E/C.18/2021/CRP.36

Distr.: General
4 October 2021

Original: English

Committee of Experts on International Cooperation in Tax Matters
Twenty-third session

Virtual meetings of 19 -28 October 2021
Item 5 (n) of the provisional agenda
Relationship of tax, trade and investment agreements

Secretariat note

Summary

This paper is *for decision* and recommends formation of a multistakeholder subcommittee on the Relationship of Tax, Trade and Investment Agreements. It outlines some of the key issues and questions surrounding the interaction of tax (tax agreements, but also tax policy and administration) and non-tax treaties. It proposes that a Subcommittee could provide for Committee consideration draft guidance on (a) issues to be taken account of in administration or guidance where investment treaties (or mixed treaties) are relevant to tax treaty operation or tax administration or policy more generally; and (b) the similar interaction of tax and trade treaties, especially whether the UN Model Tax Convention guidance of interaction of tax treaties with the General Agreement on Trade in Services needs confirming or updating.

Background

1. Note E/C/2019/CRP.14 ("the 2019 note") on the Interaction of Tax Trade and Investment Agreements was prepared by the UN DESA Secretariat after consultation with the OECD Tax Secretariat for the Committee's Eighteenth session in 2019. While further work on the issue was widely supported, no guidance was issued by the last Membership because of the pressure of other workloads, especially taxation of the digital economy. The commitment of the OECD Secretariat to its taxation of the digitalized economy workstream also made impossible the proposed close collaboration on this issue.

2. As noted in the report of that Eighteenth session, the Committee endorsed the proposal for follow-up work at the secretariat level, to be carried out in consultation with interested Committee members, which would comprise two streams: (a) the preparation of a more detailed paper on the relevant issues and possible responses, including specific drafting options, by the Twentieth session; and (b) the development of a guide on how to address claims under non-tax treaties against tax measures and pre-emptively deal with them, including through risk assessment, avoidance and mitigation.

3. The Matter was further discussed at the Nineteenth session, and the report of that session noted the possibility of merging work on the two streams into a single document with attachments. The Secretariat noted the important work done by the UN Conference on International Trade and Development (UNCTAD) Division on Investment and Enterprise on investment treaties and the importance of partnering with the Division in that regard, especially in view of the UNCTAD Investment Policy Framework for Sustainable Development, which served as a tool for tax policymakers. One Member noted the importance of examining country practice in addressing the overlap issue.

4. At the Twentieth Session, the Secretariat, after consultation with Committee Members, proposed that the agenda item on relationship of tax with trade and investment treaties should not be dealt with further by the Committee within its current membership, given the need to discuss other urgent business, the limited time for discussion owing to the COVID-19 pandemic and the inability to work jointly with the secretariat of the Organization for Economic Cooperation and Development (OECD) owing to that organization's other commitments. The proposal was accepted.

5. Since these developments, a valuable new document on this issue has become available, the UN Conference on Trade and Development (UNCTAD) International investment agreements and their implications for tax measures: what tax policymakers need to know. UNCTAD consulted with the Secretariat and others when preparing that document.

Indicative Issues

6. The 2019 note provided information for the Committee on some of the key issues arising from the interaction of tax and certain bilateral, regional or multilateral trade or investment treaties (collectively referred to as "non-tax treaties") and some issues for enquiry.

7. The note examined the non-tax agreements that may impact on tax measures and administration:

- bilateral investment treaties (BITs);
- bilateral comprehensive trade agreements, such as the Canada-European Union Comprehensive Economic and Trade Agreement (CETA);
- regional trade and investment agreements, such as the North American Free Trade Agreement (NAFTA) and its replacement, the US Mexico Canada Agreement (USMCA), the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the ASEAN Comprehensive Investment Agreement (ACAI); and
- multilateral trade and investment treaties such as the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS), as well as other WTO agreements.

8. The note recognized that, in view of the breadth of coverage and treatment of trade and investment non-tax agreements, there are inevitably overlaps between them and tax agreements. It indicated that how that overlap is managed, and the unresolved issues, vary from provision to provision, and agreement to agreement, and addressed some of the most potentially "clashing" provisions.

9. The paper noted that whether there has been such a breach of a non-tax agreement, and its consequences, will depend on:

- the tax measures involved;
- the terms of the obligations offered to investors or traders under any relevant non-tax agreements;
- the nature of any tax-related exceptions to the non-tax agreements; and
- the dispute settlement arrangements and process that apply.

10. The paper also expressed the view that guidance to countries that helps them to understand and influence these factors positively would represent a special contribution of the UN Tax Committee in the field of international tax cooperation.

