E/C.18/2022/CRP.5

Distr.: General
18 March 2022

Original: English

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

Virtual meetings of 4-7 and 11-12 April 2022
Item 3 (p) of the provisional agenda
Relationship of tax, trade and investment agreements

Co-Coordinators' Report

Summary

This paper is *for approval* and proposes the following workstreams for the subcommittee on the Relationship of Tax, Trade and Investment Agreements:

- **Workstream A – Tax and Investment Agreements**: This workstream would develop a guidance note on tax (broadly defined to also include tax policy and administration measures, not just tax agreements) and its relationship with international investment agreements (IIAs).

- **Workstream B – Tax and GATS:** This workstream would consider the relationship of tax treaties and the WTO General Agreement on Trade in Services (GATS) – evaluating the GATS relationship with tax treaties and current and possible responses, including in relation to the current UN Model. This will involve liaison with the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries.

- **Workstream C – Other Issues in Trade Agreements or Mixed Trade and Investment Agreements:** This workstream would address interactions other than those dealt with by the first two workstreams. By the nature of this work it appears best initiated after further work is done on other aspects of the workplan – as part of a "staged" approach, but preliminary work could begin earlier.

The Subcommittee seeks *the Committee's views on the issues raised in this note and its approval* of the proposed course of action.

Background and Subcommittee Mandate

1. Note E/C.18/2021/CRP.36 ("the 2021 Note") on the relationship of taxation with trade and investment agreements gave a history of the UN Secretariat work on the interaction of taxation policy and administration, including an earlier note E/C.18/2019/CRP.14 ("the 2019 Note") on similar issues. The 2021 Note recognized the work of the United Nations Conference on Trade and Development (UNCTAD) in that area, notably the March 2021 publication: 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, and the UNCTAD publication itself acknowledges the 2019 Note.

2. The 2021 Note addressed the need for guidance to tax policymakers and administrators on a variety of issues about the interaction of trade and investment treaties with tax policy and administration, including, but not limited to, tax treaties.

3. At the Twenty-third Session the 2021 Note was considered and the Report of that Session noted the presentations made and the general discussion on the subject. As also indicated in the Report, at para 114:

> The Committee agreed to establish a Subcommittee on the Relationship of Tax, Trade and Investment Agreements, with Ms. Kana, Mr. Ligomeka, and Mr. Roelofsen as Co-Coordinators, and with the following mandate:
>
> The Subcommittee is mandated:
>
> - To identify priority issues where guidance from the Committee may most usefully assist developing countries in differing situations, in particular, on the relationship of tax with investment and trade agreements, and initially report to the Committee on such issues at its twenty-fourth session, in 2022
> - Within the above context, to make proposals for consideration by the Committee, with a view to providing guidance at various points during the current membership of the Committee
>
> The Subcommittee may consult broadly, taking into account relevant work by other bodies in this area.

First Meetings of the Subcommittee

4. Fifteen Members of the UN Tax Committee are participating in the Subcommittee, and two meetings of the Subcommittee so constituted were conducted virtually on 26 January and 3 March 2022 to consider the following issues:

- The composition of the Subcommittee;
- A proposed workplan; and
- The outline of a report to the Twenty-fourth Session.

This report reflects the outcome of those discussions.

Composition of the Subcommittee

5. As noted above, 15 Committee Members participate in the Subcommittee. In view of the size of that participation and the diversity of backgrounds and perspectives involved, the Subcommittee decided that the regular participation of the Subcommittee should remain as it is currently, comprised of Committee Members only. The specialist expertise that exists among other participants in the UN Tax Committee work was readily acknowledged, however, and it was also decided that other participants will be invited to participate on an ad hoc basis, as called for by the stage of Subcommittee work.

6. In view of the proposal below to have workstreams covering the impact on taxation and tax measures of trade agreements, investment agreements and mixed agreements, and the existence of specialist expertise in each of these areas, the proposed configuration is a flexible one that is seen as the best blend of continuity of the Subcommittee with the ability to dialogue with and draw upon leading expertise on relevant issues to ensure the most informed, practical and impactful guidance.

