E/C.18/2019/CRP.14

Distr.: General
8 April 2019

Original: English

Committee of Experts on International Cooperation in Tax Matters
Eighteenth session
New York, 23-26 April 2019
Item 3 (j) of the provisional agenda
Relationship of tax treaties with trade and investment treaties

Secretariat Paper: The Interaction of Tax Trade and Investment Agreements

Summary

This paper is for INFORMATION only and does not seek a Committee decision or propose a Committee workstream at this stage. It outlines some of the key issues and questions surrounding the interaction of tax and non-tax treaties and indicates instead two streams of Secretariat work where input from Committee Members, individually or as part of a small Focus Group, would be especially helpful. These two streams of work are:

- Preparation by the secretariat of a more detailed paper on specific drafting and other options countries might take to address some of the issues arising, and

- Preparation by the Secretariat of a short guidance note on avoiding and addressing claims under non-tax treaties against tax measures.

In these workstreams, particularly the former, the Secretariat proposes working closely with the OECD and others having particular expertise.

I. INTRODUCTION

This note was prepared by the UN Secretariat after consultation with the OECD Secretariat. This cooperation is gratefully acknowledged and has been particularly useful in view of the past and ongoing work of the OECD Secretariat on the relationship of tax and non-tax agreements. This paper is not intended to reflect the views of the OECD or its Member Countries, however.

2. The note provides 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"). These issues have arisen in various sessions of the Committee and at the 17th session of the Committee the Secretariat offered to work with the OECD on a paper addressing these issues for the benefit of the Committee. The Paper does not seek to be exhaustive.

3. The paper proposes further Secretariat work, seeking input from Committee Members wishing to engage in a Focus Group. Proposed Secretariat work includes a short "How To" guide for tax administrators and policy-makers on how to avoid and deal with the potential application of non-tax agreements to tax "measures" (which are usually, including for the purposes of this paper, very widely defined to include for example, laws, regulations, procedures, requirements, or practices[1] – thereby including administrative actions).

4. While not proposing a new workstream for this Membership of the Committee at this stage, in the light of its current workload, it does propose further work at Secretariat level to define possible issues for the Committee, working as much as possible with the OECD Secretariat in view of related work in that organisation. There may be elements of the Secretariat and OECD work that may feed into other Committee work, including the next update of the UN Model Tax Convention. If so that would be done through the relevant subcommittee, such as through the Subcommittee on the Update of the Model.

II. GENERAL TYPES OF NON-TAX AGREEMENTS

5. Examples of the types of non-tax agreements that may impact on tax measures and administration are:

- 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.

[1] See for example the US-Mexico-Canada Agreement (USMCA), para. 1.4.

III. GENERAL ISSUES OF OVERLAP

6. In view of their breadth of coverage of treatment of trade and investment, there are inevitably overlaps between non-tax agreements and tax agreements. Tax measures may prima facie breach the requirements of the non-tax agreements, and, looked at from the investment or trade side, the expectation would be that tax measures should not be allowed to subvert key aspects of non-tax agreements, and thereby derogate from the "promises" of those agreements as to the investment and trading climates. How that overlap is managed, and the unresolved issues, vary from provision to provision, and agreement to agreement, as noted in this paper.

7. Recognising the varying perspectives involved and the need for a balance is at the centre of any effective guidance in this area. In fact, although this paper refers to the relationship between tax and non-tax agreements as a shorthand term, it is more understandable as an issue of the relationship between non-tax agreements and tax measures, broadly understood.

8. 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 and process that applies.

9. Guidance to countries that helps them to understand and influence these factors positively would represent a special contribution of the UN in the field of international tax cooperation.

IV. GENERAL CHALLENGES

10. The challenges in this area relate broadly to;

a. Unawareness of tax officials of the potential impact of non-tax agreements on tax measures, including legislation, regulation and administration;
b. Unawareness of trade and investment negotiators of the potential overlap, including of the coverage of tax treaties;
c. Challenges in achieving whole of government approaches to pre-empting problems, identifying them and responding to them;
d. 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" approaches to their interpretation;

e. Rules of supremacy chosen to address the overlap and their clarity or otherwise;

f. 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;

g. 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.

V. SOME SPECIFIC AREAS OF OVERLAP

11. Some important areas of interaction, and possible roles for the UN and others in relation to them, are as follows:

(1) Definitions

12. The definition of "investments" and of "investors" can have a tax impact. Some investment treaties only cover direct investment, but others cover indirect shareholdings. For example, the *Finland-Vietnam* BIT of 2008 provides:[2]

> Investments made in the territory of one Contracting Party by any legal entity of that same Contracting Party, but actually owned or controlled, directly or indirectly, by investors of the other Contracting Party, shall likewise be considered as investments of investors of the latter Contracting Party if they have been made in accordance with the laws and regulations of the former Contracting Party.

13. While this decision will be made as part of the broader policy of a country, the implications for tax measures need to be at least recognised in setting that policy. Coverage of indirect investments will mean that, in effect, investments from corporates which are resident in non-investment treaty companies may in effect be partially covered through shareholders in treaty partner countries. This in turn increases the potential of "treaty shopping" - structuring of shareholdings through investment partner countries and suggests the possible need for some form of limitation on, or denial of, benefits provision in non-tax treaties.

14. In fact, an increasing number of BITs have "Denial of Benefits" provisions to address treaty shopping of such agreements. An example is from the *Argentina-Qatar* BIT of 2016:[3]

15. Following notification, a Contracting Party may deny the benefits of this Agreement to:

1. an investor of the other Contracting Party that is a juridical person of such

[2] Art. 1(1).
[3] Art. 9(2).

Contracting Party and to an investment of such investor if the juridical person is owned or controlled directly or indirectly by investors of a Third State and the denying Contracting Party does not maintain diplomatic relations with the Third State;

2. an investor of the other Contracting Party that is a juridical person of such Contracting Party and to investments of that investor, if an investor of a Third State owns or controls directly or indirectly the juridical person and the juridical person has no substantive business operations in the territory of the other Contracting Party.

16. The Canada-EU CETA provides:[4]

> A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of that Party and to investments of that investor if: (a) an investor of a third country owns or controls the enterprise.

17. These sorts of "denial of benefits" provisions are likely to be used increasingly, and they may be more and more influenced by similar limitation on benefits provisions in tax treaties.

