The Impact of Trade and Investment Treaties on Mobilization of Taxation in Developing Countries

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EXECUTIVE SUMMARY

Developing countries need more fiscal revenue to build their infrastructure, achieve energy security and environmental sustainability, and provide social services necessary for human development. The Sustainable Development Goals also recognize the importance of fiscal mobilization (SDG 17.1 and 17.4). While trade and investment treaties have typically been assumed to be tax revenue-neutral, economic studies demonstrate that such is not, in fact, the case. The legal literature has not given much consideration to this issue, assuming instead that the tax effects of economic globalization were addressed by bilateral tax treaties. However, constraints on developing countries' fiscal resources resulting from trade and investment treaties are complex and nuanced, and they go much beyond the jurisdictional overlaps addressed by tax treaties. Trade and investment treaties constrain how countries design their tax policy, how they enforce it and how they may change it. Because of the significant cost of implementing treaty obligations, developing countries also experience a shortfall in revenue to cover for such costs.

This study offers several findings on the direct impact of trade treaties on the ability to raise revenue. First, the decrease of tariff rates at the WTO and in regional trade agreements has decreased the amount of revenue available to developing countries. Moreover, the emergence of a digital economy has substituted digital versions of traditional products and created vast opportunities for a range of digital transactions that are currently not subject to customs duties thanks to a WTO moratorium. Second, non-discrimination commitments such as the national treatment and most-favored nation obligations constrain countries' abilities to design their tax policy with respect to foreign products and foreign service suppliers. Here again, there are additional challenges with respect to the digital economy pertaining to classification of the activities, attribution of the activities to particular jurisdictions for taxation purposes and enforcing systems that would enable developing countries

to reap fiscal benefits from activities involving their territories but that are largely involving large foreign tech entities. Not only are countries' ability to tax remote businesses operating in its territory

impeded, but the tax burden falling on local competitors puts them at a competitive disadvantage vis-à-vis foreign operators.

This paper then analyzes the constraints investment treaties impose on changes in domestic tax policy. By seeking to guarantee a stable and predictable business environment for foreign investors, investment treaties constrain states' domestic policy autonomy in changing their tax system, or the application and enforcement thereof. A significant number of investor-state arbitrations have alleged that a host country's tax measure amounted to expropriation, breach of non-discrimination obligations, fair and equitable treatment or otherwise interfered with the use and enjoyment of an investment. Many of these claims have been unsuccessful but still required the state to devote resources to their defense, and possibly shy away from taking future measures (chilling effect).

A number of provisions exist in trade and investment treaties to preserve the state's fiscal autonomy, either by excluding taxation matters from the ambit of the treaty, or allowing the state to raise tariffs or to take exceptional measures. However, these provisions tend to be limited in scope because they are merely designed to avoid conflicts between tax treaties on the one hand and trade and investment treaties on the other hand. New investment agreement negotiations show significant moves by developing countries in particular to both strengthen tax compliance obligations on foreign entities and to carve out more policy autonomy for themselves against regulatory encroachment from trade and investment treaties.

Introduction

Developing countries need more fiscal revenue to build their infrastructure, achieve energy security and environmental sustainability, and provide social services necessary for human development. The United Nations' Sustainable Development Goals 17.1 and 17.4 also enshrine the need to improve tax mobilization. While trade and investment treaties have typically been assumed to be revenue-neutral, economic studies demonstrate that such is not, in fact, the case. The legal literature has not given much consideration to this issue, assuming instead that the tax effects of economic globalization were addressed by bilateral tax treaties meant to avoid double taxation. However, as a practical matter, double taxation treaties are not meant to address, redress or otherwise complement trade and investment treaties when it comes to fiscal impact or tax mobilization. Moreover, as a normative matter, trade and investment treaties have a myriad more consequences on taxation than has been recognized so far, particularly for developing countries. This article assesses the range of impacts that trade and investment treaties have on domestic tax policy and on countries' ability to reshape their tax policy as their socio-economic requirements evolve. It then draws out the implications for the negotiation of future trade and investment treaties as well as for domestic tax policy-making.

Table 1: Impact of Trade and Investment Treaties for Domestic Tax Policy

Present Impact	Future Impact
• Decreased tax revenue due to trade liberalization • Limitation on the ability to tax some economic activities • Limitations on differential taxes for foreign and domestic operators	• Constraints on changes in tax policy • Constraints on changes in judicial interpretation • Constraints on changes in enforcement

Overall, trade and investment treaties have a positive fiscal impact for rich countries, a neutral impact for middle income countries and have a negative fiscal impact for poor countries.[1] In broad terms, trade liberalization until the 1990s has proceeded largely by decreasing tariff rates levied on traded goods. Economic theory argues that such loss can and should be offset by increased fiscal revenues from the increased economic activity resulting from a more liberal and global economy. This is typically done by mobilizing direct taxation on personal income and corporate profits, tangible and intangible property, as well as levying indirect taxation on consumption, use, etc.[2]

However, poor countries are typically unable to offset the loss of tariff revenue with increased revenue from income and profit taxation, or even from broad based consumption taxes. The inability to make up for lost revenue is due to the informal nature of much of these countries' economies, poor governance, limited administrative, judicial and police infrastructure and resources to create, administer and enforce a tax system, and a limited tax base, amongst others. Overall, then, the loss of tax revenues due to decrease in tariff barriers translated into a net loss of revenue for low income countries. In those countries, the decrease duty rates was not offset by an increase in volume of imports or a general growth in their economies.

Trade and investment treaties can also add constraints to developing countries' ability to reform and enhance their tax regime. For instance, guarantees in favor of foreign investors in bilateral investment treaties can create a presumption in favor of the status quo at the time the investment is made. As a result,

1 Devika Dutt, Kevin P. Gallagher, Rachel D. Thrasher, Trade Liberalization and Fiscal Stability: What the Evidence Tells Us, GLOBAL POLICY JOURNAL (forthcoming 2019).

2 See generally, Liam Ebrill, Julia Stotsky, and Reint Gropp, Revenue aspects of trade liberalization, INTERNATIONAL MONETARY FUND OCCASIONAL PAPER SERIES 180 (1999); M. Shahe Emram and Joseph E. Stiglitz, On selective indirect tax reform in developing countries, 84 JOURNAL OF PUBLIC ECONOMICS 623 (2005); Thomas Baunsgaard and Michael Keen, Tax revenue and (or?) trade liberalization, 94 JOURNAL OF PUBLIC ECONOMICS 563 (2010).

foreign investors may bring claims for money against states subsequently changing the interpretation or enforcement of their tax policy.

Constraints on developing countries' fiscal resources resulting from trade and investment treaties are much more complex and nuanced than the mere loss of tariff revenue. For developing countries aiming to mobilize their fiscal resources more effectively, a first step is to fully understand the impact of their current trade and investment commitments on tax policy. Second, they must be able to evaluate the fiscal impact of future trade and investment negotiations. Both aspects are essential for developing countries' ability to exercise their fiscal sovereignty in a dynamic environment, where their domestic socio-economic needs change over time and the international framework also evolves with ongoing negotiations.

Table 2: Tax Issues Relating to Trade and Investment Treaties

Tax Issues Relating to Trade and Investment Treaties
• How does a proposed trade or investment treaty impact the country's ability to tax entities or activities within its borders?
• Does a proposed domestic tax measure run against a trade treaty commitment?
• Does a new domestic tax measure expose the country to liability under an investment treaty?

The relationship between taxation and global economic liberalization and integration is multifaceted and this paper explores a limited aspect of this complexity. Beyond trade and investment treaties, a number of other legal sources have a bearing on the matter, but are beyond the scope of this study. Customary international law on foreign investment, private and contractual agreements between states and investors, and double taxation treaties are some examples. Likewise, developing countries' capacity to mobilize fiscal resources is contingent on many factors other than trade and investment treaties. Domestic administrative capacity, governance and corruption problems, tax evasion and tax avoidance by domestic and foreign entities, the volume of the informal economy, how concentrated or diversified is the economy and geopolitical factors such as the relative size of the territory and the population all massively affect how many fiscal resources need to be generated, how and whether they can be generated. From a tax perspective, there are a number of tax instruments that have been left out of this study because they do not pertain directly to developing countries' ability to mobilize their fiscal resources. For instance, carbon tax adjustment and other forms of border tax adjustment all raise complex issues in relation to trade and investment treaties but they tend to be deployed by developed countries to counter policies or conditions in developing countries.

This paper first maps the direct impact of trade treaties on the ability to raise revenue (Section I). No less importantly, it analyzes the constraints that investment treaties may impose on future changes in domestic tax policy (Section II). It concludes with some outlook on how future negotiations might incorporate more awareness of the tax impact of trade and investment treaties and increase developing countries' ability to preserve their fiscal sovereignty (Section III).

Constraints on Domestic Taxation from Agreements on Trade in Goods and Services

Trade law's most direct and clear impact on countries' tax resources is the decrease in duties levied on trade in goods (also called tariffs). Trade liberalization since World War II has involved a multilateral process of converting trade barriers to tariffs and reducing these tariffs in successive rounds of trade negotiations. This process has therefore first generated fiscal revenue for governments converting non-revenue producing quotas and other non-tariff barriers into tariffs, followed by a decrease in tariffs.

Section A discusses trade law's effect on countries' ability to raise revenue from customs duties.

Trade law also regulates trade in services, which includes cross-border e-commerce. Agreements on trade in services impose qualitative regulatory restrictions, which are typically not phrased in reference to taxation but that nevertheless have a bearing on how countries can design their tax policy on trade in services. Section B maps the intersection of trade disciplines modelled after the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) and various types of domestic taxes.

Decreased Revenue from Customs Duties on Goods

The WTO's General Agreement on Tariffs and Trade (GATT) and other trade agreements generally comprise commitments by participating countries to reduce their import duties. GATT Article II incorporates individual country commitments (schedules of concessions) into the multilateral agreement. In their schedules, countries typically agree to fix their import duty rates at a "bound" rate, though they are free to apply a lower rate if they wish.

Mean applied weighted tariffs worldwide stand at 2.59 percent in 2017, down from 8.57 percent in 1995.[3] While high income countries have an average rate of 2 percent, low income countries have the highest rate, at 9 percent.[4] Fiscal revenue from these tariff duties on imports vary depending on the overall value and volume of the imported products. Countries could raise their tariffs up to the bound rates, and therefore increase their fiscal revenue from tariffs, assuming the volume and value of trade does not decrease in response to the higher rate.[5] However, bound rates are only slightly higher than applied rates on average, giving little room for low income countries to increase applied rates up to the maximum bound level.[6] There are important variations by country and by product, which is particularly significant for undiversified economies. Tariff bindings in regional trade agreements tend to be even lower than the multilateral Most Favored Nation (MFN) rates generally applicable to WTO members.[7]

Overall, trade law, whether at the WTO or in other forums, has been very effective at converting trade barriers into tariffs and then bringing those tariffs down. At the WTO, schedules of concessions, combined with the MFN clause ensures that trade partners get the most favorable treatment accorded to any other trade partner (including non-WTO) by that country, which puts further downward pressure on applicable tariff rates.

