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Taxation and the Cross-Border Trade in Services: Rethinking Non-Discrimination Obligations

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TAXATION AND THE CROSS-BORDER TRADE IN SERVICES: RETHINKING NON-DISCRIMINATION OBLIGATIONS

by

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ABSTRACT

This Article examines the conflict between tax and trade law principles in the tax treatment of a non-resident service provider. It explores that conflict through non-discrimination obligations found in the General Agreement on Trade in Services (GATS), regional trade agreements, bilateral trade agreements, and tax treaties. The interplay between these agreements has the potential to frustrate trade law objectives because States may impose discriminatory tax measures on non-resident service providers. Tax treaties can play an important role in providing a minimum non-discrimination obligation for tax measures impacting the cross-border trade in services. This Article proposes a new tax treaty non-discrimination obligation grounded in trade law principles.

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Overview

> Limited disputes and general satisfaction with the current status quo led to the present underdeveloped doctrine of trade law as applied to tax measures. There is no escape from the conclusion that countries had not been concerned about the practice of protectionism through direct tax measures and therefore had not bothered with bringing direct tax issues to the table of trade negotiations. They were politically satisfied with the status quo of practical nonapplication of WTO law to direct tax measures.
>
> This state of affairs is likely to change. . . .[1]

Significant commitments have been made in recent years to liberalize cross-border trade in services by reducing barriers to trade. These commitments include undertakings by signatory States to provide national treatment, most favored nation treatment, and a host of other commitments to such matters as transparency in legislation and administration designed to ensure the free movement of services and service providers across national borders.[2]

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1. Yariv Brauner, *International Trade and Tax Agreements May Be Coordinated, but Not Reconciled*, 25 Va. Tax Rev. 251, 282 (2005).

2. The importance of trade in services became a focal point in world trade in the 1990s. See, for example, the General Agreement on Trade in Services, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Apr. 15, 1994, 1869 U.N.T.S. 183 [hereinafter GATS] (entered into force 1 January 1995); regional trade agreements like the North American Free Trade Agreement, Dec. 8–17, 1992, 32 I.L.M. 289 [hereinafter NAFTA] (entered into force 1 January 1994); and bilateral investments agreements, U.N. Conference

The potential benefit of these trade commitments to service providers is significantly undercut by broad exceptions in these agreements for direct taxation measures.[3] The oft-quoted reason for these exceptions, or "tax carve-outs," is that bilateral tax treaties address tax matters, including non-discrimination obligations.[4]

There is however, no non-discrimination obligation in tax treaties based on the Organisation for Economic Co-operation and Development (OECD), United Nations (U.N.), or U.S. Models that applies directly to a non-resident service provider absent a permanent establishment in the source State.[5] The result is that differences in tax treatment

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on Trade and Development, *Bilateral Investment Treaties: 1959–1999*, U.N. Doc. UNCTAD/ITE/IIA/2 (Dec. 2000), http://unctad.org/en/Docs/poiteiiad2.en.pdf.

3. Direct taxes in this Article include all taxes on income and capital, such as personal or individual income taxes, corporate income taxes, capital gains taxes, and wealth taxes. Other taxes, such as taxes on the supply of goods, sales, turnover taxes, or excise duties (indirect taxes), will also affect cross-border service suppliers.

4. *See infra* notes 15 and 19 and accompanying text. Other arguments by tax experts for excluding direct tax measures from trade agreements included that many of the countries that would join the World Trade Organization (WTO) had already entered bilateral tax agreements. It was unpalatable that bilateral concessions made under these tax treaties should extend to all WTO signatories under the most favored nation obligation. It was also argued that the national treatment obligation was incompatible with important policy reasons for distinguishing between residents and non-residents in tax matters.

5. OECD Model Tax Convention on Income and on Capital, July 15, 2014, http://dx.doi.org/10.1787/mtc_cond-2014-en [hereinafter OECD Model Tax Treaty]; U.N. Model Double Taxation Convention between Developed and Developing Countries, 2011, http://www.un.org/esa/ffd/wp-content/uploads/2014/09/UN_Model_2011_Update.pdf [hereinafter U.N. Model Tax Treaty]; U.S. Model Income Tax Convention, Feb. 17, 2016, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf [hereinafter U.S. Model Tax Treaty]. The non-discrimination obligations in both the OECD and U.N. Model Tax Treaties take the form of prohibitions designed to prevent source countries from discriminating against "foreigners" with sufficient nexus to the source country. OECD Model Tax Treaty, *supra*, art. 24; U.N. Model Tax Treaty, *supra*, art. 24. Depending on the context, the non-discrimination principles found in trade agreements may apply to determine if the host country is guilty of discrimination in the area of taxation. The goal of these provisions is to ensure no less favorable tax treatment for "similarly situated" persons and businesses. Specifically, the principle of non-discrimination

between a resident and a non-resident service provider are viewed as entirely permissible under tax treaties, including measures that may negatively impact the cross-border service provider's ability to compete in the source State.[6] Such measures might include aggressive interim withholding tax, high gross withholding tax, cumbersome administrative and compliance provisions, lack of transparency, excessive fees, and lengthy refund procedures.[7] These tax measures operate to exclude non-resident

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as expressed in Article 24 of the OECD Model Tax Treaty prohibits differences in tax treatment in four major areas as follows.

> A state shall not:
>
> - Subject non-nationals to "other or more burdensome" taxation than nationals who are "in the same circumstances." OECD Model Tax Treaty, *supra*, art. 24(1).
>
> - Levy tax on a permanent establishment of a foreign enterprise "less favourably" than a domestic enterprise carrying on the same activities. *Id.* art. 24(3).
>
> - Prevent the deduction of interest, rents, royalties, or other disbursements paid to a treaty partner if paid under the same circumstances where a deduction is available if paid to a resident. *Id.* art. 24(4).
>
> - Subject foreign-owned enterprises to taxation that is "other or more burdensome" than the taxation and connected requirements applicable to "similar" domestic enterprises. *Id.* art. 24(5).

The obligation applies to "taxes of every kind and description" (that is, to all direct and indirect taxes) levied by, or on behalf of, the State, its political subdivisions, or local authorities. *Id.* art. 24(6). Article 24(4) can be viewed as an indirect non-discrimination obligation in respect of a non-resident service provider in that it permits the deduction of payments to the non-resident in the same way as its deductions are permitted to a resident service provider.

6. Differences in tax treatment between residents and non-residents are generally viewed as inherently not discriminatory for pragmatic reasons, including revenue collection.

7. Further, and somewhat ironically because of the manner in which tax and trade agreements like the GATS interact, non-resident service providers from countries without tax treaties may receive a higher level of protection from tax discrimination than those from countries that share a tax treaty. GATS, *supra* note 2, art. XIV.

service suppliers from local markets or lessen their competitiveness in those markets contrary to trade law principles. Does this matter?

The cross-border trade in services is vital to both the U.S. economy and to global trade. Reports indicate that "[s]ince 2000, the value of US service exports has risen by more than 160 percent."[8] In 2016, services accounted for approximately one-third of all U.S. exports.[9] Internationally, the OECD reports that "[s]ervices generate more than two-thirds of gross domestic product (GDP) globally and create more new jobs than any other sector."[10] These are significant economic figures.[11]

Notwithstanding the importance of trade in services, tax measures imposed by a host government on a non-resident service provider remain largely unregulated by either tax or trade agreements. The result is that there are few limitations on a country's tax practices. Customary international law provides virtually no protection against tax discrimination, and constitutional or national limitations on tax discrimination against non-residents are rare. The primary restraint against egregious tax practices is international goodwill,[12] a restraint that has often proved ineffective.

Opportunities to engage in potentially discriminatory behavior also continue to expand. The United Nations Committee of Experts recently introduced a new article to the U.N. Model Tax Treaty that will

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8. Jan Zilinsky, *The Magnitude of Global Service Exports from the United States Is Unprecedented*, Peterson Inst. for Int'l Econ. (Oct. 19, 2015, 3:45 PM), https://piie.com/blogs/trade-investment-policy-watch/magnitude-global-service-exports-united-states-unprecedented.

9. U.S. Census Bureau & U.S. Bureau of Econ. Analysis, CB 16-169/BEA 16-56, U.S. International Trade in Goods and Services: August 2016 (Oct. 5, 2016), http://www.bea.gov/newsreleases/international/trade/2016/pdf/trad0816.pdf.

10. *Services Trade*, OECD, http://www.oecd.org/tad/services-trade (last visited May 12, 2018).

11. Some limitations are imposed in integrated agreements such as the Consolidated Version of the Treaty on the Functioning of the European Union, 2012 O.J. (C 326) 47, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT&from=EN, or in limited circumstances, bilateral tax treaties.

12. Comm. of Experts on Int'l Cooperation in Tax Matters, Revised Draft Article XX and Commentary: United Nations Model Tax Convention, U.N. Doc. E/C.18/2015/CRP.5 (Aug. 26, 2015), http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP.5_Services.pdf.

operate to tax fees for technical services arising in a Contracting State, wherever performed, on a gross basis. There is no non-discrimination obligation that will apply to source State taxation measures under the treaty article. The new treaty article will most certainly create new opportunities for source State taxation.

This Article concludes that the potential for taxation measures to operate as a barrier to trade in services should not be underestimated. Tax treaties can play an important role in providing a minimum non-discrimination obligation for tax measures impacting the cross-border trade in services.[13] This Article also concludes that a tax treaty is the optimal place for the non-discrimination obligation, given the trend in trade agreements since the General Agreement on Trade in Services (GATS) was signed in 1993 to restrict the resolution of disputes about key non-discrimination obligations in tax matters to the procedures in a tax treaty.[14] Because these disputes will generally arise based on a perceived violation of a trade non-discrimination obligation, a tax treaty

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13. For a contrary view, see Arthur J. Cockfield & Brian J. Arnold, *What Can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model*, World Tax J. (May 7, 2010), https://online.ibfd.org/document/wtj_2010_02_int_2. Consider also Joel Nitikman & Lincoln Schreiner, *IFA Branch Report—Canada*, *Non-Discrimination at the Crossroads of International Taxation*, 93a Cahiers de Droit Fiscal Int'l 179, 179 (2008), who comment, "As a practical matter, discrimination for tax purposes is not a prominent issue in Canada with foreign nationals, as evidenced by the lack of litigation and because foreign persons simply see (with good advice) the differences before them, and then appropriately measure and weigh the additional cost of adapting. . . ." With respect, this seems to be a circular argument. A determination as to whether or not tax discrimination is occurring, if based on an analysis of a law that does not include a non-discrimination obligation, will inevitably lead to a lack of evidence of discriminatory treatment.