18. Further, the coverage or otherwise of indirect investments may be important in any challenge under an investment treaty to the sort of legislation on offshore indirect transfers that is being more frequently implemented by developing countries.[5]

Possible Further Lines of Enquiry:

- **Clarification of definitional options to balance the need for business certainty and an ability to regulate on taxation matters,**
    - **including as to "treaty shopping" of non-tax agreements and**
    - **including as to emerging issues such as indirect offshore transfers.**

(2) Fair and Equitable Treatment Provisions

19. For the many treaties with a "fair and equitable treatment" provision, that provision is likely to be invoked in any challenge to a tax measure, or indeed any other challenge, because it is usually an undefined (or at best, partially defined) term that is often very broadly interpreted by arbitration panels, to the benefit of investors. Some BITs (e.g. The *Morocco-Rwanda* BIT (2016) and Free Trade Agreements (e.g. the China-Australia FTA) do not have them, and that trend is likely to accelerate.

20. An example of a classically formulated Fair and Equitable Treatment provision is as follows:

[4] Art. 8.16(a).

[5] See, for example, Chapter 4 (Indirect Transfer of Assets) of the United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries (2017) https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook_2017.pdf The Platform for Collaboration on Tax (http://www.worldbank.org/en/programs/platform-for-tax-collaboration) is also finalizing a "toolkit' on this issue.

> All investments made by investors of one Contracting Party shall enjoy a fair and equitable treatment in the territory of the other Contracting Party.[6]

21. One option, adopted in the North American Free Trade Agreement – and picked up in the replacement USMCA agreement - is to clarify that the term has its "customary international law" meaning –a meaning accepted by countries as binding them in international law, as evidenced by their actions. This narrows its meaning and operation, but even there the scope of the customary international law meaning is not entirely clear.

22. In effect a Fair and Equitable Treatment provision that merely reflects the situation at customary international law would apply even without a treaty, so the treaty in such a case only reaffirms what would be guaranteed in any case – the minimum standard mandated by customary international law. Countries seek to be increasingly seeking to confirm this narrow reading where no new obligation is effectively added.

23. The NAFTA provided, along these lines, that;[7]

> Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

24. The issue of the "full protection and security" aspect of this provision is considered below.

25. The hopes of the parties to NAFTA that tribunals would limit the meaning to existing customary law protections were not realised. In a series of arbitral awards culminating in Pope and Talbot v. Canada[8], tribunals took expansive interpretations not grounded in customary international law. The three parties to the NAFTA responded by agreeing an interpretative note to the effect that FTC clarified that "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[9] The US-Mexico-Canada Agreement (USMCA) incorporated this same interpretative understanding into the agreement.[10]

26. This experience shows the risks of leaving the term undefined, but also the difficulty of defining it. It demonstrates, however, the benefits of tying the agreement into existing minimum standards under customary international law.

27. The *Nigeria-Singapore* BIT of 2016 similarly adopts a (having already defined the terms by reference to customary international law) provides a cautionary approach:[11]

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[6] *Belgium-Luxembourg Economic Union-Tajikistan* BIT (2009) Article 3.
[7] Art. 1105(1).
[8] *Pope & Talbot Inc v Canada*, Award in Respect of Damages, 31 May 2002.
[9] NAFTA Free Trade Commission Interpretative Note (n 6) s B(1)–(2)).
[10] Art. 14.6(2).
[11] Art. 3(2).

> For greater certainty, the obligation to provide "fair and equitable treatment" and "full protection and security" as described below, does not require treatment in addition to or beyond the customary international law minimum standard of treatment of aliens,

28. And it even provides an explanatory footnote:

> Customary international law results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to this article, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.

29. Finally, to address some of the jurisprudence of panels on this obligation it provides:[12]

> A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish tl1at there has been a breach of this Article.

30. This might be in part to pre-empt the argument that if all that is being referred to is the minimum standard already applicable under customary international law, there would be no point to this treaty provision – to give it meaning it must represent a higher standard.

31. A note to the *Japan-Kenya* BIT (2016) also addresses some of the issues in a similar fashion.[13]

Possible Further Lines of Enquiry:

- **Clarification of potential impacts of this provision on tax measures;**
    - **what sort of action may meet the tests of "fair and equitable treatment" at customary international law – including whether it varies with country capability - and in any likely "extensions" of this concept.**

- **Consideration of possible pros and cons of:**
    - **agreeing/ avoiding such a clause;**
    - **options to limit the treatment to the customary international law minimum standard and/or;**
    - **carving out tax measures from this provision; and**
    - **according Competent Authorities a role in the procedure/ decision-making.**

(3) Full Protection and Security

32. As noted from the discussion above of the NAFTA and USMCA, similar issues arise for a "full protection and security" clause as for the fair and equitable treatment clause.

[12] Art. 3(3).
[13] Art. 5(1).

They are sometimes included in investment treaties as a self-standing clause or (much more commonly) conjoined. That is the approach in the NAFTA and USMCA or, for example in the *Ethiopia- Spain* BIT of 2009 (not yet in force):[14]

> Investments made by investors of one Contracting Party in the territory of the other Contracting Party shall be accorded fair and equitable treatment and shall enjoy full protection and security

33. The *Finland-Vietnam* BIT of 2008 also provides, for example:[15]

> Each Contracting Party shall in its territory accord to investments and returns of investments of investors of the other Contracting Party fair and equitable treatment and full and constant protection and security.

34. Usually, it can be speculated, they are conjoined because both are expressions of minimum standards of treatment already required under customary international law, which is increasingly being made explicit in the treaties.

35. As noted, the terms used in these clauses are almost inevitably undefined. That involves risks for tax policy-makers and administrators. An investment tribunal in *Biwater v. Tanzania* (2008) gave a very broad interpretation when it stated that full protection and security "implies a State's guarantee of stability in a secure environment, both physical, commercial and legal".

<u>Possible Further Lines of Enquiry:</u>

- **Clarification of potential impacts of this provision on tax measures;**
  - **what sort of action may meet the tests of "full protection and security" at customary international law – including whether it varies with country capability - and in any likely "extensions" of this concept.**

- **Consideration of possible pros and cons of:**
  - **agreeing/ avoiding such a clause;**
  - **options to limit the treatment to the customary international law minimum standard and/or**
  - **carving out tax measures from this provision; and**
  - **according Competent Authorities a role in the decision-making.**

(4) Avoidance of arbitrary, discriminatory, or unreasonable measures

36. A provision found in many international investment treaties (sometimes combined with the fair and equitable treatment provision) is a commitment by the contracting states not to

[14] Art. 3(1).
[15] Art. 2(2).

impair protected investments by unreasonable, discriminatory, or arbitrary measures. For example, the *Germany- China* BIT (2003) provides:[16]

> Neither Contracting Party shall take any arbitrary or discriminatory measures against the management, maintenance, use, enjoyment and disposal of the investments by the investors of the other Contracting Party.

