



Trade Agreements and Taxation: Removing the Final Barrier to Trade

by

Mr. Hafiz Choudhury and Dr. Jeffrey Owens*

Introduction

The interplay of international trade and tax rules has not been the subject of much analysis, and practitioners in one area have generally eschewed a role in the other. This concept paper analyses the inter-relationship of tax and trade rules, in particular since the formation of the WTO, and considers how tax regimes affect the intent and actual implementation of trade rules.

A number of key rulings of the WTO dispute settlement bodies on the US FSC and ETI regimes, and a larger group of decisions on indirect tax issues in respect of Chile, the Philippines, Korea and Japan are some of the most notable examples where international trade rules have impacted national tax issues. Further, there have been a number of other tax issues raised within the dispute settlement mechanisms of the WTO and those under the GATT 1947 rules, which formed the basis of international trade regulation prior to the formation of the WTO.

The GATT 1947 rules and relevant cases brought before Panels formed under the agreement have established some tax principles, mainly for indirect taxes applicable to international trade in goods. However as the international trade regime is restructured to encompass services, investment measures and so forth, it is worthwhile to re-examine this area to understand

- The interplay of bilateral, regional and global trade agreements, and how national tax rules impact them.

- How the more comprehensive WTO regime can influence the limits of what states can and cannot do in the fiscal area.

This paper outlines a possible research task to analyze the above issues and also investigate how national and international tax developments impact the free movement of goods and services.

Interaction of Different Trade Rules

The project may begin by considering the layers of trade agreements and the areas of tax that each may affect. The types of agreements that may be included in the research would include:

1. WTO/GATT: The WTO/GATT agreements include wide ranging agreements in respect of trade. These have consequences on the tax/trade debate through:
 - A. The application of the “national treatment” rule under GATT Art. III (National Treatment on Internal Taxation and Regulation).
 - B. The SCM Agreement which prevents use of tax measures to support domestic industry.
 - C. Customs duty rates and quotas and in facilitating customs dispute resolution
 - D. Most-favoured nation treatment which is designed to ensure parity of treatment amongst WTO members.

**Mr. Hafiz Choudhury is a Senior Advisor for the International Tax and Investment Center (ITIC), and a Principal for The M Group Inc. He is the Former Director of the International Bureau of Fiscal Documentation. Dr. Jeffrey Owens is a Distinguished Fellow for the International Tax and Investment Center and a Professor at the Institute for Austrian and International Tax Law, Vienna University of Economics and Business. He is the former Head of the Centre for Tax Policy and Administration at the Organisation for Economic Co-operation and Development.*

2. General Agreement on Trade in Services (GATS): In a world economy where trade in services is increasingly important, the interaction of the international tax regime for services, which is still in development, and the international trade regime for services set up by GATS will need to be considered.
3. Regional agreements: Regional agreements bring together groups of countries at various stages of economic integration. These will include:
 - A. Groupings that have already developed or plan to develop a common framework on indirect taxes (e.g. EU, GCC).
 - B. Groups where there are also attempts to harmonize direct taxes e.g. through EU case law, and development of initiatives on home state taxation and a common tax base or arrangements such as the Andean Community agreement on double taxation.
 - C. Implementation of a customs union (e.g. EU, Mercosur, GCC, ASEAN etc.);
4. Agreements between regional groupings: (e.g. progress towards an EU-Mercosur agreement and possible consequences for tax/customs duties).
5. Single country-grouping agreements: Variants of FTAs that are concluded between regional groupings and single countries, (e.g. ASEAN-China; ASEAN-Australia etc.), generally with less wide ranging provisions than those within regional groupings.
6. Free trade agreements: FTAs generally include an agreement to lower customs duties between partners. They are concluded between individual countries, or can be regional (e.g. NAFTA).

These networks of arrangements have created a plethora of interlocking, and possibly some mutually incompatible, obligations. The study will examine the possible impact of these arrangements on domestic and bilateral tax regimes.

Interplay with Bilateral and Multilateral Investment Guarantee Agreements

A separate, but related, concept paper addresses the question of interaction of bilateral investment protection treaties (BITs) and double taxation agreements (DTAs). Bilateral investment protection agreements may have taxation impact; e.g. a claimant may invoke the BIT to assert that a taxation measure amounts to an expropriation, or use the arbitration procedures in the BIT to settle a tax issue. The BIT should clarify which treaty takes

precedence when there is a conflict between the terms of the treaty and the terms of a double taxation agreement.