14. To renegotiate the more than 500 regional and bilateral free trade agreements currently in existence to include a non-discrimination obligation is dismissed as impractical. Incorporating a non-discrimination obligation that would apply to a non-resident service provider in current free trade agreements is also an impractical solution given the current international political environment. In future free trade agreements, the inclusion of such an obligation might be considered. If so, dispute resolution ought to be reserved for the competent authorities (designated authorities) specified in the trade agreement if a non-discrimination obligation is added to tax treaties. This would result in parallel non-discrimination obligations for trade partners under regional trade agreements or bilateral investment treaties that have not entered into a tax treaty.

non-discrimination obligation based on trade law principles is an obvious choice. A proposal for such a non-discrimination obligation is offered.

I. Background

The issue of whether a non-discrimination obligation should apply to tax measures that impact a non-resident service provider is not new. It initially surfaced as a trade law matter at the multilateral level in 1993 during the GATS negotiations.[15] Of the four proposed modes of supply[16] under the GATS, three potentially gave rise to taxation rights in the State in which the income from services was derived.[17] At issue was whether these taxation rights should be subject to the national treatment obligation. There are many reports of the ensuing debate and in particular the objection by the United States to according a non-resident service

15. The United States strongly opposed the inclusion of direct taxes in the national treatment requirements under the GATS. *See* Gerlando Cappadona, *National Report Italy*, *in* WTO and Direct Taxation 431 & n.17 (Michael Lang et al. eds., 2005); Tycho H.E. Stahl, *Liberalizing International Trade in Services: The Case for Sidestepping the GATT*, 19 Yale J. Int'l L. 405 (1994). The matter was also the subject of discussion during the negotiations for the North American Free Trade Agreement (NAFTA) which came into effect in 1994. The NAFTA operates by initially carving out all tax measures and then selectively including some. NAFTA, *supra* note 2, art. 2103.

16. The four modes of supply are in summary form: Mode 1: Cross-Border Supply; Mode 2: Consumption Abroad; Mode 3, Commercial Presence; and Mode 4: Presence of Natural Persons. GATS, *supra* note 2, art. I(2).

17. The first of the four modes anticipates the cross-border supply of a service—for example, an accountant advising a client by telephone. In some countries this may give rise to source country tax obligations, reinforced through withholding tax collected by the consumer. Two of the four broad modes of supply that fall under the agreement (Modes 3 and 4) involve the service provider of one Member State being present in the other, again giving rise to potential and direct host country rights. Services provided through Mode 3 may benefit from the Treaty Article non-discrimination obligation as it applies to a permanent establishment. There is no non-discrimination obligation in respect of Modes 1 and 4. The non-discrimination obligation that potentially applies to the Mode 2 supply of a service is found in the indirect tax treaty non-discrimination obligation that requires the source state to permit a deduction from income for payment to a non-resident in the same circumstances that it would permit a deduction if made to a resident. This indirect obligation would also apply to services provided through Mode 1.

provider national treatment in tax matters. Among the United States' concerns was that if a national treatment obligation was included in the GATS, the dispute settlement procedures of the World Trade Organization (WTO) would apply in resolving complaints about a Member country's potentially discriminatory income tax practices.[18] The final WTO agreement adopted a compromise position. Direct tax measures were carved out of the national treatment obligation under the GATS as an exception, and the ability to challenge whether the national treatment obligation had been violated was restricted if the matter fell within the scope of a tax treaty.[19]

This strategy to carve out tax measures in favor of tax treaties was also adopted and, in many cases, expanded by other regional trade agreements like the North American Free Trade Agreement (NAFTA), Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA),[20] and most recently in the Trans-Pacific

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18. The U.S. view was that any issues with respect to tax measures could be dealt with adequately through the dispute settlement procedures in income tax treaties. Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 Yale J. Int'l L. 79 (1998).

19. At a news conference in 1993, "Treasury Assistant Secretary for Tax Policy Leslie B. Samuels said that the United States opposes language in a proposed trade-in-services agreement that would guarantee tax nondiscrimination. He argued instead that the issue of nondiscrimination is better addressed in the framework of bilateral tax conventions." John Turro, *U.S. Tax Concerns Threaten Final GATT Talks*, 61 Tax Notes 1151, 1151 (Dec. 6, 1993). Of interest also are the comments Samuels made as he headed for final negotiations: "Samuels plans to leave Washington to return to the bargaining table in Geneva on December 7 [1993] to negotiate language that 'recognizes that tax laws will have primacy, except and only if they clearly are a disguised trade barrier.'" *Id.* at 1152. That does not appear to have been the result.

20. *Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area*, signed 27 February 2009, [2010] ATS 1. The AANZFTA entered into force on January 1, 2010, for eight countries: Australia, New Zealand, Brunei, Burma, Malaysia, the Philippines, Singapore, and Vietnam. *See About AANZFTA*, ANZCHAM Phil., http://anzcham.com/doing-business-in-ph/aanzfta/ (last visited May 13, 2018). Thailand implemented the AANZFTA on March 12, 2010; Cambodia, Indonesia, and Laos implemented the AANZFTA during 2011 and 2012. *See News: ASEAN-Australia-New Zealand Free Trade Agreement*, Aust. Gov't, Dep't Foreign Aff. & Trade, http://dfat.gov.au/trade/agreements/in-force/aanzfta/news/Pages/news.aspx (last visited May 13, 2018).

Partnership Agreement (TPP),[21] as well as in dozens of bilateral free trade agreements.[22] It is a precedent that trade negotiators appear determined to follow in trade agreements, at least with respect to the trade in services.[23] The result is a complex web of international agreements that result in difficult interpretation issues and inconsistent non-discrimination obligations in respect of the cross-border trade in services. Perhaps more importantly, the extensive web of international obligations in trade agreements leaves taxation as one of the last unregulated barriers to the cross-border trade in services.

The following provides an overview of the non-discrimination obligations under the GATS, two regional trade agreements, select bilateral free trade agreements, and the tax carve-out from these obligations. The overview provides a stark picture of the extremely limited non-discrimination obligations that currently apply to tax measures that may impact a non-resident service supplier. It begins with the GATS.

A subsequent First Protocol has been fully implemented by all but Indonesia and Cambodia. *Id.*

21. Trans-Pacific Partnership Agreement, Feb. 4, 2016, https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text [hereinafter TPP]. The TPP was signed by then President Obama but formally abandoned by President Trump in January 2017. *See* Peter Baker, *Trump Abandons Trans-Pacific Partnership, Obama's Signature Trade Deal*, N.Y. Times (Jan. 23, 2017), https://www.nytimes.com/2017/01/23/us/politics/tpp-trump-trade-nafta.html. A discussion of the non-discrimination obligations in the agreement is included notwithstanding President Trump's decision to withdraw as it provides the most recent snapshot of the non-discrimination obligations, including the tax carve-out, in a regional trade agreement. The TPP has now been changed to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). In March 2018, the CPTPP was signed by 11 countries. *See From TPP to CPTPP*, Ctr. for Strategic & Int'l Stud. (Mar. 8, 2018), https://www.csis.org/analysis/tpp-cptpp.

22. *See, e.g.*, Free Trade Agreement Between Canada and the Republic of Colombia, Nov. 21, 2008, 2011 Can. T.S. No. 11 [hereinafter CCFTA] (entered into force 15 August 2011); Free Trade Agreement Between Canada and the Republic of Panama, Can.-Pan., May 14, 2010, 2013 Can. T.S. No. 9 [hereinafter CPFTA] (entered into force 1 April 2013).

23. As will be discussed later, trade agreements have expanded the carve-out for tax measures to include all tax measures—an open-ended expression that appears to exclude only customs and related duties affecting the trade in goods.

II. The Tax Carve-Out in Trade Agreements

A. The GATS

The GATS created a new standard for international trade in services. It applies to all measures by Members "affecting" all trade in services[24] and every possible mode of supply, including the cross-border supply and consumption of services, and the cross-border movement of service suppliers through the establishment of a commercial presence or in person.[25]

Non-discrimination is one of the basic principles of the GATS, and the foundation for the most favored nation and national treatment obligations generally incorporated into trade agreements. The most favored nation obligation requires that a host country tax foreign-service providers from one country no less favorably than those from another. The national treatment obligation requires that the host country treat foreign-service providers and domestic-service providers similarly or comparably.

Of no surprise, the most favored nation obligation is limited by the GATS, and preferential tax treatment of parties from one country over another is expressly authorized, provided it is the result of a tax treaty.[26] This is a sensible exception. Tax treaties are generally bilateral in nature, and the GATS exception serves to protect the bargain negotiated by the tax treaty partners.

There is also an exception from the national treatment obligation as it relates to the tax treatment of services and service providers.[27]

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24. GATS, *supra* note 2, art. I(1).

25. *Id.* art. I(2). Additionally, the GATS contains a series of annexes and understandings providing detailed rules with regard to various types of services, such as financial, air transport and maritime transport services, and access to telecommunications networks. *Id.* art. XXIX.

26. *Id.* art. XIV(e). This is "[s]ubject to the requirement that such measures are not 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 in services. . . ." *Id.* art. XIV (introductory language).

27. *Id.* art. XIV(d).

Specifically, any Member may adopt or enforce direct[28] tax measures that are inconsistent with national treatment, "provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Member countries."[29] The meaning of the expression "equitable or effective" is defined in a footnote[30] that provides illustrations of taxes and tax policies that may be excluded from the national

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28. The GATS provides a definition as follows:

> "[D]irect taxes" comprise all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

Id. art. XXVIII(o).

29. *Id.* art. XIV(d).

30. Specifically, the GATS refers to the following activities:

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

treatment obligation. These include, for example, the right to impose withholding tax as well as to apply special provisions such as transfer pricing rules to prevent tax avoidance.[31]

The exception from the national treatment obligation for direct tax measures is not absolute. Each Member State remains subject to the overriding non-discrimination obligation in Article XIV of the GATS, which imposes the requirement, known as the GATS chapeau, that "such measures are not 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 in services."[32] This non-discrimination obligation, which is basic to international trade law, imposes an important, albeit limited, restriction on the discretion of a Member State when imposing direct tax measures on the services or service providers of other Member States contrary to the GATS national treatment obligation.[33]

> (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
>
> (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.
>
> Tax terms or concepts in [the GATS Article XIV(d)] and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

Id. art. XIV n.6.

31. The footnote further specifies that tax terms or concepts listed in the footnote describing the "carve out" from the national treatment obligation are to be "determined according to tax definitions and concepts" or their equivalent "under the domestic law of the Member taking the measure." *Id.*

32. *Id.* art. XIV.