37. The *Finland-Vietnam* BIT (2008) similarly provides:[17]

> Neither Contracting Party shall in its territory impair by unreasonable or arbitrary measures the acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposal of investments of investors of the other Contracting Party.

38. This is an uncertain standard, arguably extend well beyond customary international law standards although it appears to very rarely be relied on as the exclusive or main basis of a case, let alone with other decisions.[18] Certainly there is some value in those tax officials involved in investment agreement teams putting investment colleagues to task during preparations as to the meaning of the term, what it adds to customary international law protections, why it is necessary and its likely impact on tax measures.

39. ln practice, the non-impairment standard is rarely relied upon by investors as the principal or exclusive basis of their case. It is therefore hardly surprising that arbitral decisions usually do not turn on whether this standard has in fact been breached.

<u>Possible Further Lines of Enquiry:</u>

- **Clarification of potential impacts of this provision on tax measures;**
    - **what sort of action may meet the tests of “arbitrary, discriminatory, or unreasonable measures” at customary international law – including whether it varies with country capability - and in any likely “extensions” of this concept.**

- **Consideration of possible pros and cons of:**
    - **agreeing/ avoiding such a clause;**
    - **options to limit the treatment to the customary international law minimum standard and/or**
    - **carving out tax measures from this provision; and**
    - **according Competent Authorities a role in the decision-making.**

[16] Art. 2(3).
[17] Art. 2(3).
[18] See, e.g. the discussion in Heiskanen Veijo, “Arbitrary and Unreasonable Measures”, in August Reinisch, *Standards of Investment Protection* (Oxford, 2008) 87-110.

(5) Transfer of Funds

40. Because investments can become non-viable if profits during their lifetime or the proceeds of sale cannot be repatriated, investment agreements almost inevitably prevent restrictions, including undue delays, upon the free flow of such funds.

41. Just as the IMF Articles frame the definition of "payments for current transactions" in the context of "net income on investments",[19] better transfer of Funds provisions in BITs require the free transfer of funds net of applicable taxes, including withholding taxes and capital gains tax. This is probably implicit but is best explicitly put. Similarly, tax reporting requirements are often explicitly allowed, even though they should not intrinsically breach the transfer of funds obligation anyway.

42. The ASEAN Comprehensive Investment Agreement achieves the balance between taxation and investment climate objectives by providing, first, that there is no general taxation exemption for restrictions on transfers[20] (presumably to prevent taxation being used as a pretence to deny transfer of the proceeds of an investment).

43. It then provides, however, in the Transfers Article itself that:[21]

> Notwithstanding paragraphs 1 and 2 [the operative paragraphs], a Member State may prevent or delay a transfer through the equitable, non-discriminatory, and good faith application of its laws and regulations relating to: …. (f) taxation;

44. Similarly, the *Kenya-Slovakia* BIT of 2009 (not yet in force) provides:[22]

> Notwithstanding paragraphs 1 and 2 of this Article, a Contracting Party may delay a transfer through the application of measures ensuring investors' compliance with the host Contracting Party's laws and regulations on the payment of taxes and dues in force at the time request for transfer was made, and provided that the application of such laws and regulations shall not unnecessarily impair the free transfer ensured by this Agreement.

45. These sorts of clauses gives a great deal of protection to taxation measures, but as so often with tax measures in non-tax agreements, there are certain basic requirements which policy-makers and administrators need to bear in mind to avoid breaching non-tax agreements, bearing in mind that terms such as "equitable, non-discriminatory, and good faith" will be interpreted by tribunals composed, most likely, of investment or trade specialists rather than tax experts.

46. Other agreements provide exceptions under the Transfers Article, but not for taxation, such as the *Austria-Nigeria* BIT of 2013 (not yet in force):[23]

[19] Art. XXX.3(d).
[20] Art. 3(4).
[21] Art. 13(3)(f).
[22] Art. 7(3).
[23] Art. 9(4).

> Notwithstanding paragraphs (1) to (3) and without prejudice to measures adopted by a Contracting Party in pursuance of its international obligations as mentioned in Article 3(4), a Contracting Party may also prevent a transfer through the equitable, non-discriminatory and good faith application of laws and regulations on bankruptcy, insolvency or the protection of rights of creditors, on the issuing, trading and dealing in securities, futures, options and derivatives, on reports or records of transfer, on the prevention of money laundering or terrorist financing, or in connection with criminal offences and orders or judgements in administrative and adjudicatory proceedings, provided that such measures and their application shall not be used as a means of avoiding the Contracting Party's commitments or obligations under this Agreement.

<u>Possible Further Lines of Enquiry:</u>

- **Is there a need for tax exceptions or is that implicit?**
- **If there is a need, how should it be framed in a way that can be negotiated?**
- **Should there be a threshold test (e.g. that measures must be "equitable, non-discriminatory, and good faith")?**
- **How should reasonable delays because of tax requirements be addressed?**

(6) "Umbrella" Clauses

47. It might be thought that contractual provisions with investors as to taxes are purely contractual and can be overruled by domestic legislation, to the extent the domestic legal system, including the constitution, allows this. "Stabilisation" clauses in contracts may prevent, or provide for compensation in the event of, changes to the amount of tax levied for example, and may provide for arbitration of disputes, but even this is within the framework of a domestic law system.

48. The stabilisation clause for several oil and gas Production Sharing Contracts in *Burlington v. Ecuador*, an ICSID proceeding, was as follows, for example:[24]

> "Modification to the tax system: In the event of a modification to the tax system or the creation or elimination of new taxes not foreseen in this Contract, which have an impact on the economics of this Contract, a correction factor will be included in the production sharing percentages to absorb the impact of the increase or decrease in the tax102".

49. However, there is an extra element in many investment agreements. This is the so-called "umbrella" clause in BITs or other non-tax ingredients. An umbrella clause is designed to impose 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.

