB 10 [299], and also Wylie J's summary in the current decision at [2017] NZHC 3289, [18] [20].)

This kind of litigation is difficult. An applicant ends up fighting with an arm tied behind its back.

In short, without disclosure by the Commissioner, the applicants face real problems stating specifically what error infects the decision to issue an information notice. Unable to be specific, the applicants face difficulty in justifying court-ordered disclosure. It is a "Catch 22" situation.

And without documents, it is difficult to plead and prove an error.

Since Chatfield had been denied disclosure, this makes its success doubly important.

It indicates that the court will act on slight evidence from the applicant, if the Commissioner (who may be assumed to have the information) is unwilling to place contradictory evidence before the court.

And the court will not simply accept the say-so of an official that she has made all necessary checks, and satisfied herself as to the foreign request.

Whether NZ High Court should hear the case

The NZ Commissioner argued that her decision to issue the information notices was not even susceptible to judicial review: [37].

This was a surprising development. It may be hoped we do not see this ventured again in a democracy where the Executive is subject to the rule of law.

In short, the argument was that it was "simply not in the public interest for judicial review to be available in the circumstances of this case". The Commissioner argued that the application to court had undermined NZ's reputation internationally by delaying provision of information, despite the DTA's requirements.

And it was argued that the matter dealt with relations between States, dealing with each other through senior public servants, the Competent Authorities. Rather, the peer review system under the auspices of the OECD was said to provide a safeguard.

Wylie J considered that this case simply involved him assessing compliance with a domestic statute, and was justiciable: [40].

His Honour's reasons were more elaborate, but that is the gist. It is a simple answer, in the face of overreach in the Executive's argument.

Testing Lawfulness of Information Notices

Chatfield succeeded in showing that the decision to issue the information notices had miscarried. The Competent Authority was not shown to have made appropriate enquiries, to justify issuing the notices.

The Competent Authority "needed to satisfy himself that the information sought [by Korea] came within the terms of the DTA and [NZ's] tax laws, that the nature of the information sought was (or at least appeared to be) consistent with the grounds for the request, and that the type of information sought was broadly what would be expected to be necessary for or relevant to any inquiry of the nature indicated": [47].

Article 25 of this DTA provided for the exchange of information *necessary* to prevent fiscal evasion, or for carrying out:

- the provisions of the DTA, or
- the domestic laws of Korea and NZ concerning taxes covered by the DTA.

The word "necessary" meant "required or needed". This meant something "more than simple expediency or desirability": [75].

Article 26 of the current OECD model convention refers instead to "such information as is foreseeably relevant". That is a different concept. That language is picked up in some Australian DTAs (eg Germany), but not all (eg Hungary). It is also in our Taxation Information Exchange Agreements, and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Article 4).

Thus, so far as *Chatfield* depends on concepts of *necessity*, check against the language of the treaty you are considering. Interestingly, this change of language did not materially affect the result of the application for disclosure in *AXY v Comptroller of Income Tax* [2015] SGHC 291, [7]-[9], [22] (Singapore High Court). Given the way *Chatfield* and *AXY* [2017] SGHC 42 were ultimately run, I doubt that will be decisive in future cases. Rather, it is the course of administrative decision-making, by the receiving jurisdiction, which is attacked.

In terms of Article 25 of the Korean-NZ treaty, and under the older language of "necessary", Wylie J found that the Competent Authority had to satisfy himself, by clear and specific evidence, that:

- all of the information requested by Korea was needed or required in relation to an investigation into, or other action being taken by Korea against a Korean taxpayer;
- the information was in regard to a tax covered by that treaty or fiscal evasion.

The Competent Authority also had to be satisfied that any information exchanged "would only be used in relation to those taxes, and that [Korea] had been unable to obtain the information in Korea": [78].

How Chatfield showed decision unlawful

Although not having the benefit of court ordered disclosure, and apparently lacking meaningful response under NZ's freedom of information laws, the evidence compiled by Chatfield tended to show:

- At least some of the same information sought by the NZ information notices had also been sought in Korea by the Korean authority, from a former associate of the principal of taxpayers of interest. This tended to show that information was available in Korea to the Korean authority under Korean law.
- The Korean authority had issued a notice suspending the Korean tax audit, giving a reason related to seeking information abroad.
- Enquiries concerned some years now outside Korea's tax amendment periods.
- Enquiries potentially touched on areas related to Korea's investigation of a non-tax matter.

This evidence for the applicants was relatively weak: but the evidence of the NZ Commissioner was described as vague and non specific: [80] & [89].

Wylie J said at [85]:

"The days when a Court will accept an official's simple assertion that a power has been exercised lawfully are long over."

And Wylie J said at [89]:

"Chatfield has been able to raise relatively little, ***but the little it has raised rings alarm bells, albeit quietly***. ***Those bells ring a little louder given the vague affidavits of [the investigator and the Competent Authority]***. There is a high duty on public authority respondents to assist the Court with full and accurate explanations and to give the Court all the facts relevant to the matter in issue. Here, the relevant facts and the supporting documents are in the possession of the Commissioner. It should have been a relatively straightforward matter for the Commissioner to produce them but they have not been produced. Rather, I am left with the non specific evidence of the officer responsible for undertaking the necessary enquiries. In my view, the Commissioner has not been as candid in her conduct of this case as might have been expected." [Emphasis added]

NZ Commissioner wanted to give secret evidence

There was another interesting feature of this case.

Where there is a claim for public interest immunity, the State may have the court cleared, and place material before the court in private. But the point of that procedure is usually to persuade the court to exclude evidence. For example, the Crown may wish to prevent disclosure of Cabinet papers or the like. So the point is often exclusionary.