33. Note however, that no justification is required under Article XIV unless the national treatment obligation is otherwise violated. To establish such a violation, three conditions must be met. First, the non-resident service provider must be "like" a national service provider; second, the difference in treatment must be based on the national origin of the service or service provider;

The role of the GATS, including the non-discrimination obligations, may be severely limited with respect to a tax measure if a bilateral tax treaty is in effect between the Member countries.[34] Specifically, a Member may not invoke the national treatment obligation under either the consultation or dispute resolution provisions in the GATS with respect to a measure of another Member that falls within the scope of an international agreement related to the avoidance of double taxation.[35] When this restriction applies remains unclear. The OECD has opined that the phrase "falls within the scope" of a tax treaty is inherently ambiguous, leaving some doubt as to whether a tax treaty will apply to all measures relating to taxation,[36] or whether some tax measures may remain subject to the non-discrimination obligations in the GATS.[37]

What is clear is that if the matter falls within the scope of a tax treaty, any challenge as to whether a direct tax measure violates the national treatment obligation under the GATS is effectively eliminated. Any challenge with respect to an indirect tax measure is also eliminated if indirect tax measures are addressed in the non-discrimination provisions in the tax treaty.[38] If the matter falls within the scope of a tax treaty,

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and third, the treatment accorded to the non-resident must be less favorable than that accorded to a resident national. GATT Secretariat, *The Applicability of the GATS to Tax Measures*, GATT Doc. MTN.GNS/W/210 (Dec. 1, 1993), https://www.wto.org/gatt_docs/English/SULPDF/92140133.pdf.

34. GATS, *supra* note 2, art. XXII(3). This will serve to prevent debate about a Member government's right to exercise wide powers under its domestic law both to safeguard the tax base and to define its scope.

35. *Id.*

36. *See* OECD Model Tax Treaty, *supra* note 5, commentary on art. 25, para. 92.

37. The OECD provides the following additional guidance:

> While it seems clear that a country could not argue in good faith that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is unclear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.

Id. (footnote omitted).

38. Indirect taxes remain subject to the GATS national treatment obligation, but access to the GATS consultation and dispute resolution process may be limited if the tax treaty non-discrimination provisions include indirect

there is no trade law, non-discrimination obligation that would prevent a Member State from imposing a tax measure that is arbitrary, unjustifiable, or a disguised restriction on the trade in services. The non-resident must rely solely on the non-discrimination obligations in the applicable tax treaty. As stated, there is no non-discrimination obligation that would apply to the non-resident service provider under a tax treaty absent a permanent establishment in the source State.

Do all matters of non-discrimination with respect to direct tax measures fall within the scope[39] of a tax treaty?[40] Some tax treaty partners, including Canada and the United States, have attempted to answer this question through additional language in the tax treaty to clarify its scope.[41]

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taxes. Article 24(6) of the OECD Model Tax Treaty, *supra* note 5, for example, includes "taxes of every kind and description." If the applicable tax treaty includes similar language or specific language related to indirect taxes, an indirect tax measure would fall within the scope of the tax treaty and the Member State would be subject to the restriction in the GATS Article XXII(3). See, for example, Article 25 of the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Sept. 26, 1980, T.I.A.S. No. 11087, 1984 Can. T.S. No. 15 [hereinafter Canada-U.S. Tax Treaty] (entered into force 16 August 1984).

39. If one is of the view that a direct tax measure may violate the GATS national treatment non-discrimination obligation but falls outside the scope of a tax treaty, the issue of the "scope" of the tax treaty must first be resolved. In case of disagreement between Members as to whether a measure falls within the scope of such an agreement between them, the GATS, *supra* note 2, article XXII paragraph 3 provides that "it shall be open to either Member to bring this matter before the Council for Trade in Services. The Council shall refer the matter to arbitration. The decision of the arbitrator shall be final and binding on the Members" (footnote omitted).

40. The OECD and UN Model Tax Treaties both include a non-discrimination article. OECD Model Tax Treaty, *supra* note 5, art. 24(3); UN Model Tax Treaty, *supra* 5, art. 24(3). In order to avoid doubt, some tax treaties have clarified the role of the GATS.

41. For example, in the case of the U.S.-Canada Tax Treaty, a Third Protocol provides that for the purposes of GATS, Canada and the US agree that a tax measure will fall under the tax treaty if it relates to Article 25 (Non-Discrimination) or, if it does not relate to non-discrimination, it falls within another tax treaty provision, but only to the extent that the measure relates to a matter dealt with in that tax treaty provision. Canada-U.S. Tax Treaty, *supra* note 38, art. 29.

Challenging interpretive issues remain for Member States that have entered into a tax treaty if the tax treaty does not include a non-discrimination article.[42] One interpretation is the GATS limited non-discrimination obligation applies. Another plausible interpretation is that the issue of non-discrimination falls within the scope of a tax treaty but that no non-discrimination obligation applies if none is included in the tax treaty.

In summary, direct tax measures are initially subject to a carve-out from both the national treatment and most favored nation obligations under the GATS but remain subject to more limited trade discipline under the GATS chapeau requirement—specifically, that the measure may not be arbitrary, unjustifiable discrimination, or a disguised restriction on trade in services. The ability to challenge whether a measure violates the national treatment obligation (including the exception) is circumvented if the matter falls within the scope of a tax treaty. The opportunity to determine whether a measure falls within the scope of a tax treaty under GATS procedures varies[43] depending on when the tax treaty was entered into. Because tax treaties are negotiated bilaterally, the ability to challenge whether the matter falls within the scope of a tax treaty may also be limited by the tax treaty to tax treaty procedures. If the matter falls within the scope of a tax treaty, there is no non-discrimination obligation in respect of a non-resident. If there is no tax treaty between the Member States, the non-resident may rely on the GATS chapeau requirement that the measure may not be arbitrary, unjustifiable, or a disguised restriction on trade in services. As a result, under the GATS structure there are

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42. *See, e.g.*, Free Trade Agreement Between the Government of Australia and the Government of the Republic of Korea, signed 8 April 2014, [2014] ATS 43, http://www.austlii.edu.au/au/other/dfat/treaties/ATS/2014/43.html (entered into force 12 December 2014).

43. A footnote to Article XXII(3) of the GATS provides that if there is a disagreement about whether the matter falls within the scope of a tax treaty and the tax treaty was in existence at the time the WTO Agreement entered into force, one country cannot unilaterally challenge the issue of the tax treaty's scope under WTO procedures. GATS, *supra* note 2, art. XXII(3) n.11. Both parties to the existing tax treaty must consent if the WTO dispute resolution procedure (rather than a tax treaty procedure) is to be engaged. *Id.* However, if future tax treaties are silent on the issue, either treaty partner may unilaterally apply to determine whether a matter falls within the scope of a tax treaty before the WTO's Council for Trade in Services, which may then refer the matter to binding arbitration. *Id.* art. XXII(3).

different non-discrimination obligations for a non-resident with respect to the tax measures that may be imposed by another Member State—with the highest level of protection, it would appear, being reserved for a non-resident from a country without a tax treaty with the source State.

B. Regional Trade Agreements

1. The North American Free Trade Agreement (NAFTA)

The NAFTA came into effect on January 1, 1994, for Canada, the United States, and Mexico. Its objectives "as elaborated more specifically through its principles and rules, including national treatment, most favored nation treatment and transparency," include the elimination of trade barriers, the facilitation of the cross-border movement of goods and services, and the promotion of fair competition in the free trade area.[44]

Chapter 12 (Cross-Border Trade in Services) of the NAFTA establishes the basic rules agreed to by Canada, the United States, and Mexico to regulate the provision of services across their respective borders. The agreement calls for national treatment and most favored nation treatment and prohibits local presence requirements.[45] The NAFTA exceeds the GATS both in scope and coverage, bringing all existing and future government measures relating to cross-border, non-financial services within the scope of Chapter 12.[46] Unlike the GATS, where specific commitments to national treatment must be negotiated, the NAFTA

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44. NAFTA, *supra* note 2, art. 102.

45. The NAFTA prohibition against requiring service providers to establish a presence (such as an office) within the territory of a NAFTA Party as a condition of market access eliminated many of the regulatory measures that cross-border service suppliers were formerly subject to when a local office was required. *Id.* ch. 12.

46. Notwithstanding the limitations on the services protected, the general provisions of the GATS reflect the overall philosophy of the General Agreement on Tariffs and Trade, 30 Oct. 1947, 55 U.N.T.S. 187. Thus, the GATS contains a number of measures not found in the services provisions in the NAFTA. For example, the GATS contains a safeguard limitation on services imports under a balance of the payments crisis. GATS, *supra* note 2, art. XII. Government procurement of services is also exempted from the most favored nation, national treatment, and market access provisions. *Id*. art. XIII. Finally, the Agreement commits Members to "enter into negotiations with a view to

operates in reverse and requires each Party to state explicitly, in various annexes, if it does not intend to conform to the general rules in Chapter 12 with respect to most favored nation, national treatment, and other NAFTA obligations.[47]

Under the NAFTA the cross-border provision of a service is defined as providing a service: "from the territory of a Party into the territory of another Party" (e.g., cross-border); "in the territory of a Party by a person of that Party to a person of another Party" (e.g., tourism); and "by a national of a Party in the territory of another Party" (e.g., an on-site visit to the service recipient by a non-resident service provider).[48] Unlike the GATS, which includes in the definition of the supply of a service, services provided by a service supplier of one Member through a commercial presence in the other, the NAFTA addresses this mode of supply through the investment provisions in Chapter 11 (Investment). A number of obligations from the Trade in Services Chapter are cross-referenced to the Investment Chapter.

The NAFTA agreement generally excludes all tax measures from the NAFTA non-discrimination obligations in very explicit language[49] but then selectively brings some taxes under trade law discipline. For purposes of the cross-border trade in services, included taxes are indirect taxes. Excluded taxes are generally direct taxes with an exception for measures related to the purchase or consumption of services.[50]

The NAFTA agreement also explicitly provides that nothing under the trade agreement "shall affect the rights and obligations of any Party under any tax convention."[51] The effect of this provision is unclear. Does it operate to negate any non-discrimination obligations under the

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developing the necessary multilateral disciplines" to avoid the trade distortive effects of subsidies on trade in services. *Id.* art. XV.

47. These exceptions are provided in lieu of grandfather provisions. Annex 1 of the NAFTA contains the three countries' reservations schedules for their non-conforming federal measures. NAFTA, *supra* note 2, Annex I; *see id.* art. 1206(a)(i). Laws and regulations that are grandfathered or listed as a reservation in Annex 1 cannot be challenged as long as they do not become more inconsistent with the Agreement.

48. See the definition in the NAFTA of "cross-border provision of a service." *Id.* art. 1213.

49. *Id.* art. 2103(1).

50. *Id.* art. 2103(4).

51. *Id.* art. 2103(2).

trade agreement if there is no equivalent non-discrimination obligation in the tax treaty? For example, the NAFTA includes a national treatment obligation with respect to all tax measures on income and capital that relate to the purchase and consumption of services. There is no equivalent non-discrimination obligation under any of the tax treaties in the NAFTA Block. Instead there is a more limited obligation requiring that for the purposes of determining taxable profits, disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.[52] If the disputed matter relates to the deductibility of an expense, the NAFTA and the tax treaty are consistent. However, if the matter relates to a Party's grant of additional tax relief or a tax credit to a consumer of domestic but not foreign (non-resident) services contrary to NAFTA Article 2103(4) the non-discrimination obligations in the trade agreement and the tax treaty are inconsistent. To the extent that this difference in tax treatment is not addressed by a non-discrimination provision in a tax treaty, is it subject to scrutiny under the national treatment obligation in the NAFTA or negated because it is inconsistent with the tax treaty?[53]

Trade law protections for indirect taxes may also be negated by the tax treaties in the NAFTA Block. Although indirect taxes are subject to trade law obligations under the NAFTA, they are also referenced in the non-discrimination article in all three of the tax treaties in the NAFTA region. However, the tax treaties do not include a non-discrimination obligation that would apply to a non-resident with respect to indirect taxes. Since the NAFTA expressly provides that the NAFTA agreement

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52. *See* OECD Model Tax Treaty, *supra* note 5, art. 24(4); *see also* Canada-U.S. Tax Treaty, *supra* note 38, art. 25(7).