11. The 2019 note then noted that the challenges in this area relate broadly to;

- lack of awareness among tax officials of the potential impact of non-tax agreements on tax measures, including legislation, regulation and administration;
- lack of awareness among trade and investment negotiators of the potential overlap, including of the coverage of tax treaties;
- challenges in achieving "whole of government" approaches to pre-empting problems, identifying them and responding to them;
- uncertainties about the scope of the overlap, especially because of the many undefined or broadly defined terms used in such treaties, variations

from treaty to treaty and diverse "jurisprudence" as to their interpretation;
- rules of supremacy chosen to address the overlap and their clarity or otherwise;
- questions, in a dispute, about *who decides whether there is an overlap*, which may be affected by their tax or non-tax knowledge and perspectives; and
- the often stark differences between dispute resolution provisions in the agreements – with mandatory binding arbitration at the instance of the investor being the norm in trade and investment agreements (although this has perhaps become more controversial recently) – and most tax treaties, where the Mutual Agreement Procedure (a country-to-country procedure) is relied on and mandatory binding arbitration is rarely part of that process, for developing countries in particular.

12. The 2019 note indicated some specific and important areas of interaction, and possible roles for the UN and others in relation to them, including:

- ***definitions, such as of "investments" and of "investors"*** which can have a tax impact (such as in providing "indirect investors" with treaty protection);
- ***"Fair and Equitable Treatment" provisions***, which are very broadly interpreted by investment panels and are likely to be invoked in any tax related investment treaty dispute;
- ***"Umbrella" clauses.*** "Stabilization" clauses in contracts may purport to prevent, or provide for compensation in the event of, changes to the amount of tax levied, for example. The so-called "umbrella" clause in investment treaties then imposes an international treaty obligation on host countries that requires them to respect contractual obligations they have entered into with respect to investments protected by the treaty. This places such obligations under the protective umbrella of international law, not just the domestic law that would otherwise normally apply exclusively.
- ***the concept of "expropriation" in investment treaties*** is somewhat uncertain, and confiscatory or arbitrary taxation could in certain cases be regarded by an arbitral tribunal as indirect expropriation. Investors have at times successfully challenged taxation measures pursuant to investor-State arbitration provisions of trade and investment agreements on grounds that they amounted to indirect expropriation. Some modern investment treaties provide that the Competent Authorities can agree that a matter is an expropriation, with overriding force.
- investment treaties inevitably include two types of ***non-discrimination provision*** – a ***Most Favoured Nation (MFN) provision***, offering investors from the treaty partner the best treatment offered to investors from other countries, and a ***National Treatment provision***, offering investors from the treaty partner the best treatment offered to investors from the host country. These can have implications for tax measures and administration. The MFN clause can prima facie be breached because different tax treaty relationships inevitably result in differing treatments for investors from

different countries. The National Treatment clause can prima facie be breached in cases where a country's own nationals are treated more favourably under domestic tax law than the investors in like situations.

- For the MFN clause, there needs to be some exception, at least for tax treaties, to prevent investors being able to pick and choose the best treatment from all available tax treaties, without their country having made the concessions that led to better treatment in another area. Further, an investor could choose the treaty that is perhaps most out of date in countering tax avoidance and evasion. For the National Treatment clause, there needs to be an awareness of the impact on any preference for one's nationals under domestic law. Further, it is an important principle of tax treaties that they do not prevent discrimination based on whether a person is a resident. To coexist with such tax treaties, non-tax treaties need to have a similar caveat or exception.
- In examining compatibility of tax and non-tax agreements on these points, the ***World Trade Organisation (WTO) agreements*** are relevant both in their own right and because most non-discrimination provisions in non-tax agreements are based in significant part on the WTO provisions. The ***General Agreement on Trade in Services (GATS)*** is a trade agreement but also, because the definition of modes of service covers, in effect, investment through "commercial presence", it also constitutes an investment agreement. When the GATS was negotiated, there was a concern that some tax measures where distinctions are made based on taxpayer resident might be in violation of the GATS National Treatment obligation. Both the OECD and UN Models note, in their commentaries to Article 24 (Non- Discrimination) that discrimination based on residence is not contrary to the National Treatment obligation.
- The GATS has an exception allowing measures inconsistent with the National Treatment obligation where "the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members". *The GATS was amended, before its conclusion, to incorporate a footnote* to that provision intended to illustrate with some degree of specificity what Members regarded as measures meeting the "equitable or effective" standard.
- A provision was also included in the GATS stating that the National Treatment obligation could not be invoked under the Agreement's dispute settlement procedures: "with respect to a measure of another Member that falls within the scope of an ***international agreement between them***

relating to the avoidance of double taxation. In case of disagreement between Members as to whether a measure falls within the scope of such an agreement between them, it shall be open to either Member to bring this matter before the Council for Trade in Services".