The GATT is ambiguous with respect to export duties. Arguably, WTO members are not explicitly prohibited from imposing export duties and no framework exists for schedules of concessions to export duties. Article II on Schedules of Concessions only contemplates import duties. By contrast, both the MFN clause (Article

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3 Tariff rate, applied, weighted mean, all products (%), https://data.worldbank.org/indicator/tm.tax.mrch.wm.ar.zs?end=2017&start=1988

4 Brazil's rate is 8.6 percent, China stands at 3.8 percent, India at 5.8 percent. Tariff rate, applied, weighted mean, all products (%), https://data.worldbank.org/indicator/tm.tax.mrch.wm.ar.zs?end=2017&start=1988

5 The Laffer curve predicts that at a certain point, increases in tariffs are inefficient because they cause a decrease in imports, resulting in a loss of overall revenue. How this theory applies in practice may depend on a number of factors. For instance, are the local customs authorities effective at administering the increased duties? Are there substitute domestic goods that will affect the tipping point at which increased duties no longer generate additional revenue? Other legal constraints may also come into play. For instance, could foreign investors affected by the increased tariffs claim that the change amounts to a breach of fair and equitable treatment under an applicable bilateral treaty (see further discussion in Section II.B below)?

- 6 The weighted mean most-favored nation tariff for the world is 4.17 percent, it is 3.4 percent for high income countries and 10.8 percent for low income countries. Tariff rate, most favored nation, weighted mean, all products (%), https://data.worldbank.org/indicator/TM.TAX.MRCH.WM.FN.ZS.
- 7 The GATT's MFN clause provides that "[w]ith respect to customs duties…imposed on or in connection with importation or exportations…, any advantage…granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." General Agreement on Tariffs and Trade, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1 [hereinafter GATT] art. I:1.

I) and the prohibitions on quotas (Article XI) specifically address restrictions on exports, which suggest that omitting exports from Article II was intentional. Therefore, there may be some leeway for members to impose export taxes generally. Resource-rich countries, particularly in Latin America and Africa, could therefore use counter-cyclical export taxes on commodities to finance economic diversification and development. Article XI:2 also specifically authorizes export restrictions "to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party" on a temporary basis and a few other cases. Limited litigation on this issue has focused on China's export restrictions on raw commodities, but China's accession agreements provided additional commitments, in particular an obligation to phase out export taxes on all but about 80 products.[8] Schedules of accession for a number of other countries have also explicitly closed the loophole on export duties to a large extent. Some regional trade agreements, including NAFTA, specifically phase out export duties. Developing countries wishing to avail themselves of the potential for strategic export taxes should be mindful whether such options continue to exist in future negotiations, particularly in bilateral and regional trade agreements.

Negotiations on tariffs may take several forms, which can affect fiscal revenues to varying degrees. Box 3 highlights some of the considerations that may come into play.

Table 3: Tariff Negotiations: A Tax Policy Checklist

Tariff Negotiations: A Tax Policy Checklist
• Negotiation modalities: formula-based negotiations for tariff cuts across the board result in less control over the fiscal impact of the cuts depending on the structure of imports. Line-by-line negotiations may preserve higher tariffs on key imports.
• Where is the tariff on the Laffer Curve? Would a decrease in tariff rate increase the volume of imports, ultimately generating the same net amount of duties? If not, how will the state make up for the lost revenue? This also depends on the efficiency of duties collection overall and in particular sectors.
• Production and consumption elasticity: what is the production and consumption elasticity between the imported and the domestic competing product and how will it be affected by a decreased tariff?
• Weighting the present and future effects of a trade negotiation: what are the economic projections regarding the relative growth or contraction of imports by sector or product? This affects the country's future ability to raise revenue through tariffs.
• Can the country benefit from an exemption from tariff cuts? For example, Least Developed Countries are typically not obligated to make reciprocal concessions.

Trade in goods derived from e-commerce further erodes revenues from tariff duties. Indeed, individual online purchases of physical products from abroad are often classified as personal household goods for customs purposes, which typically means a low or zero tariff duty. The same product imported in bulk for retail resale would be classified based on the actual product and subject to import tariffs applying to such product. Alternatively, individual shipments, often of low value, may be exempt from customs duties under *de minimis* exceptions (as it would be more costly to administer and collect duties on such transactions than the value of the duty itself).[9] The WTO moratorium on customs duties on electronic transactions has further eroded revenues, with estimates of nearly USD 5.2 billion for developing countries (excluding Least Developing Countries) of revenue foregone, using the average MFN applied rates and a further USD 344 million for LDCs

8 Report of the Appellate Body, China — Measures Related to the Exportation of Various Raw Materials, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (Jan. 30, 2012); Report of the Panel, China — Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum, WT/DS431/R, WT/DS432/R, WT/DS433/R (March 26, 2014).

9 Susanne Teltscher, Tariffs, Taxes and Electronic Commerce: Revenue Implications for Developing Countries, UNCTAD/ITCD/TAB/5, UN Sales No. E.00.II.D.36 (2000) at 9.

alone. In contrast, developed countries are estimated to be losing less than USD 290 million.[10]

Trade agreements are very much in the business of decreasing how much countries are able to levy in import tariffs. With the export duties issues in the limelight, future trade agreements are also likely to limit that revenue stream. A number of exceptions and flexibility mechanisms exist, which would allow countries to raise import duties in exceptional circumstances, often on a temporary basis, and typically involving some compensation to the affected exporting countries. These options will be examined in Section III.A below.

Constraints on Tax Policy from Trade Treaties

In addition to the direct constraints on fiscal revenue resulting from decreased bound and applied tariffs, international trade law imposes a number of restrictions regarding countries' tax policy. This section reviews typical provisions from trade treaties that constrain domestic tax policy.

1. NULLIFICATION AND IMPAIRMENT OF TRADE BENEFITS

The GATT provides a remedy when a benefit accruing under the agreements to another party is "nullified or impaired" by "the application by another contracting party of any measure, whether or not it conflicts with the provisions" of the agreement.[11] For instance, a member seeking to roll back on a tariff concession by imposing some other form of internal tax would be prevented from doing so, even if the new tax was not directly in violation of another GATT obligation, such as national treatment or most-favored nation. Even if the country did not have the intent to impair another member's trade benefit, but changed its tax legislation in a way that affected another member, the measure would be challengeable.

This provision has been seldom used, and never with respect to a tax measure.

2. NON-DISCRIMINATORY TAX TREATMENT REQUIREMENTS WITHIN THE BORDER

Aside from tariffs, most domestic tax policy comes under scrutiny under trade treaties as a result of non-discrimination obligations undertaken by states. These obligations fall broadly into two categories:

- Most favored nation (MFN) obligations amongst foreign operators, generally requiring states to treat the products, services, and service providers of another country no less favorably than it treats the like products, services, and providers of the most favored trade partners, and
- National treatment obligation generally requiring states to treat foreign products, services and providers no less favorably than the treatment accorded to like products, services, and providers.

The GATT's MFN clause requires that WTO members extend no less favorable treatment to all other WTO members than it extends to any other country, including with respect to domestic taxes and other such charges.[12] This obligation came into play with respect to taxation most recently in the case brought against Brazil's industrial policy program for the automobile sector (INOVAR-AUTO). The panel confirmed that tax reductions available under the INOVAR-AUTO program fell within the scope of GATT article I:1 and that since some of these tax advantages were granted only to Mexico and MERCOSUR members, they were inconsistent with the MFN clause.
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10 Rashmi Banga, Growing Trade in Electronic Transmissions: Implications for the South, UNCTAD RESEARCH PAPER No. 29, 18 (2019).

11 GATT art. XIII:1(b).

12 GATT art. I:1 (extending MFN treatment to "all matters referred to in paragraphs 2 and 4 of Article III."); GATT art. III:2 (addressing foreign products subjected "directly or indirectly, to internal taxes or other internal charges of any kind" and to "internal taxes or other internal charges [applied] … in a manner contrary to the principles set forth in paragraph 1."); GATT art. III:1 (enshrining WTO members' recognition that taxes "should not be applied to imported or domestic products so as to afford protection to domestic production.").

13 Panel Report, Brazil — Certain Measures Concerning Taxation and Charges, ¶¶ 7.1012-1048, WT/DS472/R (Aug. 30, 2017). In another program promoting the automotive sector, Indonesia's higher tariff and tax measures applied to imports of

National treatment involves a significantly higher volume of litigation, particularly under the GATT. Non-conformity with national treatment also makes up the bulk of notifications under the GATS, where members agree to liberalize certain sectors in principle, subject to specific notified exceptions. National treatment obligations are particularly germane to indirect taxes, such as consumption taxes, sales taxes, use taxes and value-added taxes.

A GATT-era case tackled the issue of taxes that were facially neutral but in practice, fell disproportionately on foreign products. In US-Automobiles, the European Union complained that US taxes on luxury vehicles and "gas guzzler" taxes on low fuel economy cars were a violation of the national treatment obligation of the GATT.[14] The Panel sided with the US on the luxury car tax, finding that the price threshold of $30,000 defining luxury cars was not set so as to afford protection to the domestic industry and that such luxury cars were not like products to vehicles below the threshold. As a result, the US could treat cars above $30,000 differently than other cars with respect to taxation. With respect to the gas guzzler tax, the Panel found that the fuel economy threshold was not "*aimed* at affording protection to domestic protection,"[15]nor did it have the *effect* of protecting domestic production in terms of conditions of competition.[16]

More recently, WTO members have challenged each other's domestic consumption taxes favoring domestic alcoholic beverages over imported counterparts.[17] Similarly to the US-Automobile case, the crux of the issue was whether the competing products were "like" products", such that the less favorable treatment would not be allowed, of whether the products were not "like", and could therefore be treated differently with respect to taxation. In most cases, the Panels found that the differential tax between domestic and imported beverages afforded protection to the domestic products and the tax systems were applied in a protectionist fashion. The legal test used by the Appellate Body requires determining whether:

1. "The imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other;
2. The directly competitive or substitutable imported and domestic products are "not similarly taxed"; and
3. The dissimilar taxation of the directly competitive or substitutable imported and domestic products is "applied ... so as to afford protection to domestic production"."[18]

In many of these cases, the respondent country unsuccessfully made a tax equity argument: wealthier consumers of more expensive imported liquor should bear a higher tax burden than consumers of the cheaper domestic equivalent beverages. The Panels and Appellate Body's analyses were unaffected by such arguments.