[24] *Burlington Resources, Inc. v. Republic of Ecuador,* ICSID Case No. ARB/08/5 at para 24; https://jusmundi.com/en/document/decision/en-burlington-resources-inc-v-republic-of-ecuador-decision-on-jurisdiction-wednesday-2nd-june-2010

50. The effect is that the failure to abide by the contractual obligation becomes a breach of the treaty obligation to abide by the underlying commitment. The Taxpayer can pursue the alleged breach of contractual commitment in the domestic courts, which still exists, but can also embark on Investor-State Dispute Settlement for breach of the treaty obligation to respect contractual promises. This would be ruled upon by an arbitrator or an arbitration panel. It is also possible that the umbrella clause applies not just to contractual stabilization clauses but also *statutory* stabilization clauses[25].

51. Umbrella clauses are generally broadly expressed. A common formulation is, as in the *Finland-Vietnam* BIT (2008):[26]

> Each Contracting Party shall observe any other obligation it may have with regard to a specific investment of an investor of the other Contracting Party.

52. To prevent arguments that an obligation has been entered into by a purely oral agreement, the *Spain-Ethiopia* BIT of 2009 (not yet in force, emphasis added) provides:[27]

> Each Contracting Party shall observe any obligation it may have *entered into in writing* with regard to investments of investors of the other Contracting Party.

53. There is an additional possible interaction with the exception for matters of taxation in many investment agreements. In the *Burlington v. Ecuador* case noted above, the ICSID tribunal did not refer to this as a stabilisation clause but chose to refer to this provision as a “tax indemnification clause”. They saw it as something that could be agreed upon by two private parties in similar circumstances and not as a guarantee afforded by the state as such, in view of its taxation power. This led to the tribunal deciding that the clause did not raise “matters of taxation”, expressly excluded from the tribunal’s jurisdiction.

<u>Possible Further Lines of Enquiry:</u>

- **What are the pros and cons of “Umbrella Clauses”?**
- **If they are agreed, what are possible limitations, e.g. as to written agreements?**
- **How does the tax authority know what the contractual obligations are?**

(7) Expropriation

54. A core part of investment treaties, whether bilateral, regional or multilateral, is to give assurances to investors of, at least, compensation when their property is “expropriated” – they generally do not prohibit expropriation but regulate compensation in the event of it. Historically there was a great deal of debate over what the standard of compensation should be, but in effect the standard of “prompt, adequate and effective” compensation seems to

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[25] *LG&E v. Argentina*, Decision on Liability dated 3 October 2006 , p 175.
after noting that there was no contractual stabilization clause in that case90, found that failure by Argentina to observe statutory stabilization provisions would give rise to liability under the umbrella clause.”
[26] Art. 12(2).
[27] Art. 3(2).

be applied, whatever the specific wording of BITs expropriation provisions. What the valuation of the expropriated property is often in dispute, however.

55. The concept of expropriation in non-tax agreements usually extends beyond the direct taking over of an investment ("direct taxation") to so-called "indirect" expropriation. The concept of indirect taxation is not defined in investment treaties, even though (or perhaps because) the meaning in customary international law is not altogether clear. It has been stated that:

> Indirect expropriation occurs when a state takes effective control of, or otherwise interferes with the use, enjoyment or benefit of, an investment, strongly depreciating its economic value, *even without a direct taking of property*. But there is no commonly accepted definition of indirect expropriation; ascertaining whether it has occurred will depend on the facts and on the treaty language, and on how both are interpreted by the dispute settlement body.[28]

56. The definition of indirect expropriation under international law is somewhat uncertain, then, 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[29].

<u>Possible Further Lines of Enquiry:</u>

- **Clarification of indirect expropriation concept and tax measures.**
- **Is an exception for taxation warranted, able to be negotiated, and what should it say?**
- **In the absence of an exception for tax measures, should there be a provision that the Competent Authorities can agree that a matter is not an expropriation, with overriding force?**

(8) Non-discrimination

(a) Non-discrimination in Model Tax Treaties

57. The UN and OECD Models both have non-discrimination provisions, which essentially prohibit the following types of discrimination:

- Subjecting nationals of the other Contracting State to a taxation or connected requirement, which is "other or more burdensome" than those to which nationals of that other State in the same circumstances, in particular with respect to residence, are subject - i.e. treating taxpayers differently on the basis of their

[28] International Institute for Sustainable Development, A Sustainability Toolkit for Trade Negotiators, at 5.4.4, available at https://www.iisd.org/toolkits/sustainability-toolkit-for-trade-negotiators/5-investment-provisions/5-4-safeguarding-policy-space/5-4-4-indirect-expropriation-regulatory-taking/

[29] See, for example, *Yukos Universal Limited (Isle of Man) v. The Russian Federation* (PCA Case No. AA 227) (2014). The arbitral decision was later quashed by a Netherlands court for want of jurisdiction. Currently that decision is understood to be under appeal.

nationality – importantly, different treatment based on residence is allowed ((Paragraph 1);

- Treating a permanent establishment in a Contracting State less favourably for tax purposes than a domestic enterprise carrying on the same activities. This protection does not extend to personal allowances and benefits based on civil status or family responsibilities. (Paragraph 3);
- Taxing interest, royalties, fees for technical services and other disbursements paid to a resident of the other Contracting State less favourably than income from similar business activities of a resident of that State – by not providing for deductibility as if the disbursements were paid to such a resident (Paragraph 4 – there are exceptions for some payments between related parties);
- Similarly, denying the same deductibility of debts of an enterprise of a Contracting State to a resident of the other Contracting State as those contracted to a resident of the first-mentioned State (paragraph 4); or
- Differently or less favourably taxing enterprises of a Contracting State, controlled directly or indirectly by residents of the other Contracting State, as compared with other similar enterprises of the first-mentioned State (Paragraph 5).

58. These provisions may have complex interactions with other agreements, which often have their own "Most Favoured Nation" and "National Treatment" obligations.

(b) Investment Treaties

59. 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.

60. 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.

61. 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.

62. In examining compatibility of tax and non-tax agreements on these points, the 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.

(c) GATT Most Favoured Nation Article

63. Article I:1 of the General Agreement on Tariffs and Trade ("GATT") sets out the MFN clause, in a form which has been influential for trade agreements. It grants to the "like product" of all GATT contracting parties the benefit of any advantage, favour, privilege, or immunity granted by any other contracting party to any product originating in or destined for any other country, with respect to, inter alia, customs duties and charges imposed on import or export including "internal taxes".