7. There are many possible ways in which this balance can be best achieved, including ad hoc participation of non-Committee Member experts in Subcommittee meetings, calls for written inputs and specific dialogue meetings with experts. In further refining its "outreach" strategy, which may vary across subject matters and at various stages of its work, the Subcommittee would welcome the views of Committee Members and Observers at the Twenty-fourth Session on modes of engagement.

Issues

8. The 2019 and 2021 Notes, as well as the UNCTAD 2021 publication, have provided initial information for the Subcommittee 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 agreements") and some issues for further enquiry.

9. The Notes examined some of the non-tax agreements that may impact on tax measures and administration, in the form of international investment agreements (IIAs), trade agreements, including World Trade Organisation (WTO) agreements such as the General Agreement on Trade in Services (GATS) and mixed trade and investment agreements ("mixed agreements") such as the increasing number of regional and inter-regional agreements.

10. The 2019 and 2021 Notes recognized that, in view of the breadth of coverage and treatment of trade and investment in non-tax agreements, there are inevitably overlaps between them and tax agreements. They indicated that how that overlap is managed, and the unresolved issues, vary from provision to provision, and agreement to agreement, and the Notes addressed some of the most potentially "clashing" provisions.

11. They also recognized that trade agreements and investment agreements could impact upon tax measures and administration more broadly, by for example challenges as to whether the measures or their administration meet tests provided for in such agreements, such as "most favoured nation treatment", "national treatment" or "fair and equitable treatment". It is important to note, therefore, that the Subcommittee mandate addresses not just how non-tax agreements affect the operation of tax agreements (important though that issue is) but also the impact upon tax policy and administration more generally.

12. The 2019 and 2021 Notes indicated that the challenges in this area relate broadly to;

a. Lack of awareness among tax officials of the potential impact of non-tax agreements on tax measures, including legislation, regulation and administration;

b. Lack of awareness among 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" as 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; and

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 investment

agreements and very specific trade agreement provisions. For tax treaties, 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, though it is an option provided for in the UN Model Tax Convention.

Investment Agreements

13. Without preempting the consideration by the Subcommittee, the 2019 and 2021 Notes, along with the UNCTAD publication, point to some specific and important areas of interaction, and possible roles for Tax Committee guidance in relation to them, including:

- ***Definitions, such as of "investments" and of "investors"*** which can have a tax impact (such as by providing "indirect investors" with treaty protection);
- ***National Treatment*** (NT) provisions in IIAs protect foreign investors against *de facto* and *de jure* discrimination, *vis-à-vis* national investors. From a tax perspective, it is generally accepted that distinctions in treatment can be made between residents and non-residents, thus also allowing preferential treatment of the former in some cases. As a result, differentiation between foreign investors and national investors in taxation measures may be found to go against NT as defined in IIAs. To resolve this disjuncture, explicitly including exceptions to NT provisions in IIAs, so as to allow tax measures to preserve this differential treatment, is important;
- ***Most Favoured Nation*** (MFN) provisions ensure that the treatment offered to a foreign investor of one state is also offered to foreign investors of another state. Without exceptions to MFN provisions, foreign investors may seek to import favorable tax treatment from another state's Double Tax Treaty with the host state, under the guise of the IIA MFN provisions. This could include dispute settlement as well as substantive treatment. The MFN provisions thus may require limitations;
- ***Fair and Equitable Treatment*** (FET) provisions are broad and may cover an array of investor expectations such as transparency and regulatory stability as well as "due process". Given the recurring changes in tax regulation and the breadth of application of this provision by investment tribunals, it is increasingly likely that investors will bring disputes under the FET provisions. Tax policy makers and tax administrations should be aware, not only of the open-ended FET provisions but further still, the high number of tax related investment treaty dispute claims brought under (at least in part) FET provisions;
- ***Expropriation.*** In old IIAs, not only direct expropriation but also indirect expropriation may be covered. Indirect expropriation refers to the near-total deprivation of an investment without formal expropriation. Investors have at times successfully challenged some tax measures, stating that they amount to indirect expropriation. The issue arises of how the proper functioning of tax systems can be protected from a finding of expropriation, without taxation being used a covert means of expropriation; and
- ***Umbrella Clauses*** within IIAs, require states to uphold contractual obligations related to specific investments. The otherwise purely contractual obligations between the state and a foreign investor then fall under international treaty obligations in the sense that breach of the former will be a breach of the latter - another point of concern for tax authorities, as contractual standstill or stabilization clauses may prevent updating new tax systems or reducing tax incentives.