A few industrial support programs in developing countries also raised issues under national treatment obligations.[19] In all these cases, the objective was not so much for the country to increase its tax revenue, as

certain members were struck down. Panel Report, Indonesia — Certain Measures Affecting the Automobile Industry, ¶¶ 14.123-148, WT/DS54/R (July 2, 1998).

14 Panel Report (unadopted), United States — Taxes on Automobiles, DS31/R (Oct. 11, 1994) ¶¶ 5.2, 5.19.

15 Id., ¶ 5.24.

16 Id., ¶ 5.25-5.26. Likewise, the Panel found no breach of national treatment in the different ways in which fuel economy was calculated on domestic and imported cars.

17 Appellate Body Report, Korea — Taxes on Alcoholic Beverages, WT/DS75/AB/R (Jan. 18, 1999); Appellate Body Report, Philippines — Taxes on Distilled Spirits, WT/DS403/AB/R (Dec. 21, 2011); Appellate Body Report, Japan — Taxes on Alcoholic Beverages, WT/DS8/AB/R (Oct. 4, 1996); Appellate Body Report, Chile — Taxes on Alcoholic Beverages, WT/DS87/AB/R (Dec. 13, 1999). Similar issues arose with respect to cigarettes, see Appellate Body Report, Thailand — Customs and Fiscal Measures on Cigarettes from the Philippines, WT/DS371/AB/R (June 17, 2011), Appellate Body Report, Dominican Republic — Measures Affecting the Importation and Internal Sale of Cigarettes, WT/DS302/AB/R (April 25, 2005).

18 Appellate Body Report, Chile — Taxes on Alcoholic Beverages, WT/DS87/AB/R, WT/DS110/AB/R (Dec. 13, 1999), ¶ 47 (citing Appellate Body Report, Japan — Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (Oct. 4, 1996), p. 24).

19 Appellate Body Report, China — Measures Affecting Imports of Automobile Parts, WT/DS342/AB (Dec. 15, 2008);

it was to promote local industrial production or the consumption of local products by lower taxes on the domestic products, compared to the imported product.

Direct taxes, such as income taxes, profit taxes and corporate taxes, are generally understood to be excluded from the GATT's national treatment obligation because Article III refers to taxes "affecting the internal sale, offering for sale, purchase, transportation, distribution or use of *products*" [20](emphasis added).
Taxes on products are indirect taxes, whereas direct taxes such as income taxes are unrelated to products and hence outside of the purview of this provision.

Constraints on the Taxation of Trade in Services and Cross-Border E-commerce

Agreements on cross-border trade in services are becoming ubiquitous and they tend to mirror the GATS in structure and substance. This section outlines the implications of the GATS for the taxation of cross-border delivery of services (Section 1) and then considers the special framework applying to e-commerce that further constrains countries' ability to derive tax revenue from such activities (Section 2).

1. THE GATS' IMPLICATIONS FOR THE TAXATION OF CROSS-BORDER SUPPLY OF SERVICES

WTO members are not obligated to open delivery of service to international competition, but may choose to do so sector-by-sector (so-called "positive list" approach, where only the sectors specifically listed by each country become open to international competition). Two categories of obligations arise from trade rules on services that may have fiscal implications.

First, regardless of the status of particular sectors, a basic most-favored nation (MFN) obligation applies across the board.[21] For instance, the United States is not required to allow Indian service suppliers to provide online accounting services to US businesses, but if it does allow such cross-border services, it could apply a sales tax of, for instance, 5 percent. However, because of the MFN clause, it would then have to allow these same services to be provided from Nigeria and could not tax these transactions more than 5 percent. Conversely, if the United States taxed the Nigerian service providers at 3 percent, it would have to extend the same benefit to the Indian service providers. Members may, however grandfather in some existing (in 1995) inconsistent measures by notifying them to WTO members, subject to a periodic review by the Council on Trade in Services.[22] Subsequent inconsistent measures may be maintained only if the member obtains a waiver.[23] This is particularly relevant for developing members which developed a service industry after the entry into force of the WTO agreements, which means virtually all developing countries. For countries which joined the WTO after 1995, most of which are developing countries, exemptions to their GATS MFN obligations would likely be negotiated and reflected in their protocol of accession. Conditions of accession have been increasingly stringent. Examples of MFN exemptions involving taxes typically cover the income tax regime for shipping enterprises or non-resident persons working on ships or aircrafts in the member state (e.g., Canada, Costa Rica, Chile, US) and road taxes for cross-border transportation services (e.g., Austria, Cyprus, Croatia, Estonia, EU, Russia, Turkey).

Second, if a WTO member does decide to open a particular service sector to foreign competition, it must then comply with a number of requirements (specific commitments), including non-discrimination between the foreign service supplier and domestic service suppliers (national treatment) and market

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Appellate Body Report, Brazil — Certain Measures Concerning Taxation and Charges, WT/DS472/AB (Dec. 13, 2008); Panel Report, Indonesia — Certain Measures Affecting the Automobile Industry, supra note 13.

20 Joel Slemrod and Reuven Avi-Yonah, (How) Should Trade Agreements Deal with income Tax Issues? 55 TAX L. REV. 533, 536-37 (2002).

21 General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1 [hereinafter GATS] art. II.1.

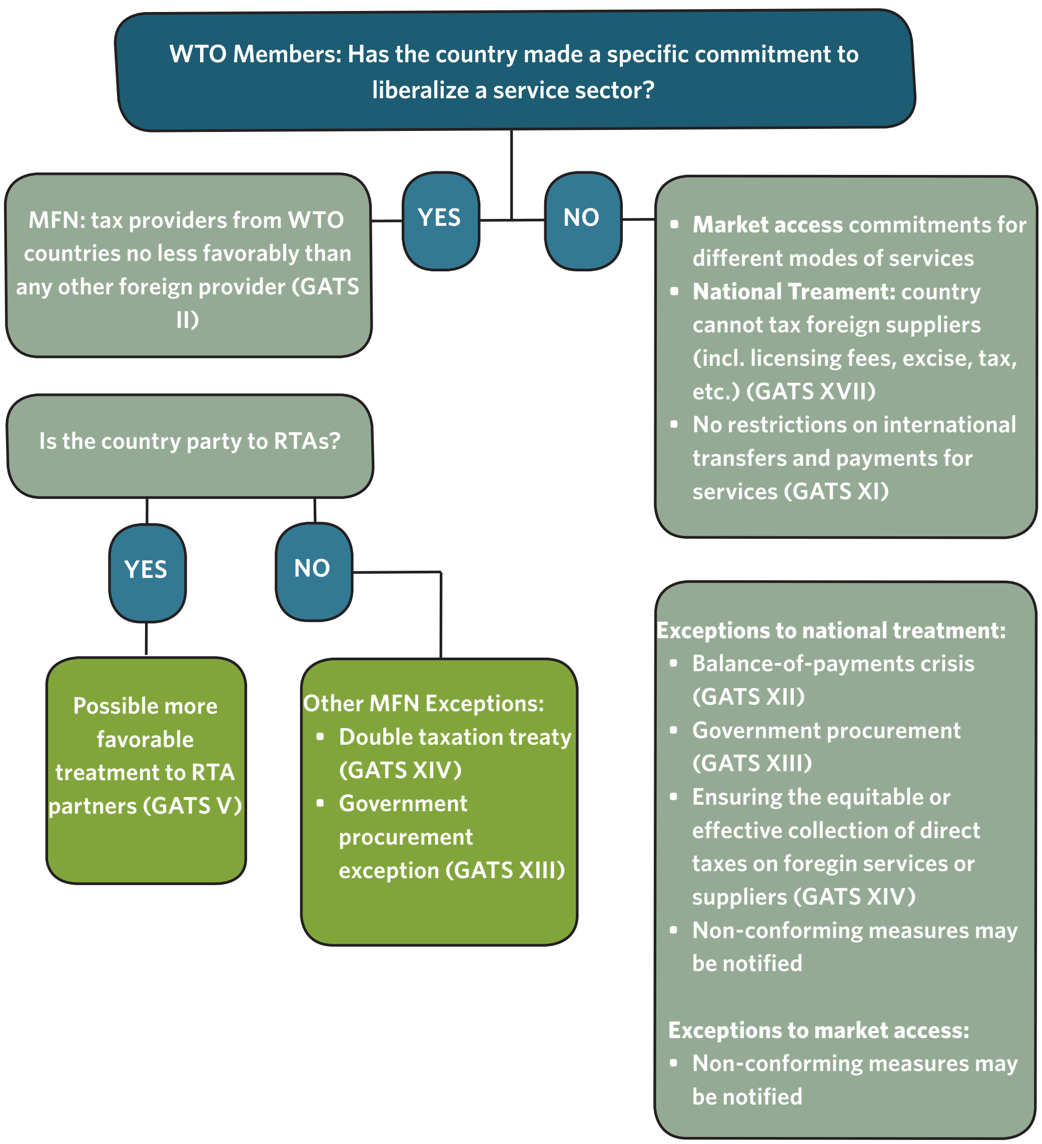
22 GATS art. II.2 and Annex on Article II Exemptions.

23 GATS Annex on Article II Exemptions para. 2 and Marrakesh Agreement Establishing the WTO, Apr. 15, 1994, 1867 U.N.T.S. 154, art. IX.3.

access obligations, which ensure that foreign service suppliers will not be encumbered in the volume, value of their transactions, number of service suppliers, licensing and other regulatory requirements, and the type of business entity they set up locally. Members may modulate their commitments when they decide to liberalize and such derogations to national treatment and market access commitments (non-conforming measures) are then enshrined in individual countries' service schedules. Using the examples above once again, the United States could decide to open the accounting sector to foreign competition, but with the caveat that foreign suppliers (such as Indian or Nigerian-based accountants in our example) need to be certified accountants just like their US counterparts. France could decide to open email and data services to foreign competition but could require foreign operators to have a local subsidiary with a certain amount of capitalization.

Table 4 summarizes the basic obligations deriving from international trade rules on services.

Table 4: Trade in Services Obligations: Implications for Taxation



A major issue here is the income tax treatment of foreign service providers. Most countries tax income generated domestically. For instance, a foreign service provider coming to a country to deliver a service (called Mode 4: presence of natural persons) could be liable for income taxes in that country. By contrast, some countries tax based on the residence of the person in that country, regardless where they accrued their income. The GATS does not address such jurisdictional clashes and overlaps by largely carving out direct taxes from the scope of the agreement and leaving members to deal with the issue under double taxation treaties.[24] Direct taxes include income taxes, taxes on capital, estate, inheritance and gift taxes, real estate appreciation taxes, and payroll taxes.[25] A similar approach to carving out direct taxes was also adopted in a number of regional trade agreements.[26] Box 5 summarizes these issues.