64. The application of MFN obligations to taxes has historically been limited to taxes on products, which are generally excise taxes. Certain income tax provisions could breach the terms of the Article (e.g. a statutory exemption for income derived by foreign companies of a country from international shipping and aircraft, provided that that country provides a reciprocal exemption to their companies[30]). The requirement for reciprocity would be contrary to this Article. Provisions of tax treaties could violate this provision, and while there is no instance of a GATT challenge to treatment provided by a tax treaty, there is no general exemption for tax treaty provisions under the GATT, unlike, as considered below, exists for the General Agreement on Trade in Services.

(d) The GATT and National Treatment

65. The relevant Article of the GATT 1994 is Article III *National Treatment on Internal Taxation and Regulation* which provides:

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1

3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit

[30] As advocated, for example, by the International Air Transport Association, "Guidelines for Taxation of International Air Transport Profits " (2015) p 3ff. available at https://www.iata.org/policy/Documents/taxation_intl_air_transport%20profits_final.pdf

> the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.
>
> 4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

66. The Interpretative Note, *Ad* Article III, which was part of the original text of Article III and has equal status to the rest of the text, provides:

> Any internal tax or other internal charge, or any regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.

67. The GATT National Treatment formulation is very influential in the context of regional trade agreements, which gives it additional relevance. The issue of its coverage of direct taxes is not a straightforward one, however.

68. Article III essentially provides that WTO Members must not accord discriminatory treatment between imports and "like" domestic products (apart from the imposition of tariffs, which is a border measure). It refers to "internal taxes" and there is a long-standing issue of the extent to which that is intended to deal with direct taxes.

69. One author has noted:[31]

> … Tariffs and other indirect taxes, whether levied at the border or internally, have long been subject to the binding multilateral rules embodied in the GATT. However, in recognition of the fact that tax measures can be used as substitutes for other types of protection and government assistance or regulation, direct as well as indirect taxes have come under increased scrutiny at the World Trade Organization (WTO). This recognition is reflected in several of the agreements negotiated under the Uruguay Round, notably those concerning subsidies and trade-related investment measures (TRIMs). These agreements reflect the realization by national governments that multilateral rules need to play an increasingly important role in regulating the use of tax as well as non-tax

[31] Michael Daly, "Is the WTO a World Tax Organization? A primer on WTO rules for tax policymakers" (2016) Pp. 1-2, available at https://www.imf.org/external/pubs/ft/tnm/2016/tnm1602.pdf. See also Daly, Michael. (2006). "The WTO Rules on Direct Taxation." *World Economy* 29 (5): 527–557.

> measures, especially where these measures affect the international movement of goods, services, capital, technology and persons.

70. The same author goes on to say that:[32]

> The DSB's rulings against Indonesia's National Car Programme[33] and especially against the United States concerning the latter's Foreign Sales Corporation (FSC) scheme[34], which, at the time, led to the largest retaliation award ever authorized in a dispute at the WTO, are particularly noteworthy. These rulings confirmed, if there were ever any doubt, that, generally speaking, direct as well as indirect taxes (including, of course, not only tariffs), are subject to WTO rules, notwithstanding efforts by tax authorities to secure specific exemptions for certain direct tax measures in these agreements.

71. Taking a prevailing Vienna Convention on the Law of Treaties analysis of Article III in its context, that can certainly be doubted.

72. As one writer has noted:[35]

> In theory, WTO rules should not interfere with direct taxation. The WTO's main objectives are to promote trade between its members, to administer and monitor the application of its rules, and to function as a dispute settlement platform. The WTO treaties, mainly the General Agreement on Tariffs and Trade (GATT), the Agreement on Trade-Related Investment Measures (TRIMS) the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and the General Agreement on Trade in Services (GATS), give the WTO a means to these ends. Direct taxes give the levying states the means to promote their own goals. Nowadays, these include not only the protection of their citizens from domestic and international violence, but also general and public welfare and other similar goals. Furthermore, unlike indirect taxes, direct taxes are not directly levied on goods and services, with which the WTO is directly concerned.

73. Though that same writer notes the tensions at play (which can perhaps be seen as a tension between the "legal" and "economic" dimensions of the GATT) when he goes on to note; "From the economic point of view, the WTO cannot reach its goals without ruling on direct taxes. Direct taxes can interfere with cross-border trade in a way similar to tariffs. They also can have a subsidy-like effect."[36]

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[32] Daly (2016) at p. 2.
[33] [Secretariat Note: The WTO Panel in *Indonesia-Autos* (DS 54, 1998) considered a tax measure involved luxury car tax exemptions or reductions granted solely to domestic car companies and cars satisfying local content requirements. As Daly notes at p. 32, although the particular dispute did not involve direct tax measures, the DSB observed at para. 14.38 that while "subsidies granted in respect of direct taxes are generally not covered by Article III:2," they "may infringe Article III:4 to the extent that they are linked to other conditions which favour the use, purchase, etc. of domestic products."]
[34] [Secretariat Note: Discussed below in this paper].
[35] Christian Neufeldt, "The WTO and Direct Taxation: Direct Tax Measures and Free Trade", Harvard International Law Journal (2018) Vol. 59 Online Journal, at p. 4.
[36] Ibid. at p. 14.

74. Those that believe the WTO jurisprudence may have overreached point to the negotiating history in the Havana Charter of what became Article III and the fact that even in the negotiations for the WTO, where an exception was sought for the GATS, none was sought for the GATT. On this view because it was understood that very few direct taxes would be caught by Article III, there was not the same call for an exception. Certainly, Professor John Jackson, a scholar of the highest eminence in the fields of the WTO and international trade law noted in 1969 that there was little or no scope for such a coverage, because income taxes did not sufficiently relate to "products".[37]

75. There are indeed strong arguments that Article III of the GATT 1994 was not intended to cover direct taxes, at least in a general way. At the conclusion of the WTO "package deal" of agreements, a hard fought[38] and broad taxation matters exception was inserted in the GATS, as we have seen. No similar exception had been included in the GATT 1947 or was added as part of the Uruguay Round negotiations. There is no evidence that WTO Members accepted that GATT was a "lost cause" with general coverage of direct taxes already accepted – the limitation to direct taxes was still being argued beyond that date.