53. A fairly comprehensive interpretation of Article 2103 of the NAFTA which addresses tax measures was provided by the Senate Finance Committee in a report to Congress. This report was incorporated into the Congressional Record for November 18, 1993. 139 Cong. Rec. 30,201, 30,218 (1993). From the report it would appear that the U.S. Senate Finance Committee was of the view that the NAFTA could be interpreted to allow for the challenge of a taxation measure that violates a NAFTA obligation if the alleged discriminatory measure is not specifically dealt with by a provision of a tax treaty. *Id.* Put differently, the U.S. Senate Finance Committee did not interpret Article 2103(2) as precluding a challenge under the NAFTA merely because a tax treaty was in place. This may be of little practical effect given the very limited national treatment obligation with respect to direct tax measures.

"shall not affect the rights and obligations under a tax treaty," is the lack of a non-discrimination obligation with respect to indirect taxes in the tax treaty sufficient to argue that no non-discrimination obligation exists under the trade agreement?

Resolution of how the trade agreement is to be interpreted in these circumstances will depend on how international principles are applied. The outcome is not obvious.[54] These observations are made with respect to the NAFTA. Similar observations can be made about the treatment of tax measures under other regional trade agreements, like the AANZFTA, and the interface between the signatories to such agreements with the bilateral tax treaties that affect them.

Non-discrimination obligations with respect to direct tax measures were also carved out of the TPP and create additional interpretation problems as will be seen below.

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54. Under general principles of international law, "inconsistency" will most likely be interpreted to mean the same thing as "conflict" and will be given a broad interpretation. Under a broad interpretation of conflict, international agreements may be in conflict where their operation is incompatible with the negative or positive obligations of the other.

The argument in favor of finding an inconsistency between the tax treaty and trade agreement in these circumstances is that it is inconsistent to have the inclusion of a non-discrimination obligation in the trade agreement combined with the absence of a non-discrimination obligation in the tax treaty. This is a conflict of aims and, in the alternative, a conflict of express and implied terms. While the trade agreement provides for an explicit non-discrimination obligation, the tax treaty in substance rejects any obligation in these circumstances and provides for the right to discriminate. Since the rights and obligations under the two agreements are incompatible with the other, there is an inconsistency between the tax treaty and the trade agreement, and the tax treaty prevails. The argument in favor of finding no inconsistency between the tax treaty and trade agreement is that there is no inconsistency between the codified rights and obligations in the agreements. There is no conflict between the trade agreement and the tax treaty because the tax treaty is silent on the matter. The right to discriminate is not an implied term of the tax treaty. Put differently, if the tax treaty is silent on the matter, an express term in the trade agreement cannot be in conflict with it. Since the operation of their respective aims are not incompatible with the rights and obligations of the other, there is no inconsistency between the tax treaty and the trade agreement, and the provisions of the trade agreement ought to prevail, meaning that the national treatment obligation applies. *See generally* Joost Pauwelyn, Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law (2003).

2. The Trans-Pacific Partnership Agreement (TPP)

The TPP Agreement was signed on February 4, 2016.[55] It is one of the largest free trade agreements ever negotiated and originally included a dozen countries of the Asia-Pacific region: the United States, Japan, Canada, Mexico, Australia, New Zealand, Malaysia, Vietnam, Chile, Peru, Singapore, and Brunei. Although U.S. President Trump formally abandoned the agreement in January of 2017, the negotiated obligations in the TPP remain the best illustration of the tax carve-out in regional trade agreements to date.[56]

The agreement builds on the core structure of the WTO Agreements and existing regional free trade agreements. In the chapter on trade in services, one finds the definition of what constitutes trade in services tracks that found in the NAFTA. The three main mechanisms to facilitate trade in services among the Parties are also the same, including commitments to extend most favored nation and national treatment to one another's services and service suppliers, a prohibition on market access restrictions, and a prohibition on measures that require service suppliers to maintain a local presence as a condition for supplying a service. Like the NAFTA, the commitments operate on a "negative list" or "top-down" basis, meaning that they apply to all service sectors except for those specifically listed in a Party's schedule.[57] The exceptions, including the carve-out for tax measures, are also largely the same.[58]

Any residual non-discrimination obligation with respect to national treatment and tax measures is exorcised through Article 29.4(2) which states, "Except as provided in this Article, nothing in this Agreement shall apply to taxation measures."

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55. TPP, *supra* note 21.

56. Following the withdrawal of the United States, the TPP has become the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). *See supra* note 21.

57. For example, Canada and Australia have both claimed reservations with respect to nonconforming measures designed to support cultural industries such as literature, film, and music. The United States claimed reservations in sectors such as maritime transport; land transport; services related to air transport; and legal, accounting, and engineering services. Australia, Chile, Malaysia, Japan, Singapore, and Vietnam claimed reservations with respect to broadcasting and/or audio-visual services; most Parties have taken reservations in legal services. *See generally* TPP, *supra* note 21.

58. *Id.* ch. 9.

The result is that, subject to a tax treaty, two limited non-discrimination obligations potentially remain to protect a non-resident service provider. First, as is the case under the NAFTA, the national treatment obligation applies to taxes on income and capital that relate to the purchase or consumption of particular services, except the conditioning of the receipt or continued receipt of an advantage that relates to the purchase or consumption of particular services on requirements to provide the service in its territory. Second, the national treatment and most favored nation obligation apply generally to indirect taxes.

Even these non-discrimination obligations are limited and do not apply, for example, to advantages accorded under a tax treaty, existing non-conforming measures or their renewal, and measures with respect to pension plans, superannuation funds, and insurance premiums. The adoption or enforcement of any new taxation measure aimed at ensuring the equitable or effective imposition or collection of taxes, including any taxation measure that differentiates between persons based on their place of residence for tax purposes, are also excepted provided that the taxation measure does not arbitrarily discriminate between persons, goods, or services of the Parties.[59]

The TPP additionally provides for the supremacy of tax treaties in the now familiar language: "Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such tax convention, that convention shall prevail to the extent of the inconsistency."[60]

It also provides supremacy to the competent authorities (designated authorities) under the tax treaty to determine whether there is an inconsistency. Specifically, the agreement incorporates a dispute resolution procedure in Article 29.4(4), which requires that, "if an issue arises as to whether any inconsistency exists between [the TPP] and the tax convention, the issue shall be referred to the designated authorities of the Parties in question."[61] A panel or tribunal established under the

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59. A footnote to the agreement indicates that this exception is to be interpreted with reference to Article XIV of the GATS but, unlike the GATS, is not restricted to services or direct taxes. In other words, the exception will also apply to indirect measures and in circumstances other than tax collection with respect to the provision of services. TPP, *supra* note 21, art. 29.4(6) & n.10.

60. TPP, *supra* note 21, art. 29.4(3).

61. The designated authorities then have six months from the date of referral to make a determination as to the existence and extent of any

TPP to consider a dispute related to a taxation measure is required to accept as binding a determination of the designated authorities of the Parties made under this paragraph. Assuming the matter is decided in favor of the non-resident, it will still not result in any direct non-discrimination obligation applicable to the service provider. The non-discrimination obligation protects the non-resident indirectly by requiring the source State to permit a deduction to the purchaser of the services.

C. Bilateral Free Trade Agreements

More than 250 bilateral free trade agreements have been negotiated globally since 1995.[62] The interaction of bilateral free trade agreements and tax treaties between the same parties is examined using as illustrations two bilateral free trade agreements entered into by Canada: the Canada-Colombia Free Trade Agreement (CCFTA)[63] and the Canada-Panama Free Trade Agreement (CPFTA).[64] As will be seen, the carve-out strategy for tax measures adopted in the bilateral free agreements entered into by Canada, as well as other jurisdictions, substantially duplicates the approach adopted in regional trade agreements like the AANZFTA and the NAFTA. Tax treaties also serve a similar role in potentially limiting trade obligations with respect to tax measures.

Both the CCFTA and the CPFTA seek, among other things, to create an expanded and secure market for the trade in services. Like the GATS and the NAFTA, both agreements contain broad obligations to provide national treatment and most favored nation treatment to the service providers of the other Party. The basic definitions are also similar to those found in the NAFTA, as is the carve-out for tax measures. Specifically, the trade agreements exclude all tax measures from trade discipline and then selectively include non-discrimination obligations in respect of particular tax measures.

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inconsistency. During that period a Party cannot initiate a procedure under TPP Chapter 28 (Dispute Settlement) or TPP Article 9.19 (Submission of a Claim to Arbitration). If those designated authorities agree, the period may be extended up to 12 months from the date of referral of the issue. TPP, *supra* note 21, art. 29.4(4).

62. *See Agreements Library*, World Bank, https://wits.worldbank.org/gptad/library.aspx (last visited May 14, 2018).

63. CCFTA, *supra* note 22.

64. CPFTA, *supra* note 22.

Included tax measures are income and capital tax measures that relate to the purchase or consumption of cross-border services or financial services, other taxes affecting services and investments, and tax measures linked to performance requirements.[65] For purposes of the cross-border trade in services, the most relevant of these obligations is with respect to the purchase or consumption of services.

Both trade agreements provide that, subject to any applicable tax treaty, the national treatment obligation applies to all taxation measures on income, capital gains, or the taxable capital of corporations to the extent that those taxes relate to the purchase or consumption of particular services from a service provider.[66] In summary, the only non-discrimination obligation that would potentially apply to a non-resident service provider with respect to income tax applies indirectly through the tax treatment of the purchaser of the services.

Subject to a tax treaty, a non-resident service provider must also be accorded national treatment and most favored nation treatment with respect to indirect taxation measures such as, in the case of Canada, the Goods and Services Tax (GST).[67]

Tax treaties generally have primacy if their provisions are inconsistent with trade agreements. Unlike the NAFTA, the free trade agreements with Colombia and Panama address an additional dispute resolution question: what happens if a "similar provision" exists in both the trade agreement and the tax treaty? Article 2204(3) of the CCFTA provides:

> Where similar provisions with respect to a taxation measure exist under this Agreement and under a tax convention, the procedural provisions of the tax convention alone shall be used, by the competent authorities identified in the tax convention, to resolve any issue related to such provisions arising under this Agreement.[68]

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65. CCFTA, *supra* note 22, art. 2204; CPFTA, *supra* note 22, art. 23.04.