In addition to the legal and logistical difficulties associated with taxing foreign-based service suppliers, such trade in services may raise equity issues. Local businesses are readily taxable, whereas a service provider located abroad but providing services locally would be beyond the jurisdictional reach of the tax authorities of the country where the service was delivered. Not only is the country's ability to tax remote businesses operating in its territory impeded, but the tax burden falling on the local competitors puts them at a competitive disadvantage vis-à-vis the foreign operator. Some countries, including France and Italy, have moved towards a transaction-based taxation model to respond to such a tax inequity and others are considering similar legislation.[27] In this approach, transactions taking place in the territory are taxed locally, regardless of where the business is based. Logistical and legal hurdles abound. Online transactions might not be trackable, asserting taxation power over foreign entities may raise jurisdictional issues and collecting taxes from foreign businesses may prove logistically difficult if the foreign entity refuses to pay. Some of these issues may also fall within the ambit of a double taxation treaty, if one applies.

For countries that rely on income, corporate and profit taxes more than on indirect taxes, the delocalization of service providers outside of their jurisdiction erodes the corporate tax base (assuming a territory-based corporate tax system, which is prevalent throughout the world). The international legal framework on cross-jurisdictional taxation, whether through bilateral double taxation treaties or investment treaties does not resolve the issue. The OECD Model Convention with Respect to Taxes on Income and on Capital (2017) relies on the permanent establishment principle to identify where an entity should be taxed. However, the definition of a permanent establishment (Article 5) contemplates only physical facilities.[28] The Commentary to Article 5 addresses e-commerce to some extent, distinguishing between the place where computer equipment is stored (which might be a place of permanent establishment), and the software or data. A website is therefore not considered a place of permanent establishment for purposes of the Model Convention because it is not located anywhere. The server on which the website data is stored, may, by contrast constitute a fixed place of business.[29]

Other trade agreements that cover services are often modelled after the GATS in terms of the type of legal obligations.[30] In some cases, liberalization is done subject to a negative list instead, which presumes that all

24 GATS art. XIV(d).

25 GATS art. XXVIII(o).

26 Catherine A. Brown, Taxation and the Cross-Border Trade in Services: Rethinking Non-Discrimination Obligations, 21 FLA. TAX REV. 715, 722-23 (2018).

27 Italy–In the Forefront of Digital services Tax Introduction, BLOOMBERG TAX INSIGHTS, https://news.bloombergtax.com/daily-tax-report-international/insight-italy-in-the-forefront-of-digital-services-tax-introduction (Feb. 19, 2019); French tax on internet giants could yield 500 million euros per year: Le Maire, REUTERS (March 3, 2019) https://www.reuters.com/article/us-france-tax-internet/french-tax-on-internet-giants-could-yield-500-million-euros-per-year-le-maire-idUSKCN1QK0ET; European Parliamentary Research Service, Corporate Taxation of a significant digital presence (Dec. 2018), http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/623571/EPRS_BRI(2018)623571_EN.pdf.

28 OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, p. 31, https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en#page32.

29 Id., ¶¶ 122-131, pp. 151-54.

30 A database of service commitments under the GATS and under about a hundred of other trade agreements is available at: http://i-tip.wto.org/services/default.aspx.

services of all modes are open to foreign competition except those listed by each trade partner. This approach may be particularly burdensome for countries with limited capacity and resources to identify precisely which sectors should be excluded, considering the present state of their economy and potential future developments.

Overall, then, MFN and national treatment obligations in trade agreements leave countries free to set the level of direct and indirect taxes as they see fit, so long as the policy does not discriminate against some foreign operators vis-à-vis other foreign operators or vis-à vis their domestic competitors. Most cases tend to involve tax revenue foregone for protectionist purposes or for industrial policy purposes. Those policies will typically involve MFN and/or national treatment obligations, as well as disciplines on subsidies. These constraints not only affect countries' current tax policy, but also their ability to change their tax policy in the future to support particular sectors of their economy or population.

Table 5: Taxing Foreign Service Suppliers

Taxes Applied to the Service Supplier (e.g. tax on profits, corporate tax)	Tax applied to the service transaction (e.g. sales tax)
• No local commercial presence (Mode 1): Difficult to tax entities extraterritorially; double taxation treaty might apply • Commercial presence (Mode 3) or natural person present (Mode 4): May be more practical to tax the entity or person present in the territory; double taxation treaty might apply	• Local consumers of the service may be taxed if the consumption can be tracked (Mode 1) • Domestic persons consuming the service abroad may be taxed if their consumption can be tracked (Mode 2) • Local commercial presence (Mode 3) or presence of natural person (Mode 4) makes it more practical to tax the suppliers based on their local transactions

2. TAXING CROSS-BORDER E-COMMERCE

Taxation of the digital economy is of growing interest to policy-makers and scholars alike, but there are sharp divides in how issues are framed, and what policies are prescribed. This section outlines the existing fiscal treatment of e-commerce within the WTO framework and Section III will outline some of the debates at play in current negotiations.

The WTO defines electronic commerce as "the production, distribution, marketing, sale or delivery of goods and services by electronic means."[31] This includes the trade in digital versions of traditional products (CDs, DVDs, books) and online purchase of physical products but also electronic transmissions accounting for vast amounts of financial transactions such as inter-banks wire transfers, money market transactions and exchange traded funds. Trade in data for marketing and other purposes is another quickly growing segment of e-commerce. E-commerce therefore is a cross-cutting topic that involves trade in services, intellectual property and at times trade in goods. This raises classification issues. Because digital transactions do not fit neatly in any of the current WTO agreements and have implications that are difficult to address through the existing framework, WTO members have launched negotiations for a possible separate agreement on e-commerce.

The GATS might cover a variety of e-commerce transactions that are classified as traded services. This is the case for financial services and marketing services, for instance. Services may be traded in four different ways[32],

31 Work Programme on Electronic Commerce ¶ 1.3, WT/L/274 (Sept. 30 1998).

32 GATS art. I.2.

but e-commerce would most likely involve two “modes” of service delivery.

First, service providers located in one country provide services into the territory of another country (mode 1). For example, online training courses may be offered from a UK institution to students elsewhere in the world; data collected by an operator based in one country may be sold to other businesses elsewhere. The country where the students are located could wish to tax the purchase of such an education service. The country where the data collection business is operating may wish to tax its business, but the country where the data is collected may also wish to tax the activity, alongside the country where the data is sold.

Second, service providers setting up a commercial presence (such as a subsidiary) in another country may provide an online service to local consumers (mode 3). For instance, Yahoo!, Inc., a California company has set up subsidiaries in a number of countries to own the local Yahoo! websites and operate them (such as Yahoo.fr in France). Here again, the country where the services are delivered (France in this example), may wish to tax the local Yahoo! subsidiary. In all cases, the home country of the service provider (the UK in the first example and the United States in the second example) may also wish to tax these service providers on profits they are making from the overseas activities of their companies, but the providers might be nominally incorporated in a third country with low or no taxes. Because the computer servers from where the transactions originate may be located in yet another country (or several), it may be difficult to relate the transaction to any particular tax jurisdiction. Inasmuch as the transaction may be characterized as a trade in services, and the GATS applies, the analysis developed in Section I.C.1 above applies. However, the more disembodied the transaction, the greater the practical obstacles to tracing economic activities, attributing them to specific tax jurisdiction and enforcing tax law against actual operators.

Developing countries now increasingly rely on consumption tax for fiscal revenues. If they are net importers of e-commerce transactions, they would have an interest in cross-border e-commerce transactions being taxed at the point of consumption, assuming they can deploy the technological and logistical tools to identify the transactions and collect taxes.

Bilateral tax treaties offer geographically patchy coverage to assist with some of these allocation issues and, like the largely analog-era trade agreements, they were not designed to address digital transactions bouncing across networks of transnational operators.

Moreover, WTO members agreed early on not to impose duties on electronic transmissions.[33] This standstill agreement has been reiterated at Ministerial Conferences since 1998, with no consensus in sight as to how to address the growing digital economy. Some developing countries wish to derive tax benefits from the exploitation of their consumer markets. Others are embracing a more “open access” philosophy, hoping that unencumbered e-commerce will help bridge the digital divide between advanced and emerging economies, and ultimately generate new economic opportunities for the latter.

Tax Policy Constraints from International Investment Agreements

The impact of international investment agreements on countries’ ability to mobilize fiscal resources may be analyzed as falling in two broad categories: immediate, direct restrictions on tax policy deriving mostly from non-discriminatory rules in the treaties and restrictions on future changes in tax policy due to general treaty protections that are designed to create a stable and predictable regulatory environment for foreign investors. Each category is examined in turn in this section.

33 The Declaration on Electronic Commerce at the Geneva Ministerial Meeting of 2013 states “we also declare that Members will continue their current practice of not imposing customs duties on electronic transmissions.” Declaration on Electronic Commerce, WT/MIN(98)/DEC/2 (May 25, 1998). This language is reiterated in all subsequent Ministerial Declarations (issued every two years). It originated from the United States. Global Electronic Commerce, Proposal by the United States, WT/GC/W/78 (Feb. 9, 1998).

Constraining Present Tax Policy: Non-Discriminatory Treatment of Foreign Investments and Investors

Like trade treaties, bilateral investment treaties typically include MFN and national treatment clauses.[34] With respect to taxation, such clauses may protect investors from a state covered by a BIT with the host state where the investment is made. For instance, a tax that is more onerous for foreign investors than for their domestic counterparts could breach the national treatment obligation. Similarly, a country imposing a tax that is more burdensome for an investor covered by a BIT than for another foreign investor also operating in that country could run afoul of the MFN clause.[35] Taxes measures that are facially neutral but that, by impact or by design, result in a less favorable treatment of foreign investors may also amount to a breach of MFN or national treatment guarantees. A discriminatory intent by the state is not necessary for a measure to be found in breach of MFN or national treatment obligations.[36]

Foreign investors have brought a number of cases alleging discriminatory tax treatment against the host state in arbitration proceedings available under BITs and other treaties with an investment chapter. Investors won several national treatment cases under Chapter VII of the NAFTA[37] treaty and under BITs.[38] Some MFN or national treatment cases were decided in favor of the state.[39] A number of cases involving allegations of discriminatory taxation of a foreign investor by the host state are pending[40] or have been

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34 Because most BITs only grant post-establishment rights and benefits to investors, these clauses only apply once the investment has been made, not with respect to the conditions for making the investment in the first place. However a recent trend in international investment agreements is to also address pre-establishment rights, whereby states would bind themselves to allowing foreign investors to operate domestically, rather than retain the discretionary exercise of their sovereignty on that matter. Foreign investment into a country guaranteeing pre-establishment rights would therefore become a treaty-protected right, rather than a privilege governed by domestic law.