76. More likely is it that there was a recognition or understanding by WTO negotiators that direct taxes were generally *not* covered by Article III as part of its structure. In the Havana Charter negotiation of what become Article III of the GATT 1947 and then the GATT 1994 it was agreed that (parenthesis added) "neither income taxes nor import duties came within the scope of Article 18 [later to become Article III] since this Article refers specifically to internal taxes on products."[39] The *Foreign Sales Corporations* (FSCs) panel[40], despite the provisions of the Vienna Convention on the Law of Treaties in favour of considering the context of treaty provisions, rather surprisingly found no ambiguity in the (notoriously ambiguous) issue and did not find it necessary to consider the issue. The Panel addressed the apparent need to explicitly "carve-out" tax measures from the GATS and drew implications from this about the GATT 1994, to the effect that it inherently had a wide coverage of income tax measures.

77. The general question was not directly raised in the FSCs appeal (which upheld the initial decision) and appears not to have been addressed directly since, except in one case discussed below. It has been claimed that: "At its origin, the member states did not intend

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[37] John Jackson, *World Trade and the Law of GATT* (1969) at p. 297; Cf. Michael Lennard, *The GATT 1994 and Direct Taxes: Some National Treatment and Related Issues*, *in* "WTO and Direct Taxation" 73 at 76 (Michael Lang, Judith Herdin-Winter & Ines Hofbauer-Steffel eds., (2005).

[38] Juan A. Marchetti, Petros C. Mavroidis; The Genesis of the GATS (General Agreement on Trade in Services), *European Journal of International Law*, Volume 22, Issue 3, 1 August 2011, Pages 689–721, https://doi.org/10.1093/ejil/chr051, at 718: "The US had to fight a battle on taxation; the consistency of its sub-federal taxes with the principle of non-discrimination was questionable, and, as with maritime transport, the US was unwilling to amend domestic laws." See also the revised MFN schedule of the United States MTN.GNS/W/227 dated 8 December 1993, https://docs.wto.org/gattdocs/q/UR/GNS/W227.PDF at p.3. See also: Samuels, Leslie B. "Treatment of Ambiguous Measures Under International Trade and Investment Agreements: The GATS Compromise." *Proceedings of the Annual Meeting (American Society of International Law)*, vol. 102, 2008, pp. 51–55. *JSTOR*, JSTOR, www.jstor.org/stable/25660262, p. 52ff.

[39] [original footnote] E/CONF.2/C.3/A/W/32, p.1-2; statement repeated in Havana Reports, p. 63. paragraph 44. See also E/CONF.2/C.3/SR.13, p.1. cited in Analytical Index of the GATT, volume 1, 1995, at 144. See also ARGENTINA – MEASURES AFFECTING THE EXPORT OF BOVINE HIDES AND THE IMPORT OF FINISHED LEATHER (WT/DS155/R) 19 December 2000 at 101-2

[40] Panel Report, United States - Tax Treatment for "Foreign Sales Corporations,", WT/DS108/R (Oct. 8, 1999),

the GATT or the WTO to rule on direct taxes. Yet, over time the WTO members accepted the WTO's jurisdiction on this matter. They showed this not only by acknowledging the WTO's jurisdiction on direct tax matters, but also by explicitly mentioning direct taxes in the SCM Agreement."[41] Such acceptance is not clear from the WTO negotiating history or the WTO jurisprudence (especially with no stare decisis in WTO jurisprudence[42]) however, and the matter may yet be re-litigated, though it would inevitably entail asking WTO panels to self-limit their own jurisdiction.

78. The one case mentioned in the previous paragraph case was *Argentina-Hides and Leathers*[43] The negotiating history of the Article III text was well laid out in the US Third Party Submission in that case,[44] even though it was not precisely addressed by the decision in that case. The US submission reads:[45]

> The United States argues that the negotiating history of Article III:2 demonstrates that the paragraph does not apply to income taxes. During discussions in Sub-Committee A of the Third Committee at the Havana Conference, which considered Article 18 of the Charter (on national treatment), it was stated that the sub-committee on Article 25 [XVI] "had implied that exemptions from income taxes would constitute a form of subsidy permissible under Article 25 [XVI] and therefore not precluded by Article 18." It was agreed that "neither income taxes nor import duties came within the scope of Article 18 [III] since this Article refers specifically to internal taxes on products."[46] Moreover, the negotiating history makes clear that the reference in Article III:2 to "directly or indirectly" is not a reference to indirect taxes, as that term is used in the Illustrative List of Export Subsidies.[47] Rather, it means an indirect method of imposing a tax on a product:
> …
> 9.6 The text of Article III:2, reinforced by its negotiating history, clearly demonstrates that the Article deals only with internal taxes imposed upon goods (including taxes imposed on the processing of goods). It does not apply to income taxes.

79. The submission was given very short shrift in the panel decision - the arguments were not really addressed.

[41] Christian Neufeldt, "The WTO and Direct Taxation: Direct Tax Measures and Free Trade",supra n. 35 at p.8.
[42] WTO, "Legal effect of panel and appellate body reports and DSB recommendations and rulings", https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c7s2p1_e.htm
[43] Panel Report, Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather (*Argentina – Hides and Leather*), WT/DS155/R, adopted 16 February 2001.
[44] Ibid, at pp 101-102.
[45] Ibid, at pp 101-102.
[46] [original footnote] E/CONF.2/C.3/A/W/32, p.1-2; statement repeated in Havana Reports, p. 63. paragraph 44. See also E/CONF.2/C.3/SR.13, p.1. cited in Analytical Index of the GATT, volume 1, 1995, at 144.
[47] [original footnote] The distinction between taxes on a product and taxes that are not on a product is set forth in footnote 58 of Annex I, "Illustrative List of Export Subsidies" to the Agreement on Subsidies and Countervailing Measures. Footnote 58 defines "direct taxes" as "taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership or real property." By contrast, "indirect taxes" are defined as "sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges." While these definitions are legally applicable only to the Agreement on Subsidies and Countervailing Measures, this footnote embodies generally accepted distinctions between taxes imposed on a product ("indirect taxes") and taxes imposed on income ("direct taxes").

80. In fact, despite the differences, the real question appears to be not so much whether direct taxes such as income taxes, can *ever* be caught by Article III, because they almost certainly can - there are at least some examples where a direct tax measure (such as a deduction available for purchasing locally produced vehicles but not for other vehicles) would meet the criteria of (at least) Article III:4.[48]

81. Such a product would in reality be borne by the foreign product and competitive conditions between the products would be modified. Its relationship to that product, which has passed the customs barrier, means that it can properly be regarded as "internal" whereas most direct taxes cannot be so regarded as internal in character. The more important question, since Article III does not actually refer to "direct" or "indirect" taxes is: "will the great majority of direct tax measures sufficiently affect products so as to be regulated by Article III?" This is the point on which views will differ.[49]

82. The little WTO jurisprudence that exists suggests Panels will take jurisdiction on direct taxes generally, and while the matter may be re-litigated in future, direct taxes which can be said to be borne by a product and which affect its competitive position are particularly exposed to WTO actions.