- The final decision in the event of a dispute as to whether a measure falls within the scope of a tax agreement between them is therefore made by the Council for Trade in Services, a high-level body of country representatives at the WTO in Geneva referring the matter to binding resolution under the WTO dispute settlement procedure.
- To address that issue, in its 1995 Commentary on Article 25 ***the OECD Model Double Tax Convention proposed language*** for inclusion in tax treaties. The effect of the wording is to ensure that tax treaties concluded or amended since 1995 receive the same "grandfathered" protections as pre-1995 treaties. ***The UN Model picks up the language proposed***, and the explanation of it. The OECD Commentary, as picked up in the UN Model, note the potential difficulties of leaving these tax issues to trade experts as follows:

> "Contracting States may wish to avoid these difficulties by extending bilaterally the application of the footnote to paragraph 3 of Article XXII of the GATS to conventions concluded after the entry into force of the GATS. Such a bilateral extension, which would supplement—but not violate in any way—the Contracting States' obligations under the GATS, could be incorporated in the convention by the addition of the following provision: 'For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.' "

- ***Surprisingly, very few countries, especially developing countries, make use of that provision.*** The decision on whether an issue is within the scope of a tax treaty is therefore left to non-tax experts in the WTO dispute settlement system.

- There is at least some question **of whether the provision should be elevated from an option in the Model Commentaries to a provision in the text of the Convention itself.** A similar provision may be useful in relation to other trade-related agreements, especially the increasingly common *regional* trade and investment agreements.

Possible Further Work

13. The OECD, through its Working Party on Tax Treaties (WP1) had been intending to form a working group of OECD WP1 delegates to consider these issues. While that appears to have been overtaken by other events, it will be important to invite the OECD to participate in any future work at Subcommittee level, so that common approaches are taken where possible to an issue that affects countries generally, and any differing approaches are fully articulated, including pros and cons of any such approaches.

14. The work is sufficiently urgent that it should not await further OECD engagement with the issue, however. The use of investment treaties to "litigate" tax issues appears to have accelerated, and is likely to accelerate further, increasing the importance of practical guidance in identifying, avoiding where possible, and addressing if necessary, clashes between investment or trade agreements, on the one hand, and tax agreements, policy and administration, on the other.

15. Whatever is thought about the individual case, the recent *Cairn* arbitration (with its published decision[1] – often lacking in investment arbitrations) shows the willingness of investment panels (rarely if ever tax experts) to look closely into policy issues and pronounce on matters, such as the meaning of "tax avoidance" and the appropriate test of it in a country's jurisprudence. The cost of this sort of "litigation" also adds to the urgency of the issue, with the *Cairn* award of costs amounting to (a) US$ 2,005,700.42 as reimbursement for arbitration costs; and (b) US$ 20,389,413.97 towards the investor's legal costs incurred in the arbitration proceedings. Enforcement action might also be sought against governmental assets.[2] Whatever one considers about the merits of the particular case, the value of "early warning systems" that such issues may arise, and of steps to avoid or address such issues as soon and as effectively and economically as possible, are evident.

16. Streams of investment agreement panel "jurisprudence" allow investors to claim not just the substantive treatment offered to other investors in a similar position under other treaties, but also dispute resolution provisions[3]. The implications or otherwise for countries of expanding the dispute resolution options available in some treaties, whether bilateral, regional or multilateral, but not at least intentionally in the case of others, may therefore need close consideration. As another example, at a time when the elimination of wasteful tax incentives is receiving deserved attention, consideration needs to be given to whether a country agreeing to such elimination might be nevertheless obligated by investment treaty provisions to compensate the investor to the level of the investment incentive "lost" over time. An example could be breaching a contractual stabilization clause that has become an investment treaty breach because of a treaty "umbrella clause".

[1] *Cairn Energy PLC and Cairn UK Holdings Limited v. The Republic of India*, ("Cairn Energy") Final Award, PCA Case No. 2016-07, at https://jusmundi.com/en/document/decision/en-cairn-energy-plc-and-cairn-uk-holdings- limited-v-the-republic-of-india-final-award-wednesday-23rd-december-2020#

[2] See, for example, as to the *Cairn* decision: https://www.thehindu.com/business/Industry/cairn-air-india-seek-stay-on-new-york-court-proceedings/article36471735.ece

[3] See for example, *Maffezini v. The Kingdom of Spain,* ICSID Case No. ARB/97/7, Decision Jurisdiction, 25, January 2000, available at https://www.italaw.com/sites/default/files/case-documents/ita0479.pdf (paras 52ff).

17. These are difficult and nuanced issues on which views will likely differ, but Committee guidance could help countries take a holistic view of their tax risks, vulnerabilities and obligations, to the benefit of tax policy, administration and other decision- making.

