

THE RIGHTS TO CONFIDENTIALITY AND PRIVACY IN AN AGE OF TRANSPARENCY: A EUROPEAN PERSPECTIVE¹

Inadequate attention has been paid to the protection of privacy and confidentiality, and to the rules for data protection, during the rapid development of systems for automatic exchange of financial information for tax purposes: this short article aims to address this by explaining some of the background to the European perspective on taxpayers' rights in an age of transparency.

Automatic exchange of Information: a short history

Provisions for exchange of information between tax authorities have existed for over a century. One of the earliest models prepared by the League of Nations in the 1920s provided for administrative cooperation between tax authorities. Since the late 1950s, the vast majority of tax treaties based upon the OECD Draft and Model and the UN Model have contained provisions for exchange of information on request, for spontaneous exchanges, and for automatic exchanges of information. Under the latter category, substantial amounts of automatic exchange of certain categories of data have taken place for decades. On a broader scale, the Council of Europe/OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which was originally opened for signature on 24th January 1988 and which now has over 90 signatories, contained equivalent provisions for exchange on request, spontaneously, and automatically.

Within the European Union, there has also been a Directive on Administrative Cooperation in Tax Matters since 1977 – Council Directive 77/799/EEC of the 19th December 1977 – which was redrafted and replaced in 2011 by Council Directive 2011/16/EU. Again, this provided for exchange of information on request, spontaneously, and for automatic exchange.

It is well known that the main impetus for moving towards automatic exchange came from the revelations in the mid-2000s of undisclosed bank accounts held abroad by US citizens, mainly in Switzerland. This led the US Congress to pass the legislation referred to as the Foreign Account Tax Compliance Act or FATCA. This requires foreign financial institutions to identify accounts held by or for US citizens, and supply that information to the US administration. Because of the fear of a breach of obligations of confidentiality if the information were supplied directly by financial institutions in some countries, a network of Inter-Governmental Agreements was concluded to allow foreign governments to supply this information to the US. Spotting an opportunity to turn this development to their advantage, the UK and several other European countries began to conclude FATCA-like Inter-Governmental Agreements with various jurisdictions, including the UK Crown Dependencies and Overseas Territories.

¹ This is a summary of the talk delivered at the First International Conference on Taxpayers' Rights held in Washington DC in November 2015.

By the summer of 2013, it was clear that a new international standard had developed for cooperation between revenue authorities based upon automatic exchange of financial account information. Within the OECD, this was implemented by the approval of a Common Reporting Standard for automatic exchange of financial account information, approved by the OECD Council on 15th July 2013 and endorsed by the G20 in September 2013. In the European Union, in October 2014 the Council of Finance Ministers reached a political agreement to extend the Directive on Administrative Cooperation to include automatic exchange of financial account information. This was implemented by Directive 2014/107/EU of the 9th December 2014 which was followed up a Tax Transparency Package in March 2015 and has led to further amendments to the Directive on Administrative Cooperation.

The Directive requires all EU Member States to implement automatic exchange of financial information. For non-EU states, the provisions for automatic exchange of information in bilateral treaties and in the Multilateral Administrative Assistance Convention require implementation by a competent authority agreement. On 29th October 2014, a Multilateral Competent Authority Agreement was signed to give effect to automatic exchange of financial information in accordance with the CRS. The group of “early adopter” countries will start to exchange information under this agreement from September 2017.

The Directive on Administrative Cooperation (“the DAC”) and the Common Reporting Standard (“CRS”) are similar to one another in their general approach, though differ on points of detail. The United States, however, has indicated that it does not presently intend to adopt the CRS, and will continue with the FATCA arrangements, which are different in a number of respects from the DAC/CRS.

Thus, the world has moved very far and very fast from a limited amount of exchange of information between revenue authorities on request to embrace widespread exchange of financial account information automatically between governments. There are several, non-identical systems for exchange, though in practice most countries will need to operate FATCA with the US, and DAC/CRS with the rest of the world.

In this headlong rush towards automatic exchange of financial account information, very little attention seems to have been paid to the need to provide effective safeguards for the rights of taxpayers to confidentiality, privacy and data protection. No one can seriously doubt that countries may enter into arrangements for automatic exchange of information for tax purposes, but nothing authorises tax administrations to ignore the rights of taxpayers in implementing those arrangements.