<u>Possible Further Lines of Enquiry:</u>

- **Consideration of tax measures most likely to be subject to GATT National Treatment challenge and how can GATT consistency be achieved for such measures?**
- **Can and should the GATS clauses in the UN and OECD Model Commentaries (discussed below) be extended to GATT issues?**

(e) The General Agreement on Trade in Services

83. 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"[50], it constitutes an investment agreement.

84. The relevant GATS obligations as they apply to tax measures are:

- Most Favoured Nation (MFN) Treatment. Without a taxation exception, MFN treatment might require WTO members to provide to services and service suppliers of other countries the most favourable treatment under any of its bilateral DTAs;
- National Treatment. Without proper qualification, National Treatment obligations might affect the generally accepted practice of making legitimate distinctions between residents and non-residents under domestic tax systems, even when specifically provided for in treaties; and

[48] Cf. Michael Lennard, *The GATT 1994 and Direct Taxes: Some National Treatment and Related Issues, in* "WTO and Direct Taxation" 73 at 101 (Michael Lang, Judith Herdin-Winter & Ines Hofbauer-Steffel eds., (2005)).
[49] Ibid, Lennard
[50] Art. 1:2.

- Dispute Resolution. WTO disputes have their own dispute settlement procedures, in which panelists and, in particular, Appellate Body (the final appeals tribunal) members are unlikely to have tax experience. Taxpayers might engage in forum shopping in this type of dispute settlement rather than the more tax expert-driven, but (in most cases – absent mandatory binding arbitration) less binding DTA Mutual Agreement Procedure.

85. When the GATS was negotiated, there was a cause 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. For example, the UN Commentary notes (at paragraph 7):

> The expression “in the same circumstances” refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar 518 Article 24 Commentary circumstances both in law and in fact. The expression “in particular with respect to residence” makes clear that the residence of the taxpayer is one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances. The expression “in the same circumstances” would be sufficient by itself to establish that a taxpayer who is a resident of a Contracting State and one who is not a resident of that State are not in the same circumstances.

86. 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[51] intended to illustrate with some degree of specificity what Members regarded as measures meeting the “equitable or effective” standard. It provides:

> Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:
>
> (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member’s territory; or
> (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member’s territory; or
> (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
> (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member’s territory; or
> (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or

[51] Footnote 6.

(vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base. Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

87. A provision was also included 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".

88. Of course, prima facie, the question of whether the "equitable or effective" standard has been met, and the interpretation of the footnote, would both be determined by a GATS dispute settlement body – a WTO tribunal. Significantly, such a tribunal would also prima facie decide whether a measure of another WTO Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation.

89. In some cases, this issue never will arise – there was a "grandfathering" exception inserted – in the case of tax agreements existing at the time of the entry into force of the Agreement Establishing the WTO, whereby disputes may be brought before the Council for Trade in Services only with the consent of both parties to the agreement. That is less important than it once was as any agreement entering into force after 31 December 1994 is *not* protected by this exception

90. It is even possible that a pre-1995 treaty amended afterwards loses the protection of this exception. At the least, it would not seem to have protection for actions relating to the amended provision, but protection as a whole may be lost by a partial amendment. This decision would (again) appear to be reserved to the WTO decision-making apparatus, as a jurisdictional matter, in any case.

91. The issue of coverage of amendments to "grandfathered" provisions is dealt with more specifically in the USMCA agreement for example, by extending the exception for grandfathered provisions to:[52]

> "… an amendment to a non-conforming provision of a taxation measure in existence as of the date of entry into force of NAFTA 1994 to the extent that the amendment does not decrease its conformity, at the time of the amendment, with any of those Articles"

92. The GATS exception at least gives some protection to provisions "within the scope" of tax treaties. This has some further cascading implications as follows:

[52] USMCA, Art. 32.3(6)(f).

a. It only applies to measures falling within the scope of a double taxation agreement. It would not apply to legislation outside the agreement.
b. It *might* not, therefore, apply to general anti-avoidance provisions or specific anti-avoidance provisions not referred to in the treaty that are regarded, by the Article 1 Commentaries to both the OECD and UN models as consistent with the treaty because the treaty is regarded as leaving them intact, rather than being restricted by its terms. These sorts of provisions, increasingly important parts of the global tax system, might only be "protected" by exceptions related to domestic tax measures.

   An alternative argument exists, it should be noted, that as tax treaties only ever preserve a taxing right, in the view of nearly all countries, the preservation of GAARs and SAARs, like the preservation of other taxing rights, by the treaty outlined in the UN and OECD Commentaries, means they "fall *within the scope* of an international agreement between them relating to the avoidance of double taxation".
c. 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 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 arbitration under the WTO dispute settlement procedure.

94. To address the issue of "interpretative jurisdiction" noted in subparagraph (c) above, 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 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:

> 93. 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.
>
> 94. Problems like those discussed above may arise in relation with other bilateral or multilateral agreements related to trade or investment. Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention

are dealt with through the mutual agreement procedure rather than through the dispute settlement mechanism of such agreements.

95. 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 commentaries to a provision in the text of the Convention itself.

Possible Further Lines of Enquiry:

- **Is the GATS clause worth preserving in the Models?**
- **Does the clause need to be modified?**
- **How can it be given more prominence (e.g. by inclusion in the text of the Model?)**

(f) Non-discrimination in other Agreements

96. In Regional and Interregional agreements, the MFN obligation usually reflects the GATT formulation. The operation of the MFN provision in non-tax treaties can be very circumscribed such as under the USMCA, where it does not apply to taxes on income, on capital gains, on the taxable capital of corporations or taxes on estates, inheritances, gifts and generation-skipping transfers[53].

97. Tax treaties are usually given specific precedence over the MFN provisions, however, usually by a provision such as the following USMCA provision:[54]

> Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such tax convention, that convention shall prevail to the extent of the inconsistency.

98. And sometimes, as under the USMCA, there is a provision to at least give tax officials the chance to determine if there is an inconsistency with a tax convention (i.e. the tax officials can agree on the existence and extent, or otherwise of an inconsistency) If they do agree the decision binds any dispute resolution panel.[55] Such provisions are likely to become increasingly common.