35 See Matthew Davie, Taxation-Based Investment Treaty Claims, 6 J. INTL DISPUTE SETTLEMENT 202, 208-09 (2015).

36 See generally S.D. Myers, Inc. and Government of Canada, UNCITRAL Arbitration, First Partial Award ¶¶ 252-254 (Nov. 13, 2000), https://www.italaw.com/sites/default/files/case-documents/ita0747.pdf:

[I]n assessing whether a measure is contrary to a national treatment norm, the following factors should be taken into account:

- whether the practical effect of the measure is to create a disproportionate benefit for nationals over non nationals;

- whether the measure, on its face, appears to favour its nationals over non-nationals who are protected by the relevant treaty.

253. Each of these factors must be explored in the context of all the facts to determine whether there actually has been a denial of national treatment.

254. Intent is important, but protectionist intent is not necessarily decisive on its own. The existence of an intent to favour nationals over non-nationals would not give rise to a breach of Chapter 1102 of the NAFTA if the measure in question were to produced no adverse effect on the non-national complainant. The word "treatment" suggests that practical impact is required to produce a breach of Article 1102, not merely a motive or intent that is in violation of Chapter 11.

37 Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No ARB(AF)/99/1, Award (Dec. 16, 2002) (the investor was denied certain tax rebates on exported tobacco products, but the rebates were granted to Mexican businesses in breach of the national treatment clause); Archer Daniels Midland Company et. al v. United Mexican States, ICSID Case No ARB(AF)/04/5, Award (Nov. 21, 2007) (Soft drinks made with high fructose corn syrup were subject to a 20 percent tax by the Mexican government, while soft drinks sweetened with sugar cane, which were typically made in Mexico were not taxed. The tribunal found a breach of the national treatment obligation.); Corn Products international, Inc. v. United Mexican States, ICSID Case No. ARB(AF)/04/1, Award (Aug. 18, 2009) (also finding a national treatment violation regarding taxes on soft drinks); Cargill, Inc. v. United Mexican States, ICSID Case no. ARB(AF)/05/2, Award (Sept. 18, 2009) (also finding a national treatment violation regarding taxes on soft drinks).

38 Occidental Exploration and Petroleum Company v. The Republic of Ecuador, UNCITRAL, Award (July 1, 2004) (VAT credits and tax refunds on oil exports denied to the foreign investor but granted to domestic exporters).

39 Sergei Paushok and others v. The Government of Mongolia, UNCITRAL, Award on Jurisdiction and Liability (April 28, 2011), https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/276/paushok-v-mongolia (the investor was subject to a windfall profit tax that was not imposed on Canadian investors operating in the same sector, but the tribunal said that the special deal that the Canadian company had negotiated but the two investors in a dissimilar position, such that the MFN clause did not apply); Ahmonseto, Inc. and others v. Arab Republic of Egypt, ICSID Case No. ARB/02/15, Award (June 18, 2007).

40 Sergei Paushok v. The Government of Mongolia, supra note 39 (imposition of windfall taxes on the sale of gold).

settled confidentially or discontinued.[41] Even when the claims are ultimately unsuccessful, host states must allocate resources to their defense, uncertain outcomes create a climate of instability with potentially adverse economic and political effects, and states may face a regulatory chilling effect.

Investment treaties may also provide protection against discrimination in the enforcement of a country's tax policy (for example, if a foreign investor is targeted for auditing or prosecution more so than domestic entities or other foreign investors).

Constraining Future Tax Policy: Indirect Expropriation; Fair and Equitable Treatment of Investors

Aside from national treatment and MFN, domestic tax laws and their application have been challenged under investment agreements' expropriation provisions and requirements of fair and equitable treatment (FET).

Numerous investor state disputes deal with domestic changes in tax policy that adversely affect foreign investor. Indirect expropriation[42] and fair and equitable treatment[43] provisions in investment treaties offer a vehicle for such claims. With respect to indirect expropriation, investors often claim that a change in tax law, resulting in a higher tax burden for themselves or their investment so decreases the value of the investment that it is tantamount to a taking by the state in breach of the treaty. Fair and equitable treatment claims typically involve investors complaining that a change in tax policy so dramatically changes the conditions for their investment that it unfairly surprises them and is disallowed under the treaty.

Some examples of changes in tax policies that have or could be challenged include termination of rebates or exemptions, taxation on capital transfer, profit repatriation, taxation of passive income (particularly on intellectual property).[44]

Most claims of indirect expropriation through taxation are not successful. States are presumed to be within their right in exercising their taxation power. To succeed, an investor must show a substantial deprivation of the investment's value, which is a high bar. In the case of Mexico's imposition of a 20 percent tax on sales of soft drinks made with high fructose corn syrup, some investors claimed indirect expropriation in addition to the national treatment claims mentioned in Section II.A above, but these were not successful.[45] Even when a

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41 J.M. Longyear, LLC v. Government of Canada, Claim (2014), https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/570/longyear-v-canada (ineligibility for tax reductions); Bidzina Ivanishvili v. Georgia, Claim, ICSID Case No. ARB/12/27 (2012) https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/474/bidzina-ivanishvili-v-georgia (legislative amendments purportedly giving tax authorities priority over the secured claims of banks); Lao Holdings N.V. v. Lao People's Democratic Republic (I), ICSID Case No. ARB(AF)/12/6 (2012) (80 percent tax on casino revenues and allegedly unfair and oppressive audits).

42 E.g., 2012 U.S. Model Bilateral Investment Treaty, art 6:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment](1) through (3).

Annex B para. 4 further specifies that "The second situation addressed by Article 6 [Expropriation and Compensation] (1) is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure." https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf

43 E.g., 2012 U.S. Model Bilateral Investment Treaty, id., art 5:

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. ...

2. ... (a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.

44 Davies, supra note 35, at 204-208.

45 Archer Daniels Midland Company et. al v. United Mexican States, ICSID Case No ARB(AF)/04/5, Award, ¶ 251 (Nov. 21, 2007).

tax measure makes the business unprofitable, arbitrators have not necessarily found that the measure was expropriatory.[46]

In addition to a substantial deprivation of value, the tax measure must have an exceptional or arbitrary character that takes it outside the realm of normal government activity for it to be considered expropriatory. Perhaps the most notorious such case involved the treatment of Yukos and affiliated companies by Russia in the 2000s. The claim was mostly one of expropriation, but it also involved the discriminatory targeting of Yukos and affiliate companies for tax audits. After subjecting Yukos to numerous tax audits and imposing large tax assessments for alleged tax liabilities, Russia prevented Yukos from paying the proffered tax bills by immediately freezing its assets. When Yukos was unable to pay due to the freeze, Russia seized the assets and sold them below market value to Rosneft, a competing Russian state-owned enterprise. It is well known that the CEO of Yukos at the time was a political critic of Russia's President Putin and the entire scheme was widely understood as a political maneuver to dispossess him of the company and deliver the lucrative assets to Putin's control. A series of investor-state disputes brought by Yukos shareholders against Russia ensued, with arbitration awards in favor of the investors.[47]

Fair and equitable treatment claims are more likely to succeed than expropriation claims. In the words of one landmark arbitration, FET claims require a showing of state conduct that is "arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory …, or involves a lack of due process leading to an outcome which offends judicial propriety.[48]

Although the standard seems very high, it may in fact be easier to reach than expropriation.[49]

It has been likened to a standard of good faith and respect for the investor's legitimate expectations. As such, it is fairly fluid in its interpretation and potentially the most problematic for states wishing to change their tax policy. The issue is whether investors have a legitimate expectation that the tax treatment they enjoyed when they invested should remain the same, or whether they should expect the state to evolve its policies, particularly in developing countries that may be in the process of building their tax apparatus. Box 5 provides an illustration with the case of *Occidental Petroleum v. Ecuador.*[50]

Allowing FET claims to go forward in cases of a change in tax regime is particularly problematic because investors could, instead, take contractual steps to protect themselves against such changes. For instance, investors could seek a tax stabilization agreement from the host state.[51]

Such agreements, even though they are private contracts between an investor and the state, may even benefit from some protections offered by an applicable bilateral investment treaty, including its dispute settlement provisions, through the operation of "umbrella clauses."[52] FET should therefore not be used as

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46 Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No ARB(AF)/99/1, Award, ¶ 112 (Dec. 16, 2002). See also Occidental Exploration and Petroleum Company v. The Republic of Ecuador, UNCITRAL, Award, ¶ 89 (July 1, 2004); Sergei Paushok and others v. The Government of Mongolia, UNCITRAL, Award on Jurisdiction and Liability, ¶ 302-36 (April 28, 2011); EnCana Corporation v. Republic of Ecuador, UNCITRAL, Award, ¶ 174-77 (Feb. 3, 2006) (a loss of tax breaks amounting to 10 percent of the transaction value was not an expropriation); Burlington Resources Inc. v. The Republic of Ecuador, ICSID Case No ARB/06/08/5, Decision on Liability, ¶ 450 (Dec. 14, 2012) (the windfall tax did not render the investment "totally" unprofitable); Perenco Ecuador Ltd v. The Republic of Ecuador and another, ICSID Case No ARB/08/6, Decision on Remaining Issues of Jurisdiction and on Liability, ¶ 672, 684 (Sept. 12, 2014) (drawing a distinction between "a partial deprivation of value, which is not an expropriation, and a complete or near complete deprivation of value, which can constitute an expropriation." In this case, a windfall tax of 99 percent of profits above a certain benchmark were not found to be an expropriation).

47 RosInvestCo UK LTD v. The Russian Federation, SCC Case No. V079/2005, Final award (Sept. 12, 2010); Renta 4 SVSA and others v. The Russian Federation, SCC No. 24/2007, Award (July 20, 2012); Yukos Universal Ltd (Isle of Man) v. The Russian Federation, PCA Case No. AA 227, Final Award (July 18, 2014).

48 Waste Management Ltd v. United Mexican States, ICSID Case No. ARB(AF)/00/3, Award, ¶ 98 (April 30, 2004).

49 See e.g., Occidental Exploration and Petroleum Company v. The Republic of Ecuador, supra note 38, ¶ 186 (the investor was unsuccessful on the expropriation claim but succeeded on the FET claim on the same facts).

50 Id.

51 Davie, supra note 35, at 208, 219. The CPTPP also contemplates elevating the legal status of stabilization agreement offered by a state to that of a multilateral obligation. For instance, Peru stipulated that "A stability agreement … may constitute one of multiple written instruments that make up an "investment agreement", as defined in Article 9.1 (Definitions). If that is the case, a breach of such a stability agreement by Peru may constitute a breach of the investment agreement of which it is a part." (Annex 9L, Section B.3).