66. CCFTA, *supra* note 22, art. 2204(5)(a). These agreements also clarify that this obligation does not prevent a Party from conditioning the receipt or continued receipt of an advantage relating to the purchase or consumption of particular services on requirements to provide the service in its territory. *See, e.g.*, *id.* art. 2204(5)(c)(iv).

67. *See, e.g.*, CPFTA, *supra* note 22, art. 23.05.

68. CCFTA, *supra* note 22, art. 2204(3).

The addition of this language resolves any potential ambiguity about the appropriate forum for dispute resolution if there are similar provisions. Unfortunately, it does not resolve the issue of whether two provisions are similar.[69]

The potential impact of the carve-out for tax measures under these two free trade agreements is different for the non-resident service provider. This difference is discussed from the perspective of a Canadian service provider who is providing services in Colombia and Panama, respectively.

A tax treaty between Canada and Colombia was signed in 2008 and came into force in 2012.[70] The Canada-Colombia Tax Treaty follows the OECD Model Tax Treaty. It applies to all taxes subject to the Convention levied by the government of Canada under its Income Tax Act, but not to other taxes such as, for example, the GST. There is no non-discrimination obligation in the Canada-Colombia Tax Treaty that applies directly to a non-resident service provider absent a permanent establishment by the Canadian in Colombia. The indirect national treatment obligation under the CCFTA that relates to the deductibility of amounts in respect of the purchase or consumption of services may also

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69. *Id.* art. 2204(8)(a), (c). If the dispute relates to whether a measure of a Party is a taxation measure, either Party may refer the issue to the competent authorities of the Parties. The competent authorities then have six months to determine the issue. If they fail to do so, a panel may decide. There is a similar process for determining whether a measure falls within the scope of a tax treaty. The matter is to be referred to the competent authorities, and failing agreement by them, to a panel. In order to resolve an issue where the provisions are similar under a tax treaty and the CCFTA, Article 2204(3) requires that the procedural provisions of the tax treaty alone be used by the competent authorities identified in the tax convention to resolve any issue related to the provisions.

70. Convention between Canada and the Republic of Colombia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, Nov. 21, 2008, 2012 Can. T.S. No. 14, https://www.fin.gc.ca/treaties-conventions/colombia08_1-eng.asp [hereinafter Canada-Colombia Tax Treaty] (entered into force 12 June 2012). In Canada, the Treaty withholding tax applies as of January 1, 2013; the same is true in Canada for other taxes. *Id.* art. 29(1). In Colombia, the effective date "in respect of taxes on income that is obtained and amounts paid, deposited, or accounted for as expenses" is January 1, 2013, while "in all other cases, [the effective date is] as of the date on which the Convention enters into force." *Id.*

be negated if it is considered to be inconsistent with the rights and obligations of the parties under an applicable tax agreement. The argument in favor of a finding of inconsistency is that the tax treaty between Canada and Colombia does not include a non-discrimination obligation that relates to the purchase or consumption of services.[71]

For the purposes of the GATS, the Canada-Colombia tax treaty includes the standard wording that any dispute between the Contracting States as to whether a measure falls within the scope of the Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States.[72] The tax treaty article goes on to provide that any doubt as to the interpretation of the tax treaty paragraph is to be resolved through the Mutual Agreement Procedure in the tax treaty.[73] Without agreement under that procedure, the dispute "shall be resolved . . . pursuant to any other procedure agreed to by both Contracting States."[74]

The outcome will be different if the services are provided in Panama because there is no tax treaty between Canada and Panama. A Canadian service provider in Panama alleging tax discrimination must seek a remedy, if any, under the GATS. Canada and Panama are both Members of the WTO and as signatories are required to observe their multilateral commitments, including the scheduled national treatment and most favored nation obligations under the GATS. Because there is no tax treaty between Canada and Panama, a Canadian service provider may rely, subject to GATS Article XIV(d), on Panama's national treatment obligation under the GATS and is not restricted from accessing

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71. This conclusion depends on how the trade agreement is interpreted. Read literally the CCFTA, *supra* note 22, art. 2204(2) is clear that "[n]othing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency." The imposition of a non-discrimination obligation under the trade agreement when there is none under the tax treaty is arguably inconsistent. The better view appears to be that if the tax treaty is silent on the matter, it does not provide for a right or obligation that is inconsistent with the trade agreement. Put differently, there is no inconsistency unless the non-discrimination obligation in the trade agreement conflicts with an actual obligation in the tax treaty.

72. Canada-Colombia Tax Treaty, *supra* note 70, art. 28(2).

73. *Id.*

74. *Id.*

the GATS dispute resolution procedures. The national treatment obligation under the GATS is not violated if the tax measure meets the GATS exception—that is, the measure is aimed at ensuring the equitable or efficient collection of taxes[75] and is not arbitrary or unjustifiable discrimination or a disguised restriction on trade in services. The same result would occur for a service provider from the United States. Both the United States and Panama are Members of the WTO, and there is no tax treaty between the United States and Panama.

III. The Potential for Discriminatory Tax Treatment

Trade agreements include, at best, very limited non-discrimination obligations in respect of the tax treatment of a non-resident service provider. Tax treaties based on the OECD and UN Model tax treaties provide none. Does this matter? This Article concludes that it does.

Tax measures may serve as barriers to trade in a variety of ways, even a tax measure purportedly aimed at ensuring the equitable or effective imposition or collection of direct tax. Differences in the tax treatment of residents and non-residents are common and accepted. These differences in tax treatment can be found in the domestic law or administrative practices of the "source" State,[76] including how tax treaties are interpreted and applied.

One of the most significant differences in the tax treatment of a non-resident under domestic law is the imposition of withholding tax by the source State, typically on a gross basis, on income for services paid to the non-resident.[77] This difference is generally justified on the ground that a non-resident service provider poses collection and enforcement problems. Liability for withholding generally falls on the resident

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75. GATS, *supra* note 2, art. XIV.

76. As will be discussed, although views may differ on the "source" of service income, the tax treatment of the non-resident service provider is generally based on how source is interpreted by the "payor" state.

77. Many countries are very concerned about securing their source country rights over income from services and do so through withholding tax. The point of this Part is not to argue that withholding taxes are not appropriate in many circumstances. Rather the objective of the Part is to demonstrate the wide variances in practice in the imposition of withholding taxes and the potential impact this may have on a non-resident service provider.

payor.[78] Practices vary in different countries as to whether the withholding tax is an interim or a final obligation.[79] Practices also vary as to whether or not a withholding tax will be imposed notwithstanding a tax treaty exemption.

Whether or not the withholding tax is final, the withholding tax liability is likely to represent a substantial tax burden. The rate of withholding imposed on income from services can range from 15% in the Czech Republic to 35% in Argentina, Brazil, and Chile.[80] These rates may be higher if the payments are made to residents subject to a preferential tax regime or in a low-tax jurisdiction. Because the withholding taxes are generally applied to the gross amount of income, they may represent a substantial tax burden on net services income after taking into account related expenditures.[81]

There may also be differences in administrative practices in the source State that may negatively impact a non-resident service provider.[82] Taxing agencies are generally given broad discretion in establishing

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78. *See* Karin Simader, Withholding Taxes and the Fundamental Freedoms (2013).

79. *See* Ariane Pickering, *General Report: Enterprise Services*, 97a Cahiers de Droit Fiscal Int'l 17 (2012). Some countries such as Australia, Canada, Israel, New Zealand, Portugal, and the United Kingdom impose withholding taxes on services income when payments are made to non-residents. *Id.* at 32. However, refunds may be granted if the non-resident files a tax return and the net tax liability is less than the withholding tax. Other countries impose a final withholding tax on income from services rendered by non-residents, especially when the non-resident does not have a permanent establishment in the countries. These countries include Argentina, Brazil, Chile, Chinese Taipei, Colombia, Czech Republic, France, India, Italy, Japan, Mexico, Peru, South Korea, Spain, Uruguay, and Venezuela. *Id.* at 32 & n.33. Withholding taxes imposed by these countries are final in that they represent the non-residents' final tax liability in these countries and will not be refunded (unless a lower rate applies under an applicable tax treaty).

80. *Id.* at 33.

81. *See* Shee Boon Law, *Withholding Taxes on Services Income—A 21st Century Outlaw or a Necessary Evil?, in* Taxation of Business Profits in the 21st Century—Selected Issues under Tax Treaties 79 (Carlos Gutiérrez & Andreas Perdelwitz eds., 2013).

82. *See, e.g.*, Income Tax Regulations, C.R.C., c 945 § 105 (Can.) (dealing with withholding taxes and the waiver process).

administrative practices that can increase the impact of tax provisions already negatively affecting a non-resident service provider. It is no surprise that the imposition of gross withholding taxes[83] on non-resident service fees may interfere with the ability of the service provider to do business in the other country. Conversely, the ability to secure a waiver or exemption from withholding tax in circumstances where there is no ultimate tax liability in the other country will clearly be a benefit to the service provider.

Perhaps the most effective way of illustrating the potential impact of such tax measures is by an examination of a country's domestic regime and in particular its withholding tax regime. Canadian withholding tax provisions are used as an example because Canada's domestic law and administrative practices are those with which the author is most familiar. The discussion, although factual, is intended to be illustrative only and can be easily repeated using legislation and administrative practices in many other source countries. As will be seen, there are clear differences in the tax treatment of a resident when compared to a non-resident service provider by Canada as a source State—differences that will affect the competitive position of the non-resident.[84]

Canada collects tax imposed on the income earned by non-residents performing services in Canada by way of withholding tax.[85]

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83. "Gross withholding taxes" is defined in VERN KRISHNA, THE FUNDAMENTALS OF CANADIAN INCOME TAX 1725 (8th ed. 2004), as:

> In international tax law, a withholding tax is a tax levied by the country in which income arises (the source country) at a flat rate on the gross amount of the income paid by a resident of the country to a non-resident. The tax is usually collected by the resident taxpayer and remitted to the government on behalf of the non-resident person.

84. *See* Natasha Miklaucic & Lorna Sinclair, *Regulations 102 and 105 and Cross-Border Compliance Issues, in* REPORT OF PROCEEDINGS OF THE SIXTY-FIFTH TAX CONFERENCE 24-1 (Can. Tax Found. 2014).