99. The National Treatment obligations in regional and inter-regional agreements generally track fairly closely the GATT and GATS provisions. The USMCA[56] and CPTPP[57] include provisions that clarify the meaning of "like circumstances" (for MFN as well as NT purposes) as depending on the totality of the circumstances, "including whether the relevant

[53] USMCA, Art. 32.3(6)(b).
[54] USMCA, Art. 32.3(3).
[55] USMCA, Art. 32.3(4).
[56] Arts. 14(4)(4) and Art. 14(5)(4).
[57] Art. 9(4) fn. 14.

treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives".

100. A recent BIT, Morocco-Nigeria (2016) which is not yet in force, elaborates further:[58]

> For greater certainty-, references to "like circumstances" in paragraph 2 requires an overall examination on a case-by-case basis of all the circumstances of an investment including, but not limited to:
>
> a) its effects on third person and the local community;
> b) its effects on the local, regional or national environment, including the cumulative effects of all investments within a jurisdiction on the environment;
> c) the sector in which the investor is in;
> d) the aim of the measure concerned;
> f) the regulatory process generally applied in relation to the measure concerned; The examination referred to in this paragraph shall not be limited to or be biased toward anyone factor.

101. It further provides exceptions for[59]: the benefit of any treatment, preference or privilege resulting from: …. c) any international agreement or any domestic legislation relating wholly or mainly to taxation, d) other Agreement for the avoidance of double taxation …

Possible Further Lines of Enquiry:

- **Should there be exceptions for Most Favoured Nation treatment and National Treatment for:**
  - **Tax agreements - and if so how should they be described?**
    - **Is a reference to "double taxation avoidance" agreements or the like too narrow?**
  - **Domestic tax measures - and if so how should they be described?**
  - **Should the meaning of "like circumstances" be elaborated and if so, how?**

(9) Tax Measure Exceptions

102. How tax is made an exception to non-tax agreements varies. The 2012 US Model BIT provides for a carveout of tax measures, but then gives the expropriation provisions an overriding force, but with a chance to competent authorities to agree there is no expropriation. Supremacy is given to a tax convention (defined broadly and not just in terms of avoiding double taxation, which might be a useful extension as the avoidance of double non-taxation and other aspects of tax agreement among nations may become more important over time. The US Model BIT provides;

> Article 21: Taxation
> 1. Except as provided in this Article, nothing in Section A shall impose obligations with respect to taxation measures.

[58] Art. 6(3).
[59] Art. 6(5).

> 2. Article 6 [Expropriation] shall apply to all taxation measures, except that a claimant that asserts that a taxation measure involves an expropriation may submit a claim to arbitration under Section B only if: (a) the claimant has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measure involves an expropriation; and (b) within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.
> 3. Subject to paragraph 4, Article 8 [Performance Requirements] (2) through (4) shall apply to all taxation measures.
> 4. Nothing in this Treaty shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Treaty and any such convention, that convention shall prevail to the extent of the inconsistency. In the case of a tax convention between the Parties, the competent authorities under that convention shall have sole responsibility for determining whether any inconsistency exists between this Treaty and that convention. Article 22: Entry into Force,

103. Other treaties exclude or partially exclude taxation measures (or types of them, so as obligations under tax conventions) from certain obligations, especially National Treatment and Most Favoured Nation treatment.

104. The *Nigeria-Singapore* BIT of 2016 is broadly worded:[60]

> This Agreement shall not apply to: (b) matters of taxation in the territory of either party, which shall be governed by any tax treaty between the Parties and the domestic laws of each Party,

105. Other BITs cover the whole agreement but are relatively sparse in the breadth of their tax carve-out. The *Austria-Nigeria* BIT of 2009 (not yet in force) provides, for example:[61]

> No provision of this Agreement shall be construed […] as to oblige a Contracting Party to extend to the investors of the other Contracting Party and to their investments or returns the present or future benefit of any treatment, preference or privilege resulting from obligations of a Contracting Party under an international agreement, international arrangement or domestic legislation regarding taxation.

106. While other BITs not only limit themselves to tax treaties, but define the treaties that are excepted in the context of avoidance of double taxation, as in the *Switzerland-Tajikistan* BIT of 2009:[62]

> If a Contracting Party accords special advantages to investors of any third State by virtue of an agreement establishing a free trade area, a customs union or a common market or by virtue of an agreement on the avoidance of double taxation, it shall not be obliged to accord such advantages to investors of the other Contracting Party.

[60] Art 2(3)(b).
[61] Art 3(4)(c).
[62] Art. 4(3).

<u>Possible Further Lines of Enquiry:</u>

- **What are the pros and cons of various options for general taxation exemptions?**
- **Should Competent Authorities have a role and if so how should it be included in the process?**

VI. POSSIBLE FURTHER WORK

107. The OECD, through its Working Party on Tax Treaties (WP1) is forming a working group of OECD WP1 delegates to consider these issues. It will be important to engage very closely with the OECD on any future work at secretariat or Committee level, to ensure that, while the particular UN focus is not lost, 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 differing approaches.

108. <u>As one work stream,</u> it is proposed that the Secretariat, working closely with the OECD Secretariat, and in a joint paper if feasible, but also liaising with other stakeholders, presents by no later than the 20th session a more detailed paper on specific drafting and other options countries might take to address some of the issues arising between tax and non-tax agreements, and options to spread greater understanding of the issues involved.

109. <u>As a second work stream</u>, in response to uncertainties expressed to the Secretariat about what tax authorities can do in the case that they are informed tax measures are being challenged under non-tax agreements, or indeed to prevent conflicts arising, the Secretariat will be preparing a short “How to” guide on avoiding and addressing claims under non-tax treaties against tax measures.

110. This will include very practical advice on issues such as:

- Pre-empting problems, including through whole of government approaches;
- Negotiation issues – opportunities for tax officials to influence outcome;
- 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;
- Effectively inputting into decisions about arbitrators – knowing who the experts are;
- Working effectively with governmental leads (Ministries of Foreign Affairs and of Justice, for example); and
- Key issues for non-tax agreement dispute settlement.

111. Input on both workstreams will be sought from Committee Members, the OECD, UNCTAD (which has special expertise on tax treaties) other UN agencies and regional commissions as appropriate, academia, business and civil society, for example. A small focus group of Members of the Committee with whom the secretariat could consult with, would be especially useful.