52 Umbrella clauses appear in numerous BITs, but their scope and applicability to fiscal issues is uncertain. They

a back door to protect investors who failed to bargain privately for a particular tax treatment and hence assumed the risk of regulatory changes.

Table 6: Case study - Occidental Petroleum in Ecuador

Case Study: Occidental Petroleum in Equador
▪ **The tax break:** Ecuadorean legislation provides for the reimbursement of VAT paid on supplies used by Occi in its oil exploration and exploitation activities in Ecuador, and oil exports.
▪ **The dispute:** Whether the benefit of the tax break was computed into the new investment contract between Ecuador and Occi, terminating entitlement to separate reimbursements.
▪ **The claims:** expropriation, FET, national treatment, arbitrary or discriminatory measure impairing the use and enjoyment of the investment in breach of international law and the US-Ecuador BIT.
▪ **The tax carve-out in the BIT:** Not a bar to jurisdiction because the dispute relates to the investment and a tax matter covered by the article is involved.
▪ **The outcome:**
• Taxation may lead to expropriation claims but it is "evident" that there is no expropriation here (claim not admissible).
• The treatment of the tax authorities was arbitrary due to the uncertain legal landscape but did not result in an impairment of the use or enjoyment of the investment.
• Occi was treated less favorably than domestic entities by the tax authorities in breach of the national treatment obligation.
• FET obligations were breached because "[t]he tax law was changed without providing any clarity about its meaning and extent and the practice and regulations were also inconsistent with such changes." The Tribunal noted: "[Occi] undertook its investments, including its participation in the pipeline arrangements, in a legal and business environment that was certain and predictable. This environment was changed as a matter of policy and legal interpretation, thus resulting in the breach of fair and equitable treatment.
• Good faith by the tax authorities was irrelevant to the findings.
• Occi was awarded USD 71 million of VAT reimbursement + USD 3.5 million in interest. Ecuador must bear 55% of arbitration costs.
• Future dealings: The Tribunal noted that the parties may renegotiate their contract so as to explicitly exclude VAT reimbursements in the future.

Even where there is no applicable BIT, guarantees of good faith and fair treatment may arise under international law. Such was the case in *Duke Energy v. Peru.*[53] The investor benefited from tax stabilization

typically state: "Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party." Agreement between the Swiss Confederation and the Republic of Paraguay on the Promotion and Reciprocal Protection of Investments, art. 11, signed Jan. 31, 1992, entered into force April 23, 1992, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4828/download. For a discussion of umbrella clauses, see e.g., Jarrod Wong, Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes, 14 GEO. MASON L. REV. 137 (2006). Some authors argue that umbrella clauses have a chilling effect on developing countries' taxation of foreign investors, particularly in the oil and gas sector, where investors typically secure stabilization agreements. Cristina Bodea et al., Global Treaties and Domestic Politics: Do BITs Constrain Fiscal Policy in Developing Countries? 11-13 (2018) available at SSRN: https://ssrn.com/abstract=3288100 or http://dx.doi.org/10.2139/ssrn.3288100.

53 Duke Energy International Peru Investments No. 1 Ltd. v. Republic of Peru, ICSID Case No. ARB/03/28, Award (Aug.

guarantees, which were authorized under domestic Peruvian law on the protection of investment. Peru then modified the interpretation and application of its tax stabilization regime. The tribunal examined whether Peruvian courts and Peruvian authorities had been unreasonable such as to breach stability guarantees under international law and found that they had not.[54] However, the tribunal did find a breach of a guarantee of tax stabilization with respect to the interpretation and application of one law at stake.[55] It seems that this finding was based on the Tribunal's interpretation of Peruvian law, even though the tribunal posits elsewhere that it does not sit as a court of appeals for Peruvian law. It also examined whether the investor had reasonably relied on stabilization interpretations such that Peru could be estopped from changing the regime. The tribunal found that the claimant had failed to meet its burden of proof.[56]

In conclusion, domestic tax policies have been challenged under BITs via different types of claims. Many of these claims have been unsuccessful, but in any case, the state had to devote resources to defend its tax policy autonomy.[57]

The Dutch BITs, in particular, have been a favored vector for investors. However, the Netherlands recently adopted a new model BIT that would limit the ability of investors to gain benefits through simple shell incorporation as Dutch companies.[58] It will take some length of time for this new format to supersede the older Dutch BITs, if the government pursues this course of action.

Preserving Domestic Tax Autonomy: Carve-Outs, Exceptions and Future Negotiations

Trade and investment treaties typically include some provisions to preserve states' policy autonomy regarding tax law and policy. This section assesses what they are and how they operate to maintain the state's ability to raise tax revenue. It also highlights their limitations and offers some perspectives on strengthening tax policy autonomy in future trade and investment agreements.

Maintaining the Ability to Raise Tax Revenue: Safeguards, Carve-Outs and Exceptions

Trade and investment treaties offer a number of avenues for states to assert and protect their taxing power. Most of these provisions are not directly aimed at tax policy but may be used for fiscal mobilization. Others are explicitly aimed at avoiding conflicts between trade and investment obligations on the one hand, and domestic and international tax rules on the other hand, but their scope and interpretation is uncertain.

1. TARIFF AND SERVICES LIBERALIZATION RENEGOTIATIONS

Trade treaties allow states to renegotiate their market liberalization commitments. With respect to tariffs on trade in goods, the GATT allows a party to increase its tariffs above the bound rate, subject to negotiation with affected parties and possible compensation to any party suffering a loss as a result of the modified tariff.[59] With respect to trade in services, the GATS also allows modification or withdrawal of a scheduled

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18, 2008).

54 *Id.* ¶ 307.

55 Id. ¶¶ 345, 365-66.

56 *Id.* ¶¶ 322-23

57 For a list of investor-state tax dispute, see, e.g., Claire Provost, *Taxes on trial – How trade deals threaten tax justice*, Transnational Institute Research Paper, 10-12 (Feb. 2016) available at https://www.tni.org/files/publication-downloads/taxes-on-trial.pdf.

58 Netherlands model Investment Agreement (Oct. 19, 2018) arts. 1(b)(ii) and 1(c) (requiring companies to conduct "substantial business activities" in their home state in order to qualify as an investor under the treaty).

59 GATT art. XXVIII:4 (allowing a party to enter into negotiations to modify its tariff schedule "in special circumstances").

commitment, subject to negotiations with affected members and possible compensation.[60] If compensation is not forthcoming, affected parties may seek arbitration and possibly retaliate in an equivalent amount of trade benefits vis-à-vis the party which modified its schedule.

Such provisions therefore make it possible, albeit costly, for a state to raise its tariffs or otherwise reduce its market access to foreign competition. In theory, the goal is to maintain an equivalent level of trade liberalization, such that if a party wishes to change its policy in one sector, it will need to offset it in another sector. The net fiscal impact of such rearrangements may be correspondingly marginal. These provisions are really meant for a party to protect the domestic producers of a sector, or the balance of trade in a sector, rather than to roll back on trade liberalization for purposes of increasing fiscal resources. In practice, such renegotiations seldom, if ever occur.[61] For fiscal mobilization purposes, tariffs and services liberalization renegotiations will likely be of minimal use.

2. TEMPORARY INCREASES IN TARIFFS

A range of other provisions giving states flexibility with their trade commitments are more commonly used than outright tariff or market access renegotiations.

Safeguards and antidumping duties are aimed at protecting domestic producers against surges in competing imports and certain foreign trade practices deemed unfair, respectively.[62] However, both consist in the imposition of higher tariffs on some products on a temporary basis. Such tariffs may generate additional fiscal resources at the border if the import of targeted products does not decline to the extent that it offsets the potential additional revenues. Safeguard, countervailing duties and antidumping duties may also indirectly stem a decline in tax revenue if they help tax-paying domestic producers to stay in business in the face of foreign competition. Maintaining such businesses may have direct and indirect taxes benefits domestically.

States may also take temporary measures to protect their balance-of-payments, including by raising tariffs or otherwise limiting imports, and rolling back on market access commitments.[63] Such measures may play a role to avert or limit an outflow of domestic currency, which may indirectly protect the country's currency value and its sovereign debt position. Balance-of-payment restrictions are not designed to help a country mobilize taxation, but rather to temporarily stave off massive loss of fiscal resources. In practice, at the WTO, the Committee on Balance-of-Payments Restrictions has worked diligently with members towards the termination of their balance-of-payment restrictions in the early 2000s, with virtually all programs having now ended. Several countries which encountered serious balance-of-payment difficulties since then have not availed themselves of these flexibilities. While Argentina and Greece have not implemented restrictions in response to their recent and ongoing crises, Ecuador made a notification in June 2017 of its implementation of restrictive measures for a period of fifteen months.[64] Ukraine also had recourse to balance-of payment protection measures in 2015, the only other WTO member to do so over the past decade.[65]

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60 GATS art. XXI.

61 A few months after the Uruguay Agreements came into force, Brazil notified an increase of import tariffs on 109 products for a maximum period of one year, specifying that "the measure, of a temporary character, has as its objective the preservation of the results already achieved by the economic stabilization plan "Plano Real) and does not affect the process of liberalization of the Brazilian economy and its integration to the international economy." Notification in pursuance of Paragraph 3 of the Understanding Regarding Notification, consultation, dispute settlement and surveillance and the Decision on notification procedures annexed to the Final Act embodying the results of the Uruguay Round of multilateral trade negotiations – Communication from Brazil, WT/L/66 (May 10, 1995). It is unclear whether the increase in tariff was made pursuant to GATT art. XXVIII (which provided some additional flexibilities during the first few months of the WTO).

62 GATT arts. VI (antidumping duties) XIX (safeguards); Agreement on Antidumping, Agreement on Safeguards; GATS art. X (emergency safeguard measures).

63 GATT arts. XII, XVIII:B; GATS art. XII

64 Notification under Paragraph 9 of the Understanding on the Balance-of-Payments provisions of the General Agreement on Tariffs and Trade 1994 – Communication from Ecuador, WT/BOP/N/84 (June 16, 2017). Ecuador had previously eased some earlier restrictions. Notification under Paragraph 9 of the Understanding on the Balance-of-Payments provisions of the General Agreement on Tariffs and Trade 1994 – Communication from Ecuador, WT/BOP/N/83 (Oct. 4, 2016) (terminating restrictions that had been put into place in April 2015).

65 Notification under Paragraph 9 of the Understanding on the Balance-of-Payments provisions of the General

3. TAX CARVE-OUTS IN TRADE IN SERVICES AGREEMENTS

The GATS contains two significant features to protect members' tax policy.