The rights under European Union Law and the European Convention on Human Rights to privacy and data protection

Privacy and confidentiality

The starting point for a discussion of taxpayers' rights in connection with the automatic exchange of information is Article 8 of the European Convention on Human Rights which was concluded in 1950. That article deals with "rights to respect for private and family life" and provides as follows:

- "1. Everyone has the right to respect for his private and family life, his home and his correspondence.
2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others." (Emphasis added)

There is a parallel provision in Article 7 of the Charter of Fundamental Rights of the European Union.

There is a limited, but growing, jurisprudence on the right to privacy in Article 8 and its application to the gathering or exchange of information between tax authorities. In one of the earlier cases of the European Commission on Human Rights, X (Hardy-Spirlet) v Belgium (decision of 7th December 1982), the Commission held that any gathering of information from a taxpayer by a revenue authority was prima facie a breach of the right to privacy, and could only be justified if it was in accordance with the law, necessary in a democratic society, and was not disproportionate. This was followed in one of the leading cases of the European Court of Human Rights, Funke etc v France (Appln. no. 10828/84, 25th February 1993).

More recently, several cases have considered challenges to the exchange of information. In FS v Germany (Appln. No. 30128/96, 27 Nov 1996) the European Court of Human Rights held that exchange of information between Austria and Germany under the Directive on Administrative Cooperation was lawful and not disproportionate. In discussing the right of a taxpayer to ask for information to be gathered from a foreign state, the Court of Human Rights in Janyr v Czech Republic (Appln. No. 42937/08, 31st Oct 2013) found that the taxpayer had received a fair trial even though only partial information was obtained from a foreign jurisdiction. Finally, in the Sabou case (Case C-276/12, 22nd Oct 2013) the Court of Justice of the European Union discussed the possible participation of the taxpayer in the formulation of questions and the examination of witnesses; the Court of Justice took the view that the gathering of information was essentially an administrative procedure and did not necessarily require protection of fair trial rights.

In summary, the gathering, retention and exchange of information between tax authorities is prima facie a breach of the right to privacy in Article 8 of the European Convention or

Article 7 of the European Charter. However, such gathering, retention and exchange of information may be lawful if it is in accordance with the law, necessary in a democratic society (so that there is a fair balance between the rights of the individual and the interest of the state) and the gathering of information is not disproportionate. Successful challenges are likely to be rare, but tax authorities within the Council of Europe must respect these rights when enacting legislation and implementing measures for exchange.

Data protection

When the European Convention on Human Rights was drafted in the late 1940s, the idea of gathering and exchanging large amounts of data held in electronic form could hardly have been foreseen. Consequently, in the European Convention there is no specific protection for the processing of data. However, within European Union Law there are several explicit texts dealing with data protection. These text exist at the level of the treaties establishing the European Union itself. Thus, for example, Article 16 of the Treaty on the Functioning of the European Union provides as follows:

“1. Everyone has the right to the protection of personal data concerning them.

2. The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall lay down the rules relating to the protection of individuals with regard to the processing of personal data by Union institutions, bodies, offices and agencies, and by the Member States when carrying out activities which fall within the scope of Union law, and the rules relating to the free movement of such data. Compliance with these rules shall be subject to the control of independent authorities.”

Similarly, the European Charter on Fundamental Rights has an explicit provision on data protection in Article 8 which provides as follows:

“Everyone has the right to the protection of personal data concerning him or her.

Such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified.

Compliance with these rules shall be subject to control by an independent authority.”

In the European Union, data protection is presently given effect by Directive 95/46/EC of 24th October 1995 “on the protection of individuals with regard to the processing of personal data and on the free movement of such data”. This Directive (which will be replaced by a Regulation within the next few months) gives very specific rights to any individual whose personal data is subject to any form of processing. For example, under Article 11 the “data subject” has a right to know of the collection of data, and under Article 12 has the right to access that data and to rectify any inaccuracies. Under Article 23, the data subject has a right to compensation for any unlawful processing of data. The Data Protection Directive also contains specific provisions dealing with the transfer of personal data to third countries (i.e., countries that are not Member States of the European Union) thus, under Article 25, “the transfer to a third country of personal data... may only take place if...the third country in question ensures an adequate level of protection.”

The protection of data processing within the European Union is overseen by a working party established under Article 29 of the Directive, which consists of representatives of all the Member States. This Working Party has expressed on a number of occasions its concern about the inadequate level of safeguards for data protection in connection with the automatic exchange of information for tax purposes. Thus, in a letter of 21st June 2012 discussing the application of data protection to FATCA the Working Party said the following:

“16.1 The WP29 shares the concerns expressed by some in relation to dual compliance with FATCA and the Directive. Without an appropriate legal basis justifying both sets of obligations imposed on European FFIs would result in the unlawful processing of personal data.”