85. In addition to withholding taxes, there may be liability for indirect taxes such as the Goods and Services Tax (GST). For GST purposes, the threshold for non-residents being required to register, collect, and remit GST is very different. For GST purposes, the service provider must only be carrying on business in Canada. Thus, while a non-resident may be exempt from Canadian income tax under a tax treaty, they may not be exempt from being

Specifically, Income Tax Regulation 105 (Regulation 105) provides that "[e]very person paying to a non-resident person a fee, commission or other amount in respect of services rendered in Canada, of any nature whatsoever, shall deduct or withhold 15 per cent of such payment" and remit it to the Canada Revenue Agency (CRA).[86] Tax withheld pursuant to this provision operates, in effect, as an installment in respect of the non-resident's potential Canadian tax liability for income tax. Potentially significant penalties and interest charges apply to the procurer of services for failure to withhold, remit, and report as required under the Canadian Income Tax Act.[87]

The broad language of Regulation 105 casts a wide net over payments that may be subject to withholding.[88] The reference to "every person paying a fee" includes individuals, corporations, trusts, partnerships, and legal representatives, whether resident or non-resident of Canada. The CRA has taken the position that each member of a partnership is responsible for Regulation 105 withholding. Also included in Regulation 105 are payments made by third parties and tax-exempt parties.

Non-resident service providers who elect to subcontract a portion of the work in Canada to a resident contractor are also subject to full withholding. If the work is subcontracted to a non-resident contractor, the payment from the non-resident service provider to the non-resident contractor must also be subject to withholding.

The CRA has made it clear that Canada does not relinquish its right to Regulation 105 withholding through income tax treaties; rather, it may relinquish this right only through the waiver process. A payor may reduce or eliminate the withholding when the CRA issues either an income and expense waiver or a treaty-based waiver to the non-resident.

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required to register, collect, and remit GST. Since in many cases this GST would be recovered by the payor, there is no net tax revenue generated by the CRA in these circumstances, only the administrative and compliance burden.

86. Income Tax Regulations, *supra* note 82, § 105.

87. Income Tax Act, R.S.C. 1985, c 1 (5th Supp.) (Can.) [hereinafter ITA].

88. Income Tax Regulations, *supra* note 82, § 105 lists the exempt forms of payments, which include remuneration to non-residents, payments made to a registered non-resident insurer, and payments made to an authorized foreign bank in respect of its Canadian banking business.

A non-resident may apply for a waiver of the withholding tax if it can show, before performing the services in Canada, that the tax liability is less than the amount to be withheld, either due to a tax treaty exemption or an estimation of its income and expenses.[89] Under most tax treaties, business income earned by a non-resident in Canada is taxable in Canada only if the non-resident carries on the business through a permanent establishment in Canada. Despite the perceived benefits, this waiver process is cumbersome and therefore rarely utilized.

The requirement that a non-resident who performs services in Canada must file a Canadian income tax return is not affected by either the granting of a waiver or reduction of withholding on amounts subject to Regulation 105. Therefore, non-residents providing a service in Canada must file a Canadian tax return even if the sole purpose is to indicate that they do not have a permanent establishment in Canada.

The costs and administrative duties associated with Regulation 105 compliance are significant for any Canadian entity. Regulation 105 imposes a duty on the payor to withhold, remit, and report. Anecdotal evidence confirms that these requirements frustrate Canadian businesses facing significant administrative responsibilities for another person's tax liability. If a payor fails to deduct and remit the amount in accordance with the Canadian Income Tax Act and Regulation 105, they will be liable for the entire amount together with interest and penalties. The penalties can be severe.[90]

Canadian payors will assume a number of additional tax obligations if they hire a non-resident when compared to their obligations if they hire a Canadian resident. For example, regardless of whether the non-resident obtains a waiver, the payor is obliged to annually report to

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89. This income and expense waiver application would normally include information and documentation relating to the contract to be performed in Canada, including the gross amount of the contract, any allocation of services inside and outside of Canada, and identifiable expenses such as travel, per-diems, etc., relating to the services to be performed in Canada. The CRA has published information pertaining to the Regulation 105 waiver process. Can. Rev. Agency, Information Circular 75-6R2, Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada (2005).

90. *See* ITA, *supra* note 87, § 227(8). Under certain circumstances, this penalty could be increased to 20%. *Id.* § 227(8)(b). In addition, interest will also be due on amounts not withheld. *Id.* § 227(8.3).

the CRA all amounts paid to a non-resident.[91] The Canadian payor must also issue a special information return to the non-resident or face additional penalties. The Canadian payor may assume considerable risk with respect to its proper basis for withholding.[92]

The Canadian payor will also be concerned about whether the non-resident renders his or her services inside or outside of Canada. As payments for services performed outside of Canada are not subject to Regulation 105 withholding, a reasonable allocation of the payment will be required and evidenced by precise documentation. To the extent the services are performed outside Canada, the payor's ability to claim Scientific Research and Experimental Development and Investment Tax Credits may be impacted. This can be at a substantial loss to the corporation.

In the context of cross-border trade and taxation, it is important to make clear that it is not just the existence of Regulation 105 that is problematic. It is also how Regulation 105 is interpreted and administered by tax authorities. The CRA has stated that it broadly interprets the wording "payments in respect of" services rendered in Canada, and in the past it has imposed interest and penalties on the Canadian taxpayer for failure to withhold an amount under Regulation 105 with respect to expenses reimbursed to non-resident service providers for

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91. The information is reported on a T4A-NR Information Return. This return must be filed by the last day of February for all payments made during the preceding year. Can. Rev. Agency, RC445 T4A-NR, Payments to Non-Residents for Services Provided in Canada (Dec. 12, 2017), https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4445.html (updated annually).

92. Weyerhaeuser Co. v. The Queen, [2007] 2 C.T.C. 2408, para. 4 (Can. Tax Ct.). In *Weyerhaeuser*, the CRA charged a Canadian payor almost a million dollars for withholding tax, interest, and penalties. The Canadian payor had paid over $14 million to non-resident independent contractors in the ordinary course of its business and remitted 15% based on that amount. At issue was the failure to withhold on amounts paid to reimburse expenses and for services identified in invoices as rendered outside Canada. Fortunately for the taxpayer, the court found that withholding applied only to amounts paid as fees or other remuneration. *Id.* paras. 8–13. This favorable finding may have done little to detract from the time and costs to defend against an assessment triggered by the hiring of non-residents. It did not extend to the reimbursement of out-of-pocket expenses.

such things as travel costs, telephone, fax and postage charges, and photocopying.[93] The CRA has since revised its position with respect to withholding taxes and expenses, but its broad interpretative approach leaves many unconcerned about the proper amounts to be withheld.

Do Canada's withholding requirements have a negative impact on a non-resident's ability to compete in providing services in Canada? An expert advisory panel identified a number of potentially distortive effects with respect to interim withholding obligations on income from trade in services.[94] These included costs to both Canadian businesses and service providers. In particular, Canadian businesses reported additional administrative responsibility for the non-resident's tax liability, significant costs associated with compliance, and a trend by service providers of grossing-up their fees to offset the withholding tax, resulting in additional costs and hampering the ability to engage skilled workers from outside Canada. Non-resident service providers also reported the negative impact of both the administrative costs associated with the refund process and reduced or delayed revenues and cash flow problems if they did not receive a gross-up from the payor.[95] Similar concerns were expressed in respect of withholding obligations for non-resident employees despite a tax treaty exemption.[96] An affirmative answer to the question

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93. *Id.* paras. 8–13.

94. Advisory Panel on Canada's System of Int'l Tax'n, Final Report: Enhancing Canada's International Tax Advantage 87–90 (Dec. 2008), https://www.fin.gc.ca/access/tt-it/apcsit-gcrcfi/pdf/apcsit-report-rapport-gcrcfi-eng.pdf [hereinafter Can. Advisory Panel].

95. As a result, the Advisory Committee recommended eliminating withholding tax requirements related to services performed and employment functions carried on in Canada where the non-resident certifies the income is exempt from Canadian tax because of a tax treaty. *Id.* at 89.

96. Income Tax Regulations, *supra* note 82, § 102. In the Canadian context, the withholding obligation under Regulation 102

> applies to such a broad range of situations, it places a significant administrative burden on the non-residents, as well as Canadian corporations who carry out the administrative duties on behalf of related non-resident employers. For example, where a non-resident performs employment duties in Canada for just one day, a withholding obligation is placed on the employer. Although a waiver can be obtained if the employee ultimately will not be taxable in Canada, the time delay is

of whether this less favorable tax treatment inhibits a non-resident's ability to compete in Canada and thereby inhibits the cross-border flow of trade in services seems obvious.

Are these differences in tax treatment between resident and non-resident service providers considered discriminatory under current tax or trade law provisions? The answer is no. Will a non-resident service provider fare better in other parts of the world? In many cases it appears the answer is also no.

The point being made is not that all differences in tax treatment between a resident and non-resident service provider by a host country are necessarily discriminatory, but rather that there is no applicable

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> often considerable, making the process unhelpful. In practice, it is difficult for non-resident companies to set up a process to withhold and remit various Canadian taxes for what may be small amounts.

Can. Advisory Panel, *supra* note 94, at 88.

As of June 2016, non-resident Canadian employers that are resident in a country with which Canada has a tax treaty, and are certified by the CRA, are not required to make withholdings on account of Canadian income tax on payments made to a non-resident employee in respect of employment services performed in Canada if the employee (i) is exempt from Canadian income tax in respect of the payment because of a tax treaty, and (ii) is either (A) not in Canada for 90 or more days in any 12-month period that includes the time of the applicable payment, or (B) not in Canada for 45 or more days in the calendar year that includes the time of the applicable payment. Can. Rev. Agency, RC473, Application for Non-Resident Employer Certification (July 4, 2017), https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/rc473/rc473-17e.pdf. While the new exemption is an improvement towards relaxing the waiver process, the exemption is quite limited and employers remain subject to onerous tracking and reporting requirements when employing non-residents. Employers must track the number of days the employee spends in Canada working for them, the employee's employment with any other employer, and even the amount of personal time spent in Canada. *Id.* A proposed amendment provides that the employer shall not be subject to penalties for failing to withhold if the employer has no reason to believe, after "reasonable inquiry," that the employee was not a "qualifying non-resident employee." *See Canada Provides Clarification on Tax Withholding Obligations for Nonresident Employers with Frequent Business Travellers to Canada*, EY (Aug. 2015), http://taxinsights.ey.com/archive/archive-news/canada-provides-clarification-on-tax-withholding-obligations.aspx.

non-discrimination obligation against which to judge that fact.[97] This is not just a hypothetical issue for a U.S. service provider. Canada is one of the United States' largest trading partners with the cross-border provision of services accounting for U.S. exports of services of an estimated $54.2 billion in 2016—43.1% greater than 2006 levels.[98]

Is the United States immune from the use of discriminatory tax practices in the tax treatment of a non-resident? Apparently not. As David Rosenbloom recently observed:

> [A]lthough the United States would never endorse discrimination as a general principle, Congress often seeks to, and regularly does, enact discriminatory tax legislation. The qualifications in the text of the article's paragraphs—"similar enterprises," "same activities," "under the same conditions," "in the same circumstances"—reflect the tension between the rhetorical and sentimental appeal of the nondiscrimination principle, on the one hand, and the hard realities of tax enforcement and revenue raising, on the other. For at least several decades, Congress has leaned on these phrases in enacting laws that draw distinctions between domestic and foreign taxpayers. What has become clear is that the qualifying words are accommodating enough to justify increasingly distant deviations from the spirit, if not the letter, of nondiscrimination. By manipulating the level of generality at which the "conditions," "circumstances," or whatever else are described, it has been possible to discriminate in substance while professing nonviolation of U.S. treaty commitments.[99]

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97. Developing countries, for example, may apply gross withholding taxes because they are administratively the easiest to apply.