First, a general exception allows members to take measures that would otherwise breach their national treatment obligation "provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect to services or service suppliers of other Members." The agreement further specifies that such measures may include taxation on non-resident service suppliers when they supply services domestically, taxation of local consumers of services provided from abroad and a range of other measures.[66]

Second, the GATS carves out measures that are inconsistent with the MFN obligation due to double taxation treaties or other international tax agreements.[67] Nonetheless, the measure must be applied in a way that is not an arbitrary or unjustifiable discrimination between countries where similar conditions prevail or a disguised restriction on trade. The provision is often dubbed a "tax carve-out" and is a relatively common feature of agreements on trade in services, including NAFTA and the Trans-Pacific Partnership (TPP).[68] The TPP added a broader catch-all clause for any conflict between the national treatment obligation and tax measures.[69]

Notably, these provisions are limited in their application, as they are exceptions to the national treatment and the MFN obligations, respectively. They are also subject to interpretation. In the case of the national treatment exception, the issue will be whether the measure is deemed to be "aimed at ensuring ... equitable or effective" taxation or tax enforcement. No case has interpreted this provision so far. Based on WTO jurisprudence, "aimed at" suggests an objective relationship standard based on the actual design and operation of the measure, rather than as an examination of the political motivation behind the measure. The GATT standard of a measure "relating" to a listed objective is probably the closest to an "aimed at" requirement.[70] There is no guidance in existing cases as to how the "equitable" term might be interpreted, and how much deference might be given to the state imposing the measure. Future trade agreements with similar provisions should clarify that the state imposing the measure must be afforded maximum deference in the determination of equitability of taxation and that the effectiveness requirement must take into account the specific constraints and limitations of the taxing authorities, with, here again, significant deference to the imposing state.

Moreover, the chapeau of the General Exceptions article requires that a measure "not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade."[71] This applies to both the national treatment exception for "equitable or effective" taxation and the MFN exception when the discrimination is due to compliance

Agreement on Tariffs and Trade 1994 – Communication from Ecuador, WT/BOP/N/78 (Jan. 20, 2015).

66 GATS art. XIV (d) and footnote 6.

67 GATS art. XIV(e).

68 Brown, *supra* note 26, at 722-23.

69 TPP art. 29.4(2) ("Except as provided in this Article, nothing in this Agreement shall apply to taxation measures."). For an examination of the scope of tax carve-outs, *see generally* Brown, *supra* note 26, at 722-740. For an examination of tax carve-outs in Australian trade in services agreements, *see* Tania Voon, *Balancing Regulatory Autonomy with Liberalisation of Trade in Services: An Analytical Assessment of Australia's Obligations Under Preferential Trade Agreements*, 18 Melbourne J. Int'l Law 373, 401-02 (2017).

70 In *China – Rare Earths*, the Panel stated: "the rational connection test endorsed by the Appellate Body in US – Shrimp is potentially less strict than the previously employed "primarily aimed at" standard. However, it is important to note that the Appellate Body in US – Shrimp appeared to retain the "substantial relationship" test developed in US – Gasoline. This suggests that, while measures need not be primarily aimed at conservation, they must still bear a substantial, close, and real relationship to the conservation objective; as the Appellate Body said in US – Gasoline, a merely incidental or inadvertent connection will not suffice." Panel Report, *China — Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, ¶ 7.283, WT/DS431/R (March 26, 2014).

71 GATS art. XIV, *see also* interpretation of the same language in GATT art. XX.

with a bilateral tax treaty or other similar agreement. The Panels and the Appellate Body have interpreted this requirement to mean that states' measures must also be the least trade restrictive alternatives that will achieve the purpose allowed in the general exception.[72]

Tax carve-outs in trade agreements are therefore somewhat vague and generally untested. While the language is fairly open-ended, interpretative practice at the WTO suggests that a number of tools could and likely would be utilized to constrain states' policy autonomy if a challenge were to arise.

4. TAX CARVE-OUTS AND NON-CONFORMING MEASURES IN INVESTMENT TREATIES

Taxation is explicitly addressed in two ways in investment treaties: first a compliance provision might reassert investors' obligation to comply with local law, including tax law; second, the treaty protections might not extend to taxation measures, through the operation of carve-out clauses similar to those included in trade treaties. With respect to tax carve-outs, negotiators should be aware of three main sets of issues: first, the definition of tax measures, second, the scope of any carve-out, and third, the judicial or arbitral review of both the definition of tax measures and their possible inclusion in the scope of dispute settlement clauses of the treaty.

Investment agreements offer a range of tax carve-outs. Some exclusionary clauses address the applicability of specific provisions to taxation matters while others broadly exclude taxation measures from the treaty and from the adjudicative power of arbitrators under the treaty.[73]

For instance, the US-Argentina bilateral investment treaty implies only a soft best efforts intent to apply the ethos of the treaty to taxation matters, but specifically extends the coverage of the treaty, in particular its dispute settlement provisions, to taxation issues in relation to expropriation and to monetary transfers (such as repatriation of capital, profits, etc):

With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.Nevertheless, the provisions of this Treaty, and in particular Article VII and VIII [dispute settlement], shall apply to matters of taxation only with respect to the following:

> expropriation, pursuant to Article IV;
>
> transfers, pursuant to Article V; or
>
> the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VII(l)(a) or (b),
>
> to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement

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72 Panel Report, China – Rare Earths, ¶¶ 7.202-360, supra note 61 discussing the chapeau of GATT article XX: "the chapeau "allows for a degree of discrimination provided it is justified and not arbitrary and where the complainants are unable to demonstrate the availability of a WTO-consistent alternative measure."

73 *See generally* Davie, *supra* note 35, at 210-216 (on the history and varying scope of tax carve-out clauses in investment agreements). The 2012 U.S. Model BIT article 21 provides:

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

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 authorities21 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."

provisions and are not resolved within a reasonable period of time.[74]

Such language would restrict investor complaints relating to taxation to indirect expropriation claims, which, as discussed in Section II.B. above, are the hardest to win, and to claims relating to transfers.

The Netherlands-Hong Kong BIT provides that

> Without prejudice to Article 3(1) [fair and equitable treatment], the provisions in this Agreement relative to the grant of treatment not less favourable than that accorded to the investors of either Contracting Party or to investors of any other State shall not be construed so as to oblige one Contracting Party to extend to the investors of the other the benefit of any treatment, preference or privilege resulting from:
>
> (1) any international agreement or arrangement relating wholly or mainly to taxation or any domestic legislation relating wholly or mainly to taxation
>
> ..., or
>
> (3) reciprocal arrangements with any other State.[75]

Unlike the US-Argentina BIT, this language would seem to disallow tax-related indirect expropriation claims, but leave the door open to the easier to win claims under FET.

By contrast, the investment chapter of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP, incorporating the TPP) does not include a tax carve-out. Instead, the CPTPP provides a complex set of tax carve-outs (art. 29.4) in the General Exceptions Chapter that apply to some or all trade, investment, e-commerce and specific other CPTPP commitments. The investment chapter of the CPTPP merely specifies that, absent some legal guarantee to the contrary, the loss of a subsidy or government grant, does not, in itself, mount to an expropriation.[76] This is perhaps a response to some of the tax-related indirect expropriation claims made under BITs, as mentioned in Section II.B above.

Additionally, general exceptions or escape clauses may be available in investment treaties for states facing situations of fiscal crisis. Traditionally, provisions on non-precluded measures would have been the only such recourse. Invoking such exceptions has been very limited in practice and largely unsuccessful in arbitrations. The CPTPP recently took a different tack, allowing parties to notify "non-conforming" measures in place at the time of the signature of the treaty.[77] This is essentially a way for states to customize their obligations by stipulating their own exceptions to the treaty's provisions. However, such an approach is static, in that it only covers rules and policies in place at the time of the treaty, but not future policies that might run afoul of treaty obligations. Here again, states' ability to effectuate future changes in tax policy may be subject to investment treaty claims and disputes.

In conclusion, a number of legal avenues exist to exclude fiscal matters from trade and investment treaties. In practice, exclusionary provisions are somewhat limited in coverage and their effectiveness to protect states' tax policy autonomy in dispute settlement is largely untested. Perhaps most importantly,

74 Treaty Between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, Signed November 14, 1991; Entered into Force October 20, 1994, art. XII, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/127/download.

75 Agreement on the Encouragement and Protection of Investments between the Government of Hong Kong and the Government of the Kingdom of the Netherlands, in force Sept. 1, 1993, art. 7, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1517/download.

76 Comprehensive and Progressive Agreement for Trans-Pacific Partnership ch. 9, art. 9.8.6. (Mar. 8, 2018), https://www.mfat.govt.nz/assets/Trans-Pacific-Partnership/Text/9.-Investment-Chapter.pdf (hereinafter CPTPP).

77 *Id.* art. 9.12

they are aimed at avoiding conflicts of law, rather than at creating a reasoned, comprehensive effort to separate tax policy from trade and investment regulation. More recent model investment agreements from emerging countries, such as the new Indian Model BIT, demonstrate some attempt to reverse this trend and to exclude taxation matters from trade and investment law. The choice by some developing countries, including South Africa and Indonesia, to withdraw or let lapse their bilateral investment treaties is another way to ensure that balancing the intersection of taxation and investment law remains the sole province of domestic authorities.

Protecting Tax Autonomy in Current Trade and Investment Negotiations

DEBATES ON THE FISCAL IMPLICATIONS OF DATA TRANSACTIONS AND E-COMMERCE

Trade negotiations on e-commerce, and particularly debates about the treatment of cross-border data flows, show that no consensus exists among WTO members, or even categories of members, with developing countries divided on the preferred approach to a number of contentious issues. The shift to other forums, such as the TPP has raised the stakes, as regional trade agreements, by definition, include only limited subsets of countries, but the standards they set might have spill-over effects on non-participating countries.[78] Developing countries engaged in negotiations on e-commerce should be cognizant of a number of fiscal issues outlined below.

With respect to tax issues, the USTR's Digital 2 Dozen principles for negotiations supported by the tech industry include prohibiting digital customs duties and securing market access on investment and cross-border digital services (see GATS discussion above).[79] Some commentators have warned that current strategies in the CPTPP and at the WTO are likely to lead to a consolidation of market dominance by the biggest US digital technology and services firms, and would foreclose opportunities for "digital development" in emerging countries.[80] Such concerns are echoed in particular by the African Group (a WTO coalition of sub-Saharan African members) and Least Developed Countries, which generally oppose negotiations on e-commerce in the current framework. On the other hand, the Friends of E-Commerce for Development group comprising Argentina, Chile, China, Colombia, Costa Rica, Kazakhstan, Kenya, Mexico, Moldova, Montenegro, Nigeria, Pakistan, Sri Lanka, and Uruguay[81] are seeking a way to move ahead in negotiations in a way that protects the interests of developing members. Participants in this group also have their own varying negotiation priorities.