Here, the NZ Commissioner sought to clear the High Court, to run positive evidence, by giving Wylie J the background documents. We can speculate, given what is said, that those background documents would have been Korea's request, the NZ Competent Authority's notes, and correspondence with the Korean Competent Authority: [63] & [65].

Wylie J said that this was not satisfactory.

His Honour explored whether the background documents might be provided only to the applicants' counsel (under a confidentiality undertaking); or even to counsel appointed as *amicus curiae*, as had happened in another case, *Avowal Administrative Attorneys Ltd v District Court at North Shore* [2008] 1 NZLR 675.

Neither course was satisfactory to the NZ Commissioner.

Wylie J said: "I record my surprise at the Commissioner's stance …" in not agreeing to permit amicus counsel to be appointed to review the background information and assist the Court in the absence of the applicant: [71].

Rather, so far from being matters of high policy and international relations, his Honour pointed out that [71]:

"It is clear from the … DTA, that documents exchanged may be disclosed by officials in the contracting states in public Court proceedings or in judicial decisions."

It is not unusual in Australia for documents to be provided to some members of a legal team (and relevant witnesses), under confidentiality undertakings: *Ex parte Fielder Gillespie Ltd* [1984] 2 Qd R 339.

Whilst that can cause ethical dilemmas, it is a better solution, in most cases, to the alternative, being appointment of *amicus curiae* who comes in cold, and may lack the same exposure to this specialist field.

Lessons for Conduct of Defence

This matter involved potentially sensitive matters of international relations. There is the potential for misunderstanding, given the differing systems of administration and law in the 2 countries involved, NZ and Korea. I do not mean to be critical, but to find the lessons to be drawn from the case.

The weakness in the NZ Commissioner's case was that she would not allow the taxpayer's counsel (nor even allow *amicus* counsel) to see the background materials, which potentially would have quelled doubt.

The NZ Commissioner may well have had her hands tied by other parties, in making these forensic decisions. We will never know.

But our courts conduct their business in public. States making and receiving requests for information should take note.

Here, if the NZ Commissioner had felt free to disclose (and had disclosed) the basic background documents, in 2015, one can speculate whether the matter would have resolved quickly, or at least whether the trial in 2017 could have been conducted without this prejudicial overhang.

Further, the clear message is that the courts will not simply accept the say-so of the Executive. The requesting and receiving States must be prepared for common law courts to require frankness in response to judicial review.

Developments in court-ordered disclosure

Critical to the conduct of this case at trial was the denial to the applicants of court-ordered disclosure of documents.

Given the prejudice this caused the Commissioner in her conduct of her defence, and in light of international trends, I speculate that this will not be an issue again.

The previous decision of Ellis J, in *Chatfield & Co Ltd v CIR* [2016] NZHC 1234, denying disclosure to Chatfield, has previously been noted: 2017 WTB 10 [299].

At the time, I noted a more liberal approach taken to disclosure in an unreported decision of the Grand Court of the Caymans, *MH Investments*.

Since then, there has been another unreported decision, for the British Virgin Islands. Unfortunately no official transcript has emerged. We are left, as in the old days, with a newspaper report.

Friar Tuck Ltd, Quiver Inc v International Tax Authority is a decision of the Eastern Caribbean High Court (31 March 2017, Ellis J). (It is a different Justice Ellis.)

The report in the *Cayman Financial Review* is very full, and quotes her Honour as saying in part that:

".. procedural fairness demands that the [International Tax Authority] provide a sufficient level and degree of information to enable representations to be made as to the lawfulness of the notice or indeed the request".

See the article by Mr Carlyle K Rogers in *The Cayman Financial Review*, 18 July 2017, "Friar Truck Ltd, Quiver Inc and International Tax Authority: a British Virgin Islands' decision with far reaching consequences in defense of the rule of law": http://www.caymanfinancialreview.com/2017/07/18/friar-tuck-ltd-quiver-inc-and-international-tax-authority-a-british-virgin-islands-decision-with-far-reaching-consequences-in-defense-of-the-rule-of-law/

Further, the Singapore High Court in *AXY v Comptroller of Income Tax* [2015] SGHC 291; [2016] SLR 616, [23] had little doubt that the foreign Request, in that case, was liable to disclosure.

AXY was put on the basis of alleged failure by Singapore's official to exercise an independent discretion to issue domestic information notices.

The applicant, AXY, got the Request, and also succeeded in obtaining disclosure of correspondence between the States. Normally, disclosure of the other correspondence would have been consistent with disclosure of the foreign request. In *AXY*, the Singapore authority practically conceded this by conduct.

None of *MH Investments*, *Friar Tuck*, nor the disclosure decision in *AXY*, are mentioned by Wylie J in *Chatfield*. Those cases may not have been directly relevant.

But ***his Honour's decision is potentially relevant to future decisions about disclosure, and specifically whether a Revenue authority resists such a request for court-ordered disclosure***.

As *AXY* shows, if a case is put carefully, this will open up the foreign request. We now know, from the evidence in *AXY*, that there is likely to be a substantial trail of other correspondence, so it is no mere fishing expedition to ask for that as well.

Conclusions

The NZ Commissioner still has time within which to file an appeal. Regardless, ***this decision is of wide import***, and may guide how States proceed in future, including in making and responding to international requests; and in serving and defending domestic information notices.

Given the specific matters that Wylie J found had to be checked by the receiving State, it will not simply be a case of taking care in making sure that a request is less specific, facilitating disclosure in the course of litigation. A balance will need to be struck in drawing such requests.