14. Newer IIAs seek to address many of these issues, but many older IIAs still operate. Noting the newer options would be a part of the role of guidance in this area.

Tax Treaties and the General Agreement on Trade in Services

15. As indicated in the 2021 Note, the World Trade Organisation (WTO) General Agreement on

Trade in Services (GATS) is a trade agreement but also, because the definition of modes of service provision, 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 residence, as allowed by tax treaties, might be in violation of the GATS National Treatment obligation, since trade and investment agreements generally do not permit such a distinction (as noted above).

16. 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". Because of the issue noted above, the GATS was amended, before its conclusion, to incorporate a footnote to that provision intended to illustrate with some degree of specificity what WTO Members regarded as measures meeting the "equitable or effective" standard.

17. 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".

18. 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 which oversees the GATS Agreement.

19. 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, notes 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.' "

20. As indicated in the 2021 Note, few countries, especially developing countries, actually make use of that provision. The decision on whether an issue is within the scope of a tax treaty is therefore in most cases left to non-tax experts in the WTO dispute settlement system.

21. This current work presents an opportunity to re-evaluate the issues, risks and any opportunities in this area. Questions include: whether the provision should be elevated from an option in the Model Commentaries to a provision in the text of the Convention itself, whether further elaboration of the issue might be required, and whether or not a similar provision may be useful in relation to other trade-related agreements, especially the increasingly common regional trade and investment agreements. Some aspects of the work will involve some coordination with the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries.

A Proposed Workplan

22. The Subcommittee, in the light of its mandate and the issues noted above, considers that focused guidance that helps officials in both developing and developed countries assess the scope of the interaction of trade and investment agreements (including mixed trade and investment agreements) to manage the risks, to promote whole of government approaches and to ultimately improve the way in which areas of interaction are identified and addressed, would represent a unique and practical UN Tax Committee contribution.

23. The Subcommittee proposes guidance in three workstreams, to be completed during the term of the current Membership. The proposed workstreams are as follows:

Workstream A – Tax and Investment Agreements

24. This workstream would give guidance on tax (broadly defined to also include tax policy and administration measures, not just tax agreements) and its relationship with IIAs, addressing issues for tax officials involved in IIA negotiations (and encouraging tax representation in developing negotiating positions and conducting negotiations). It would also address policy and administration issues that may arise as to the way tax treaties interact with IIA provisions, but also how domestic law may interact (such as whether some IIAs require a certain level of domestic law "due process"). Guidance in this area may prevent disputes arising. This workstream may also provide useful practical guidance for tax officials once a dispute has arisen.

25. This workstream can build upon other work in this area, including the 2021 UNCTAD publication, by providing practical guidance for tax officials, especially in developing countries, to identify and manage risks in this area.

26. The proposed product would be a guidance note that meets the objectives outlined in paragraph 33 of this paper. Assuming drafting is considered twice by the Committee,[1] at the Twenty-fifth and Twenty-sixth Sessions, the guidance note should be completed at the Twenty-sixth (approximately April 2023) Session, or at latest, the Twenty-seventh Session (approximately October 2023). Completion at the Twenty-seventh Session is perhaps most likely because some of the drafting is likely to be seen for the first time at the Twenty-sixth Session.

Workstream B – Tax and Investment Agreements - Relationship of Tax Treaties and WTO General Agreement on Trade in Services (GATS)

27. As noted above, this workstream would review General Agreement on Trade in Services (GATS) provisions (especially on National Treatment) and their relationship to tax treaties. It would consider results with and without the optional wording found in Part D of the Model Commentary on Article 25 ("Interaction Between the Mutual Agreement Procedure and the Dispute Resolution Mechanism of the GATS") as well as the usage of the optional wording in practice, and it would make recommendations on the optional wording and its usage. As noted above, it would involve some coordination with the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries.

28. There may be other interactions of tax policy and administration and the GATS, but they would be best considered as part of Workstream C.

29. The proposed product would be a guidance note that meets the objectives outlined in paragraph 33 of this paper. The timeframe would be the same as for Workstream A.