Significant points of contention include classification of services under the GATS, the application of the modes of services to digital transactions, which often involve elements of Modes 1, 2 and 3, and the interpretation and appropriateness of a technological-neutral approach.[82] How each of these terms are construed may have specific and different fiscal implications in terms of who is taxed (consumer, some service provider along the chain, etc), where taxes are levied (place where the digital transaction is consumed, place of origin of the transaction, place where the data is stored, etc), and in which kind of tax might be imposed (sales tax, value added tax, income tax, corporate tax, profit tax, transaction tax, etc). For developing countries, their evolving position as recipient and creator of e-commerce further adds to the complexity of identifying their interests and the desirable corresponding policies. Still, they remain largely a source country of e-commerce, rather than a resident country of international e-commerce businesses. Since most domestic taxation systems are resident-based, developing countries tend to have a limited ability to

78 On the mapping of trade regulation of data flows, *see generally* Susan Ariel Aaronson and Patrick Leblond, *Another Digital Divide: The Rise of Data Realms and its Implications for the WTO*, 21 J. Inl. Econ. L. 245 (2018).

79 United State Trade Representative, *The Digital 2 Dozen* (April 13, 2016), https://ustr.gov/sites/default/files/Digital-2-Dozen-Final. pdf

80 Jane Kelsey, *How a TPP-Style E-commerce Outcome in the WTO would Endanger the Development Dimension of the GATS Acquis (and Potentially the WTO)*, 21 J. Intl Econ. L. 273, 275-77 (2018).

81 https://www.wto.org/english/thewto_e/minist_e/mc11_e/briefing_notes_e/bfecom_e.htm

82 *See generally,* Kelsey, *supra* note 80, at 284-95.

mobilize the tax base for activities sourced in their territory by non-resident businesses.[83]

E-commerce raises difficult classification issues which in turn condition which trade agreements will apply and what obligations will ensue, particularly with respect to the ability to levy customs duties, or the way in which the transaction might be taxed. For instance, is the transaction a trade in goods, a trade in services, a trade in intellectual property, something else? As an early commentator put it, even if e-commerce ends up being largely tariff-free, as advocated by a number of countries, it is generally understood that it should not be tax-free, but rather "tax neutral" compared to brick and mortar equivalent transactions, particularly when it comes to consumer tax and corporate tax.[84] The OECD offered some framework principles in 1998, including that trade resulting from e-commerce should be taxed in the jurisdiction of consumption.[85] Some developing countries are following the OECD framework. For instance, South Africa will require foreign service suppliers to register for value-added taxation.[86] Yet to date, no clear and consistent framework has emerged to support this position and profit shifting by multinational corporations continues on a massive scale.[87] E-commerce appears to have resulted in an erosion of the corporate and consumer tax base, which governments are now trying to address domestically.[88]

TRENDS IN INVESTMENT TREATY NEGOTIATIONS

The volume of investor-state litigation involving tax measures, as described in Section II above, has clearly made states more attuned to what had hitherto likely been unforeseen or unintended consequences of their treaty commitments. A range of drafting options are available to protect states' taxation power in future treaties.

Provisions requiring compliance with local law (including tax law) are becoming more expansive in recent investment agreements or models, likely as part of the trend to protect host state autonomy more robustly. For instance, the new Indian Model Bilateral Investment Treaty states "The parties reaffirm and recognize that: …(iii) Investors and their investments shall comply with the provisions of law of the Parties concerning taxation, including timely payment of their tax liabilities."[89] Notably, this broad drafting would appear to elevate to an international obligation compliance both with the domestic law of the host state as well as compliance with the law of the home state of the investor. The symmetry in obligations is interesting in light of corporate tax relocation tactics that aim to decrease the company's tax liability in all jurisdictions.

Tax carve-outs clauses in investment treaties are also seeing more scrutiny from negotiators. The new Dutch model BIT (2018) illustrates a limited carve-out approach, mostly aimed at avoiding conflicts with double taxation treaties. It explicitly provides that MFN and national treatment obligations apply to taxation measures but seeks to exclude any issue covered by a double taxation treaty or other international fiscal

83 For an early examination of this issue, *see* Barrett Schaefer, *International Taxation of Electronic Commerce Income: A Proposal to Utilize Software Agents for Source-Based Taxation,*16 Santa Clara High Tech. L.J.111, 135 (2000).

84 Teltscher, *supra* note 9, at 8.

85 OECD, *Electronic Commerce: Taxation Framework Conditions,* DAF/CFA(98) 50 (1998) at https://www.oecd.org/tax/consumption/1923256.pdf.

86 Amy Wilson et al., *The effect of electronic commerce on the erosion of tax bases – Developing appropriate taxation laws in South Africa,* 18, https://www.researchgate.net/publication/309135093_The_effect_of_electronic_commerce_on_the_erosion_of_tax_bases_-_Developing_appropriate_taxation_laws_in_South_Africa (2016).

87 *See generally* Thomas R. Tørsløv, Ludvig S. Wier and Gabriel Zucman, *The Missing Profits of Nations*, Working Paper No. 24701, National Bureau of Economic Research (2018).

88 UNCTAD, *Trade and Development Report 2018* at 87, UNCTAD/TDR/2018, Sales No: E.18.II.D.7. As early as the 1990s, the United States and the European Union identified the downward pressure on tax base from e-commerce. *See generally,* Disappearing Taxes; The tap runs dry, The Economist, 31 May 1997 at 17; Max Cash, *Electronic Commerce and Tax Base Erosion,* European Parliament, Directorate-General for Research Working Paper ECON 108/EN (1999); Donald Bruce and William F. Fox, *E-Commerce in the Context of Declining State Sales Tax Bases,* 53 National Tax J. 1373 (2000). Some authors also predicted early on that tax base erosion due to e-commerce would be even more acute in developing countries. *See generally* Richard Jones and Subhajit Basu, *Taxation of Electronic Commerce: a Developing Problem*, 16 Rev. L. Computers & Technology 35, 41-44 (2002); Banga, *supra* note 10, at 17-25.

89 Model Text for the Indian Bilateral Investment Treaty, art. 11 (iii), Government of India, Ministry of Finance Department of Economic Affairs (Investment Division), F. No. 26/St20t3-IC (Dec. 28, 2015) [hereinafter India Model BIT].

agreement.[90] The draft Pan-African Investment Code also takes a very limited approach merely to avoid conflicts with double taxation treaties and to ensure the latter's prevalence over the Code.[91] The U.S. Model BIT takes a middle ground, by mostly excluding taxation measures from the ambit of its model Bilateral Investment Treaty, except that the treaty obligations on expropriation and performance requirements (such as the prohibition on local content requirements) still apply to taxation measures.[92] In all these variants, the carve-outs are designed as conflict of law tools, rather than as an exclusion of a regulatory topic from the treaty in order to protect full domestic autonomy.

By contrast, the new Indian model Bilateral Investment Treaty carves out "any law or measure regarding taxation, including measures taken to enforce taxation obligations."[93] Moreover, it specifies that the host state has jurisdiction to decide whether an alleged breach is a matter of taxation and such decision is not reviewable by arbitral tribunals. This language is no doubt a response to the number of investor-state arbitrations arising on tax issues and recent adverse decisions on other subject matters that essentially overturned Indian judicial decisions. The goal is clearly to protect tax policy autonomy, rather than merely to avoid conflicts between international investment and international tax commitments.

States wishing to preserve maximum tax policy autonomy should consider a three-pronged approach. First, they might seek a robust domestic law compliance requirement, which elevates obligations already existing under domestic law to an international law obligation enforceable against investors, if only as a defense to an investor claim or to mitigate potential damages. Second, they could draft a broad carve-out that explicitly excludes tax matters from the scope of the protections granted to investors under the treaty, particularly national treatment, expropriation, fair and equitable treatment and umbrella clauses. Third, they could preclude taxation issues from falling within the scope of treaty dispute settlement procedures. This would ensure that tax policy and enforcement remain solely within domestic jurisdiction. Lastly, a conflict-type clause, or carve-out clause to address potential overlap with bilateral or multilateral taxation treaties should protect states from potential clashes with other international obligations.

Conclusion

Trade and investment treaties affect fiscal mobilization (understood as the ability to raise revenue and to change fiscal policy) in a number of ways. In some cases, the drafters' intention to include or exclude certain tax matters is clear, but in other cases, the fiscal impact of the treaties seem to be somewhat unforeseen. There is no consistency or coherent, treatment of fiscal matters in trade and investment treaties. Yet, the volume of litigation both under trade agreements and investment agreements belies the assumption that taxation issues are dealt with by double taxation treaties and that a simple conflicts clause will serve to exclude tax matters from trade and investment treaties. Moreover, tax treaties are limited in their scope. They are proving insufficient to address transfer pricing, profit shifting, base erosion and the challenges of the digital economy. As a result, countries may face both regulatory gaps, resulting in uncertainty in interpretation, implementation and adjudication of the law, and regulatory overlap, allowing forum shopping and other maneuvering by investors and traders.

Furthermore, the interplay between trade and investment treaties, which is largely unaddressed from a legal perspective, means that benefits secured in the trade regime could be undermined by loopholes in the investment regime allowing companies to evade tax policies secured in the trade arena. Preserving tax policy autonomy is therefore also a matter of coordination between trade and investment regimes.

90 Netherlands model Investment Agreement, art. 10 (Oct. 19, 2018).

91 Pan-African Investment Code, 2016 Draft, art. 39, https://au.int/sites/default/files/documents/32844-doc-draft_pan-african_investment_code_december_2016_en.pdf

92 2012 US Model BIT art. 21 (expropriation claims based on taxation measures must first be referred to tax authorities for a determination whether the measure indeed amounts to an expropriation).

93 India Model BIT, *supra* note 76, art. 2.4.

Table 7: Trade and Investment Agreements Issues by Types of Tax

	Direct Taxes (e.g. income, profits)	Indirect Taxes (e.g. VAT, sales, use, consumption)	Customs Duties
GATT	• No national treatment obligation	• National treatment obligation • MFN obligation	• Scheduled bound rates caps tariff rates • MFN obligation applies to applied tariff rate • Possibility of tariff renegotiations, with compensation • Possibility of raising tariffs with antidumping duties, countervailing duties, safeguards duties, measures to protect the balance-of-payments
GATS	• MFN obligation; carve-out for tax treaties • Exception to national treatment for equitable or effective taxation	• MFN obligation; carve-out for tax treaties • National treatment obligation if the sector has been liberalized	N/A
Investment Agreements	• MFN and national treatment obligations prohibits discrimination • Increased taxation may amount to indirect expropriation or breach of fair and equitable treatment • Limited carve-outs	• MFN and national treatment obligations prohibits discrimination • Increased taxation may amount to indirect expropriation or breach of fair and equitable treatment • Limited carve-outs	N/A
Standstill Agreement on Digital Transactions	N/A	N/A	• No duties on digital transactions

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