18. Guidance provided could include very practical advice for non-specialists on issues such as:

- Pre-empting problems, including through whole-of-government approaches;
- Negotiation issues – opportunities for tax officials to influence outcomes;
- Identifying the nature of a claim and assessing it;
- Understanding Investor-State Dispute settlement and its differences to Competent Authority procedures;
- Understanding the standing, jurisdictional as well as substantive issues in investment disputes, and the implications;
- Effectively inputting into decisions about arbitrators – knowing who the experts are, and who understands international tax issues;
- Working effectively with governmental leads (Ministries of Foreign Affairs and of Justice, for example); and
- Key issues for non-tax agreement dispute settlement.

19. Input on such a broad but specialized workstream could be sought from Committee Members, the OECD, UNCTAD (which has special expertise on investment treaties) other UN agencies and regional commissions as appropriate, academia, business and civil society.

20. There are increasing possibilities of some form of third-party mandatory and binding dispute settlement being provided for in bilateral and even multilateral treaties. The issue therefore emerges of whether not merely substantive, but also dispute settlement,[1] treatments under one such treaty may become available to those not intended to be beneficiaries. This would most likely be through most favoured nation and possibly even fair and equitable treatment provisions, with those relying on the investment treaty protections in this way possibly receiving the benefits of treaties, without the attendant obligations.

21. Whatever consideration is given to this issue at the multilateral level, consideration by the Committee of this issue might assist countries in taking a more holistic approach to their tax treaties in their wider context. Options for Competent Authorities to have as much decision making as possible reserved to themselves, rather than matters being left fully to investment panels, at least in new treaties, could, depending upon timelines, help positively influence wider developments.

[1] See fn. 3 above.

Possible UN Value Addition

22. UNCTAD has done some excellent work at UN Secretariat level on awareness raising of tax and investment issues, and the UN Commission on International Trade Law continues to consider issues in the reform of investor/ State investment arbitration. The OECD CFA has experience in these issues also.

23. The Tax Committee could play an important role in, for example (recognizing that priorities would have to be set for any such work):

- Convening relevant experts as part of a subcommittee;
- Producing guidance, preferably in one or more concise notes, that assists experts from developing countries in:
  - Analyzing and prioritizing the issues and priorities in relation to dealing with existing trade and investment treaties, as well as negotiating new ones;
  - Understanding practices in tax policy, legislation and administration that are best adapted to identifying risks and minimizing them and their likely impact;
- Considering the existing UN Model advice on relationship of tax treaty issues with the General Agreement on Trade in Services - whether it should be refreshed, reconfirmed, deleted or otherwise;
- Step by step guidance on identifying issues in the relationship of tax, investment and trade agreements;
- Step by step guidance on how to approach identified disputes in a whole-of-government but tax administration-aware way; and
- Step by step guidance for tax officials involved in tax and investment treaty negotiations.

24. It would appear preferable to separate guidance on the (a) investment and (b) trade treaties, even though some treaties address both issues. The investment issues are probably more urgent for most developing countries, as tax issues have hitherto been litigated in high profile investment disputes more than in trade disputes. The issue of how to address interaction with the GATS treaty (which is in large part an investment agreement, despite the name) possibly deserves early consideration because it has an element of reviewing existing UN Model guidance, however - possibly in conjunction with any subcommittee on updating the UN Model.

25. *An alternative to a Subcommittee* would be additional work by a smaller group of the Committee (such as the Bureau) seeking a report with recommendations for decision at the Twenty-fourth session of the Committee. However, in view of the currency of this issue and the interest in the past, especially among Members from developing countries, setting up a Subcommittee at the twenty-third session seems appropriate.

26. Recognizing the workloads of many likely participants in the Subcommittee, use could be made of consultants to ensure all elements of these complex interactions are adequately and fairly addressed.

Recommendation

27. It is recommended that the Committee should form a multistakeholder and multidisciplinary Subcommittee on the Relationship of Tax, Trade and Investment Agreements to make recommendations on the issues and priorities, especially in providing guidance to developing country representatives about the interaction of tax, trade and investment agreements, and to report back to the Committee and provide concise practical guidance on issues as decided by the Committee. Short. focused guidance during the current Membership of the Committee may be more resource effective than seeking to provide a "handbook" or similar.

28. It is proposed that the Subcommittee should be given a mandate along the following lines:

"The Subcommittee is mandated to:

- Identify and consider the more pressing issues where guidance from the Committee may most usefully assist developing countries (and stakeholders in tax systems) in this area and initially report to the Committee on such issues at its Twenty-fourth session in 2022;
- Liaise with others active in considering these issues, including regional and other international organizations, seeking consistency of approaches where justified in the terms of this mandate;
- Within the abovementioned context, provide draft guidance on such issues as are approved by the Committee at its sessions, with a view to approval and release of short, targeted guidance at various points during the current Membership terms of the Committee."