Creation of multilateral investment guarantee agency and trade promotion arrangements (e.g. Hermes, MIGA, etc.) may add a trade component to these issues. Discussion on these issues have also raised the question as to whether regional development policies that combine trade and tax incentives (e.g. special economic zones which offer special treatment) are compatible with the tax arrangements, especially “most favoured nation” status questions in DTAs.

Technical Issues to be Considered

1. **Legal position of international agreements in national systems:** The study would look at interaction of treaties within the legal system of a particular country. This will examine the order of priority in case of conflicting interpretations and provisions for dispute resolution. It will also look at implementation of multilateral agreements within national law, differences in approach of such application, and examine the impact of gaps between international legal obligations and actual application of such principles.
2. **Interaction of trade rules on goods and tax issues/agreements, and their relative hierarchy:** As mentioned above, the regime for trade in goods has a longer track record and E.g. the World Customs Organization (WCO) sets out rules for valuation of goods crossing national borders for the purposes of customs duties. These valuations are collected by customs and could influence indirect taxes – e.g. VAT which is often collected at the border. Also, customs valuations and transfer pricing is a live area. Advance pricing agreements for both tax and customs purposes have been proposed.
3. **Trade agreements and tax on services and intangibles**
 - A. Agreements on International trade in services – The GATS does not have the same tax implications as WTO/GATT. International trade in services is therefore subject to provisions of national legislation and tax treaties in relation to PE and business taxation.
 - B. The impact of domestic indirect tax/VAT laws on services, and increasingly the rule making at regional levels, in particular within the EU, but also at ASEAN, GCC and EAC.

C. Agreements on Intangibles for direct taxation- The definition and valuation of intangibles for direct tax purposes is still a work in progress. However, consistent definition and valuation are important for the application of trade rules, since they have both tariff (mainly customs duties) and non-tariff implications. The OECD project on intangibles, the UN work on services/revision of the commentary to Art. 12 on the UN Model, and the BEPS project work on valuation will be important for trade issues. A direct practical impact will be in determining royalty/license fee in valuation of imported goods for customs duty purposes.

4. **Tax transparency and information exchange:** the research should include international agreements on these issues and their implementation in national laws. It should also look at the OECD/ Council of Europe Convention on mutual assistance in tax matters and regional arrangements – e.g. EU mutual assistance agreement – along with the relevant trade rules. Other areas to review are the impact of the OECD guidance on TIEAs, bilateral TIEAs and peer reviews under the Global Forum. Finally, DTAs generally contain an article on exchange of information and the potential impact of such arrangements on trade matters at a bilateral level should be considered.

Design of Research Program

The research programme could be structured with the following components:

- Initial desk research to examine the issues above and develop preliminary conclusions.
- Test such conclusions with private sector stakeholders to ensure that they are truly issues that affect international business and a pro-growth agenda, in line with ITIC's core principles.
- Bring together private and public sector stakeholders to outline the issues and consider how such issues can be solved. Possible partners in this area would be IFC, OECD, UNCTAD and WTO. The WCO and the EU may also be interested.

It is proposed that the research be structured around specific countries from different income levels and regions, and start from making a full inventory of their tax and trade agreements. This would enable the research work to then consider the interplay of their bilateral, regional and international obligations, and the actual impact of those

obligations on the above technical areas. The sample of countries should be drawn from OECD, BRIICS, low, middle/ high income and resource rich categories, and include a wide enough sample of the world's leading REC arrangements (EU, ASEAN, Mercosur, EAC).

The desk analysis would start from the national level, i.e. consider how international trade and tax governance was structured nationally, including the role of any "one stop" agencies to coordinate such matters (e.g. Boards of Investment). It would then progress to regional and global level arrangements, within a framework that tests for the key technical areas mentioned above.

The goal of the research would be

- To develop guidelines that international business can use in scenario planning for trade and investment, and refer to in developing risk statements for investments, especially in non-OECD markets.
- To propose to governments and multilateral bodies some approaches to clarify areas where international business faces tax barriers to international trade.

A mechanism that might be used for the latter could be the multilateral instrument envisaged under OECD/G20 BEPS project and action plan – an aim of the action plan is to develop a multilateral instrument to implement measures developed in the course of the work on BEPS, to enable countries to update their tax agreements without having to amend every DTA. Conclusions reached through research work could be proposed to national governments through ITIC's extensive network of engagement, and at forums such as BIAC. A detailed engagement plan would therefore be part of the project.