98. Leading services exports from the United States to Canada were in the travel, intellectual property (software and audio-visual), and transportation sectors. *See Canada*, Off. U.S. Trade Representative, https://ustr.gov/countries-regions/americas/canada (last visited May 15, 2018). Trade in services is up roughly 245% from 1993 (pre-NAFTA). *Id.*

99. H. David Rosenbloom & Joseph P. Brothers, *Reflections on the Intersection of U.S. Tax Treaty Policy, U.S. Tax Reform, and BEPS*, 78 Tax Notes Int'l 759, 766–67 (May 25, 2015) (footnotes omitted).

IV. Tax Treaty Reform

The status quo at best results in a fragmented standard of non-discrimination for a non-resident service provider in tax matters. The interaction of tax treaties with trade agreements may also result in different levels of protection from potentially egregious tax practices for a non-resident service provider. It is also difficult to support the notion that non-residents should remain "fair game" for source country tax authorities under free trade regimes that otherwise provide protection from discriminatory practices. Is it time to consider a consistent underlying non-discrimination obligation that would parallel trade obligations? Could such a non-discrimination obligation be included in a tax treaty?

Proceeding on the assumption that the answer to these questions is affirmative, the challenge will be in matching trade law non-discrimination obligations with tax treaty non-discrimination obligations.

In any proposal for a non-discrimination principle that would fit within the current tax treaty structure there are some obvious and preliminary considerations. First and foremost is the notion of the sovereignty of the Contracting State. Why would a sovereign State give up further taxing rights? Second, what is the role of tax treaties? Although it is widely agreed that the purpose of tax treaties in general is to prevent double taxation, or more recently double non-taxation, many consider that an objective of tax treaties is to ensure greater neutrality in the source State for a non-resident. Such neutrality promotes the most efficient allocation of resources and thereby maximizes global welfare. Should tax treaties serve a more robust role in facilitating this goal? Third, is the reality that bilateral tax treaties are fundamentally bilateral in nature? Are there any circumstances in which it would be appropriate to impose a most favored nation obligation under a bilateral treaty?

The proposed non-discrimination obligation recognizes that residents and non-residents are not alike for tax purposes but requires a minimum standard of behavior by the source State in levying tax measures. (Appendix A, below, provides the full text of the proposed non-discrimination obligation.) The broad design for the non-discrimination obligation adopts a hybrid approach. The obligation is included in Article 24, the non-discrimination article in the OECD and UN Model Tax Treaties, but the resolution of any dispute with respect to whether the

obligation has been contravened is limited to Article 25, the Mutual Agreement Procedure under the tax treaty.[100]

The proposal incorporates a non-discrimination obligation into a tax treaty that parallels the current non-discrimination obligation that would apply to a non-resident service provider under the GATS, assuming the ability to challenge whether there has been a violation of the national treatment obligation is not restricted because the matter falls within the scope of a tax treaty.[101] Stated simply, the non-discrimination obligation would require that any tax measure that applies to a non-resident service provider must not be arbitrary, unjustifiable discrimination between countries where like conditions prevail or a disguised restriction on trade in services. It is also assumed that a service provider from a country that is a signatory to a regional or bilateral free trade agreement and to a tax treaty with the applicable free trade partner, will also rely on the proposed non-discrimination obligation in the tax treaty with that partner.

Why this approach? Under the GATS, the core obligation of national treatment applies to all direct and indirect tax measures. The exception to the national treatment obligation in the GATS for "direct measures aimed at the effective imposition or collection of taxes" recognizes important structural elements of a national tax system, most importantly that residents and non-residents are not alike from the perspective of their tax obligations in the source State. There is always an element of discrimination in the imposition of differing tax measures on a non-resident. However, the mismatch between the exception from

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100. Such an approach has some implicit support from other international tax experts. *See, e.g.*, Brauner, *supra* note 1, at 307 ("[I]t is understood that there is no complete escape from WTO law and jurisprudence; the international tax regime cannot evolve to permit and serve as a safe haven to blunt violations of undisputable obligations of WTO members. This article argues that the only way to reconcile this difficulty is to require coordination of these two international regimes. The international tax regime's nonlegalistic dispute resolution mechanisms can accommodate this at the present time; it is much more difficult the other way around due to the formalities to which the court-like the WTO DSB must adhere. Primary assignment of such disputes to the international tax regime is therefore more workable.").

101. The non-discrimination obligation would apply under a tax treaty to a potentially broader spectrum of service providers because the commitment to provide national treatment is negotiated under the GATS on a sector by sector basis.

the national treatment obligation with respect to direct tax measures under the GATS is, in effect, filled with a lesser obligation or minimum standard against which national tax legislation and its administration can be measured. Specifically, the measure is subject to the requirement that it cannot be "arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services" (the GATS chapeau). What is considered "arbitrary or unjustifiable discrimination between countries where the same conditions prevail" for purposes of the GATS can be found in a number of WTO decisions.[102]

In summary, any direct tax measure imposed on a non-resident by the source State would *prima facie* be considered compliant with the GATS based on the exception for direct tax measures unless it could be

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102. The WTO Appellate Body in *US—Gambling*, the only decision that has considered the GATS Article XIV chapeau to date, found that previous decisions under Article XX of the GATT 1994 were relevant for the analysis under Article XIV. Appellate Body Report, *Measures Affecting the Cross-Border Supply of Gambling and Betting Services: Report of the Appellate Body*, WTO Doc. WT/DS285/AB/R (adopted Apr. 20, 2005). The Appellate Body provides the following overview of the key elements:

> In order for a measure to be applied in a manner which would constitute "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", three elements must exist. First, the application of the measure must result in *discrimination*. As we stated in *United States — Gasoline*, the nature and quality of this discrimination is different from the discrimination in the treatment of products which was already found to be inconsistent with one of the substantive obligations of the GATT 1994, such as Articles I, III or XI. Second, the discrimination must be *arbitrary* or *unjustifiable* in character. . . . Third, this discrimination must occur *between countries where the same conditions prevail*. *In United States — Gasoline*, we accepted the assumption of the participants in that appeal that such discrimination could occur not only between different exporting Members, but also between exporting Members and the importing Member concerned.

Appellate Body Report, United States—Import Prohibition of Certain Shrimp and Shrimp Products, ¶ 150, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998) (footnotes omitted).

established that the measure resulted in discrimination and that it was arbitrary or unjustifiable discrimination between countries where the same conditions prevail to a disguised restriction on trade in services.

The GATS standard for source country behavior in respect of direct tax measures is lower than the national treatment obligation but nonetheless provides an internationally recognized benchmark and a body of legal decisions against which a country's tax measures can be measured. This standard currently applies to a non-resident service provider from a GATS Member State who is providing services in another Member State that is not a tax treaty partner. It is proposed that a similar level or standard be adapted and applied in a tax treaty context so that this minimum-discrimination obligation will underlay any trade agreement entered into by tax treaty partners.

How can the GATS minimum standard for source State behavior be incorporated in a tax treaty? There is no national treatment obligation in a tax treaty, similar to that found in the GATS. Tax treaties are also structured based on the understanding that residents and non-residents are not alike. Nonetheless non-discrimination obligations can be found in a tax treaty in the form of prohibitions that focus on specific types of behavior. For example, in Article 24(1) of the OECD and UN Model Tax Treaties there is a prohibition against subjecting a national to "any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected."[103] It operates to prevent a Contracting State from treating two persons who are residents of that State from being treated differently on the basis of their nationality. This "other or more burdensome" standard approximates the intent of the national treatment obligation with respect to a non-national who is a resident. For purposes of this analysis it could be viewed as a proxy for it. As discussed, this obligation does not extend to a non-resident

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103. OECD Model Tax Treaty, *supra* note 5, art. 24(1); U.N. Model Tax Treaty, *supra* note 5, art. 24(1). The prohibition in OECD Article 24(1) is a prohibition against discrimination on the basis of nationality. As a practical matter, because the national of the other Contracting State must be in the same circumstances in particular with respect to residence, the prohibition operates to prevent discrimination against a tax resident solely on the basis of nationality. The result is that once a national of one Contracting State becomes a resident of the other Contracting State, the non-discrimination obligation will apply.

because a non-resident does not meet the requirement in paragraph 1 of being in the same circumstances.

If one wanted to maintain the current structure of the non-discrimination obligation in the tax treaty but provide a minimum non-discrimination obligation in respect of a non-resident service provider, one option is to extend the obligation in Article 24(1) to non-residents. An exception to the non-discrimination obligation in the tax treaty could then be made to mirror the GATS exception for direct tax measures, and the chapeau requirement in the GATS could be replicated in the tax treaty to prevent the abuse of the exception.

In a tax treaty context, this would mean that a non-resident of a Contracting State could rely on the same non-discrimination obligation as a resident national. The non-resident would not be subject to "any taxation or any requirement connected therewith that is other or more burdensome," but there would be an exception for the imposition of direct tax measures (as described in the GATS footnote and interpretive tools), and the GATS chapeau requirement would apply so that the exception could not be implemented in a manner that is arbitrary, unjustified, or a disguised restriction on trade in services.

If one applied the GATS structure in a tax treaty context, the questions would be first: Is taxation or any requirement connected therewith other or more burdensome for the non-resident? Second, if the answer is yes: Does it meet the exception for direct tax measures? And third, assuming the answer is yes: Does the manner in which the tax measure is applied by the source State meet the GATS chapeau requirement? To answer the third question, an examination of the expression "where like conditions prevail" that is used in the GATS would be required.[104]

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104. This language is slightly different than the chapeau in Article XX of the WTO agreement, which uses the expression "the same conditions." *See supra* note 102 and accompanying text. Nonetheless it invites the same comparison between the foreign and home country, with the proviso that "like conditions" may be construed as a less stringent test of comparison than the "same conditions." *See supra* note 32 and accompanying text. If one were to adapt this type of comparison in a tax treaty context it opens up some interesting possibilities. For example, it creates the potential for questioning why a high interim withholding tax is being imposed on the non-resident service provider. Is the issue enforcement and collection? If so, are the conditions with respect to the ability to collect taxes in the source State like the conditions in the resident State? Hypothetically, is the withholding tax measure necessary if

The obvious advantage of adopting the GATS approach to a non-discrimination obligation in a tax treaty is that it provides the narrowest non-discrimination obligation in respect of the tax treatment of a non-resident but still meets the internationally and already agreed to minimum standard of treatment as set out in the GATS. However, as seen, it contradicts the general understanding upon which a tax treaty is based, that residents and non-residents are not alike for tax purposes. It also creates issues for dispute resolution.