[1] The Committee Practices and Working Methods provides at para. 41 that "[a]s a best practice, the Committee should not be invited to approve a document that is presented (or circulated under written procedure) for the first time. In this context, a document that was previously presented (or circulated), and has been revised, is not considered to be presented (or circulated) for the first time."

Workstream C – Issues in trade agreements or mixed trade and investment agreements other than those addressed by the first two workstream.

30. A third workstream involves considering issues in trade agreements (possibly including issues under other WTO agreements such as the WTO Subsidies and Countervailing Measures Agreement) or mixed trade and investment agreements, being issues *other than* those addressed by the first two workstreams. By the nature of this work it appears best to fully initiate it after further work is done on other aspects of the workplan – as part of a "staged" approach. This would better allow the Subcommittee to identify and work on these Workstream C issues. However, the Subcommittee will continue to identify such issues, and will seek Committee guidance at a later session.

31. The proposed product would be a guidance note that meets the objectives outlined in paragraph 33 of this paper.

32. Assuming drafting is considered twice by the Committee, at the Twenty-sixth and Twenty-seventh Sessions, consideration of any guidance note should be completed at the Twenty-seventh Session (approximately October 2023) or at latest, the Twenty-eighth Session (approximately April 2024).

General Objectives

33. Subcommittee objectives, consistent with the mandate, are to propose guidance on issues of the relationship of taxation with investment agreements, trade agreement and mixed trade and investment agreements to:

- Help avoid impediments to the operation of effective and efficient tax systems;
- Create awareness of the potential impact of non-tax agreements on tax policy and administration;
- Assist tax officials involved with trade or investment treaty policy or negotiation;
- Encourage understanding between tax, trade and investment experts, including as to language used;
- Encourage whole of government approaches;
- Assist officials in countries generally, but particularly taking account of issues and priorities for:
    - those using the UN Model; and
    - the least developed; and
- Seek to finalize guidance in various tranches during the Committee Membership, not only at the end of the 4-year term.

Proposed Workplan and the Sustainable Development Goals

34. As noted in the Report of the Committee's Twenty-third Session, held in October 2021, the Committee agreed:

(a) To continue to discuss taxation and the Sustainable Development Goals regularly during sessions, as a permanent agenda item;

(b) To request the secretariat to provide regular updates on taxation and the Sustainable Development Goals, at each session:

(i) To preserve the focus of the Committee's work in the area;

(ii) To identify any gaps in guidance;

(iii) To establish priorities for technical work to be carried out by the secretariat; and

(c) To have subcommittees reflect on the link between their work and the Goals.

35. In addressing paragraph (c) of that conclusion, the subcommittee recognizes that by promoting fair and effective tax systems, which support both revenue and trade and investment for development, through guidance products and through advising UN DESA on capacity building activities, the Committee's work contributes to achieving the interlinked SDGs as a totality.

36. More specifically in relation to the work of the Subcommittee, an effective guidance effort in this area will promote the balance of revenue needs and the development-focused investment climate which many countries seek, by promoting whole of government, informed approaches to interlinked tax, trade and investment policy objectives. This builds greater certainty for all stakeholders in tax systems. While contributing to achieving all the interlinked SDGs, this will particularly contribute to SDG 16 (Peace, Justice and Strong Institutions) in terms of helping develop effective, accountable and transparent institutions at all levels and SDG 17 (Global Partnerships for the Goals), in terms of strengthening domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.

Matters for Decision and Next Steps.

37. The Subcommittee proposes, subject to Committee views, to commence work on Workstreams A and B after this Twenty-fourth Session of the Committee, and to collect information on possible issues for Workstream C, reporting further on all workstreams at the Twenty-fifth Session of the Committee.

38. The Subcommittee expects that it will have first drafting for aspects of Workstream A for consideration at the Committee's Twenty-fifth Session. It expects to further analyze the issues involved in Workstream B and to seek guidance at the Twenty-fifth Session. It may have Workstream B drafting proposals at that Session. It will also liaise with the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries to coordinate any work on the "GATS Clause". The cross participation of many Committee Members in the two subcommittees should assist this process. We will report on this and other aspects of the work (including any initial preliminary work on Workstream C) at the Twenty-fifth Session of the Committee.

39. The Subcommittee seeks *the Committee's views on the issues raised in this note and its approval* of the proposed course of action.