Similarly, in a letter of 18th September 2014 on the CRS the Working Party said the following:

“The practical roll-out of CRS in Europe based on existing FATCA IT solutions currently lacks adequate data protection safeguards, notwithstanding the EU proposal to amend the Directive 2011/16/EU regarding mandatory automatic exchange of information in the field of taxation. This Directive – which could be considered as transposition of the US FATCA and CRS in EU law – so far falls short of data protection safeguards.”

Thus, the Working Party established under the European Directive for data protection has warned on several occasions that inadequate safeguards have been built into the arrangements for automatic exchange of information.

The concerns of the data protection officials are most concretely reflected in amendments that were made to the Directive on Administrative Cooperation in December 2014 by

Article 1(5) of the Council Directive 2014/107/EU. This amendment inserted the following wording into the Directive of Administrative Cooperation:

“2.Reporting Financial Institutions and the competent authorities of each Member State shall be considered to be data controllers for the purposes of Directive 95/46/EC.

3.Notwithstanding paragraph 1, each Member State shall ensure that each Reporting Financial Institution under its jurisdiction informs each individual Reportable Person concerned that the information relating to him referred to in Article 8(3a) will be collected and transferred in accordance with this Directive and shall ensure that the Reporting Financial Institution provides to that individual all information that he is entitled to under its domestic legislation implementing Directive 95/46/EC in sufficient time for the individual to exercise his data protection rights and, in any case, before the Reporting Financial Institution concerned reports the information referred to in Article 8(3a) to the competent authority of its Member State of residence.

4.Information processed in accordance with this Directive shall be retained for no longer than necessary to achieve the purposes of this Directive, and in any case in accordance with each data controller's domestic rules on statute of limitations.”

This change is a critical one for European Member State. It applies the rules of data protection both to the Financial Institutions that are gathering information for the purposes of automatic exchange and to the competent authorities of each Member State that are responsible for carrying out the automatic exchange. It requires explicitly that each Reporting Financial Institution must inform the data subject that information will be collected and transferred in sufficient time for the individual to exercise his data protection rights (which includes the right to see the data and to rectify any inaccuracies). Thus, later this year or earlier next year, as Financial Institutions in Europe begin to gather information for the purposes of FATCA or the CRS, they will have to notify the data subjects that information is being gathered and will be exchanged about them.

The point to emphasise here is that data protection is not simply about the confidentiality of the data being gathered and exchanged. That the information will be kept confidential, and that there will be no unauthorised disclosure of information, is simply the starting point. Foreign tax authorities that have inadequate provisions for guaranteeing the confidentiality of data, and which are prone to leaks, are clearly providing inadequate data protection and cannot possibly receive data whilst these inadequate safeguards exist. However, confidentiality is only the starting point; data protection law gives the data subject much more extensive rights. Data may only be gathered and exchanged for a lawful purpose which must be clearly identified in sufficiently specified terms that any

misuse of the data can be challenged, and must not be retained longer than is necessary for the identified purpose. The data subject has the right to be notified and to have access to the data and the right to correct any inaccuracies. Legal remedies need to exist to protect the rights of the data subject, and compensation has to be paid for improper processing of data.

This is perhaps the most important lesson to draw from the European protection of privacy, confidentiality and data protection with regard to automatic exchange of information. The rights to protection in connection with data processing go well beyond the matter of confidentiality, and are likely to lead to a range of challenges once the systems for automatic exchange of information start to operate.

It also raises a whole series of practical questions. How will these provisions for data protection work in practice alongside the automatic exchange of information? It is necessary to identify the purposes for which information is gathered and exchanged: how will these purposes be defined and how will unlawful use be challenged? Will these purposes allow information to be used for taxpayer profiling? For how long may the data be retained before it must be destroyed? How will countries with inadequate data protection be identified, and what will the reaction be when exchange of information with those countries is refused? What will happen when (almost inevitably) there are leaks of data which have been exchanged under these systems – will the whole system be subject to destructive challenge?

This is a topic where developments are expected to take place very rapidly. There are precedents from the European Court for entire legislative arrangements for information processing to be struck down because they provide inadequate protection. It may yet be that large parts of the edifice being erected for automatic exchange of information will be struck down because the authorities concerned have, in their haste to establish a system for exchange, given inadequate attention to taxpayers' rights.