One of the primary arguments against the addition of a new non-discrimination obligation to a tax treaty would no doubt be the issue of its interpretation and application. Non-resident taxpayers ordinarily have access to domestic courts for a determination of whether a violation of a tax treaty non-discrimination obligation has occurred. As a result, some would conjecture that key structural elements of their national tax system could be struck down by overzealous judges not well schooled in tax matters. This is a plausible concern. The resolution of issues relating to this proposed non-discrimination provision could be restricted to the Mutual Agreement Procedure and resolution by the competent authorities of the two Contracting States. This approach would also provide symmetry with trade obligations.[105] Alternatively, the consent of the competent authority in the residence State could be required as a precondition to a taxpayer bringing a claim. Practically this would require that the tax administration in the State of residence of the complaining non-resident service provider support the non-resident's claim against the other Contracting State. At a minimum it would focus State to State attention on the potentially discriminatory tax measure.

V. Why Would Tax Treaty Partners Agree to an Expanded Non-Discrimination Obligation?

The discussion thus far has ignored the so-called "elephant in the room." Why would a Contracting State agree to the assumption of an additional

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the ability to collect taxes owing is supported by exchange of information and/or assistance in collection agreements in the non-resident's state of residence?

105. Service providers or recipients under the GATS can only request their national government to take action against another WTO Member government if they consider that they are being discriminated against contrary to the GATS; they may not take direct action on their own behalf in any dispute resolution process.

non-discrimination obligation under a tax treaty? There are a number of reasons for doing so.[106]

First, the proposed non-discrimination obligation restores to the non-resident service provider the same level of protection against discriminatory tax practices that is currently available under the GATS if there is no tax treaty between the non-resident's State and the source State. Second, it introduces a minimum standard to be applied in the tax treatment of a non-resident service provider. Third, it requires that the competent authority closely examine complaints against its revenue collection arm to ensure that tax measures are administered in compliance with the minimum standard. Fourth, it invites a closer examination of national measures by national governments against a common internationally accepted standard. Fifth, it is a good political choice that could result in "producing greater national gains than would result from unilateral non-discrimination."[107] In short, in the end the bargain may be worth it.[108] Finally, a tax treaty non-discrimination obligation would provide additional clarity about when trade agreements (especially the GATS) would apply to a tax measure and when the tax treaty would

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106. Two leading international tax experts have noted that the current non-discrimination rules are not grounded in principles of equity but rather the arbitrary demands of practicality. *See* Hugh J. Ault & Jacques Sasseville, *Taxation and Non-Discrimination: A Reconsideration,* World Tax J. (May 20, 2010), https://online.ibfd.org/kbase/#topic=doc&url=/collections/wtj/html/wtj_2010_02_int_5.html. An obvious example of practicality is the response to the taxation of non-residents without a permanent establishment in the host country. Non-residents who earn passive income are subject to withholding tax, "a crude, pragmatic, arbitrary response to a realisation that income tax proper cannot be made to work in respect of outward flowing passive income." John Prebble, *Philosophical and Design Problems that Arise from the Ectopic Nature of Income Tax Law and Their Impact on the Taxation of International Trade and Investment*, 13 Chinese (Taiwan) Y.B. Int'l L. & Aff. 112, 134 (1994–1995). Non-residents who earn income from services may fare considerably worse. They may not rely on any restrictions or limitations on the taxation of income from services in the source country or on any applicable non-discrimination principle.

107. Robert A. Green, *The Troubled Rule of Nondiscrimination in Taxing Foreign Direct Investment*, 26 Law & Pol'y Int'l Bus. 113 (1994).

108. *See* Rosenbloom & Brothers, *supra* note 99, at 766 ("Forfeiting the ability to discriminate might be a fair trade-off if there were concomitant benefits.").

apply, an issue that has been given considerable attention in academic literature.[109]

VI. A More Modest Proposal

A Contracting State that is not interested in an expanded non-discrimination obligation might nonetheless consider the following more modest proposal to expand the Mutual Agreement Procedure set out in Article 25 of the OECD Model Tax Treaty to permit a resident of a Contracting State to seek recourse from his or her government in respect of tax treatment that is potentially discriminatory. The competent authority of each Contracting State could then consult to resolve the issue. This would formalize the idea that discriminatory tax practices are not part of the anticipated tax treatment between tax treaty partners but would not impose an obligation on the other Contracting State other than to consult in good faith. It recognizes that bilateral tax treaties rely exclusively on intergovernmental consultation and negotiation to settle intergovernmental disputes.[110]

The primary benefit of this change is that it requires that the competent authority of a Contracting State closely examine complaints against its revenue collection arm to ensure that tax measures are not administered in a manner that would generate international ill will. It is also a process that may be much easier to get governments to agree to. "[I]t is flexible and informal and provides the necessary non-controversial atmosphere needed for resolving economic disagreements between sovereign nations in a world of anarchy."[111] Of course the many deficiencies of the current Mutual Agreement Procedure should not be ignored.[112] Typically cited deficiencies are the lack of a formal role for

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109. *See, e.g.*, Jennifer E. Farrell, The Interface of International Trade Law and Taxation: Defining the Role of the WTO 181–206 (2013); Servaas van Thiel, *The General Agreement on Trade in Services and Income Taxation, in* WTO Obligations and Opportunities: Challenges of Implementation 385 (Koen Byttebier & Kim Van der Borght eds., 2007).

110. *See* Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 Yale J. Int'l L. 79 (1998).

111. Zvi D. Altman, Dispute Resolution Under Tax Treaties 98–99 (2005).

112. Roland Ismer & Sophia Piotrowski, *A BIT Too Much: Or How Best to Resolve Tax Treaty Disputes?*, 44 Intertax 348 (2016); Jacques Malherbe,

taxpayer participation, the lack of an obligation to reach an understanding, the lack of transparency, and the lack of a timeline for dispute resolution.

A developing commentary should provide examples of practices that might be viewed as discriminatory. This would include both regulatory measures and administrative conduct. The rationale for the commentary would be that although some differences in tax treatment may have a legitimate underpinning, the presence of elements like selective enforcement may suggest discriminatory tax treatment. The commentary would acknowledge the difficult task of distinguishing legitimate taxation from the abusive exercise of tax powers and provide a system of "red flags" that might suggest a breach of the non-discrimination obligation. These "red flags" would be tied to generally recognized principles of taxation and accepted good-governance practices. It follows that arbitrariness, conspicuous deviation from international taxation practices, or an identifiable intention to discriminate against a non-resident service provider for the benefit of a domestic-service provider would lead to a presumption that the non-discrimination obligation had not been met.[113]

Rough guidelines should also be added as the basis for a form of "national treatment" protection. Two of the main source country issues for a non-resident appear to be the use of gross withholding taxes and non-transparent administrative formalities. To address the former, direction should be taken from cases from the European Union, such as when a source State should permit the deduction of directly related expenses if reported against withholding tax requirements. The non-resident might also be provided with an option for net-based taxation at graduated source country rates if appropriate administrative requirements are met.

Another area of concern appears to be the refund process for amounts that are exempt under a tax treaty but that are initially subject to withholding tax on the gross amount of the payment. For example, fees for the provision of services may be exempt under the tax treaty or subject to tax on profits only because a permanent establishment exists. Appropriate procedures may not be in place to refund to the service

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BEPS: The Issues of Dispute Resolution and Introduction of a Multilateral Treaty, 43 INTERTAX 91 (2015).

113. *See* Thomas Wälde, *National Tax Measures Affecting Foreign Investors Under the Discipline of International Investment Treaties, in* AM. SOC'Y OF INT'L LAW, THE SOVEREIGN POWER TO TAX: PROCEEDINGS OF THE 102ND ANNUAL MEETING 51, 59 (2008). Wälde discusses tax issues in the context of investment treaties.

provider claiming the benefit of a tax treaty the amount of any interim withholding tax.

The commentary should also address such issues as how income from services earned by a non-resident service provider is characterized for tax purposes in the source State as compared to how the income earned by a tax resident is characterized. For example, the commentary should provide that in general, the source State should not treat an amount as income from the provision of services if paid to a resident but as a royalty or "other income" amount under a tax treaty if it is paid to a non-resident.

In addition to changes to the Mutual Agreement Procedure in Article 25 of the OECD Model Tax Treaty, minor changes should also be made to the other provisions of the Model Tax Treaties to reduce or eliminate potentially harmful tax practices. Some useful tax changes include putting a cap on the applicable withholding tax rate for income from independent personal services. A similar cap should be considered if income from services is treated as business profits under the tax treaty.

Another useful change would be to expand the indirect non-discrimination obligation in OECD Article 24(4). Currently the provision requires that a source State allow a deduction in computing the income of a resident when paid to a non-resident under the same circumstances as when a payment is made to a resident. The non-discrimination obligation applies only to deductions. Given that many countries also use tax credits in determining final tax liability, this non-discrimination obligation should be extended to require that a tax resident may also claim a tax credit under the same circumstances as when a payment is made to a resident.

Conclusions

Different principles lie at the foundation of international tax law and trade law. From a tax law perspective it is accepted that a source country has, and should have, the sovereign right to tax income derived from within its borders and that residents and non-residents are not alike for tax purposes and should not expect to be treated alike. Differences in tax treatment between residents and non-residents are not therefore inherently discriminatory for pragmatic reasons, including revenue collection.[114] On the trade law side, tax measures that operate to exclude

114. Various measures may also be necessary and appropriate to accommodate the different challenges in assessing income derived by non-residents.

non-resident suppliers from local markets or reduce their competitiveness reduces international and national welfare contrary to international trade law objectives. The challenge is finding the right balance between providing protection for the non-resident service provider from arguably discriminatory tax practices on the one hand and preserving the State's right to act freely in pursuing State action on the other.

This Article attempts to build a bridge between the non-discrimination obligations in trade law agreements and tax treaties that impact non-resident service providers. Underlying the discussion are two broad questions. Should non-residents be "fair game"[115] for source state tax authorities? If not, what non-discrimination principle, obligation, or standard should apply? The non-discrimination obligation proposed is at best an uneasy compromise that engages the non-discrimination obligation in Article 24(1) of the OECD and UN Model Tax Treaties in a manner that was not anticipated by its drafters. Nonetheless, it attempts to safeguard the obligations assumed under trade agreements by introducing a minimum non-discrimination obligation to tax treaties while respecting tax sovereignty. The addition of such a non-discrimination obligation to a tax treaty challenges the current notion that a source State owes non-residents no such obligation. It also aligns with international trade law objectives.

Appendix A: A Proposed Non-Discrimination Obligation

The following provides a proposed non-discrimination provision that adapts the current approach in the GATS agreement with what might appear in a proposed non-discrimination obligation in a tax treaty. It would be added to Article 24 of the OECD or UN Model Tax Treaties:

> *Paragraph 7*
>
> *(a) Notwithstanding paragraph 1, Nationals of a Contracting State who provide services in the other Contracting State in a sector in which an unqualified national treatment obligation has been made by that Contracting State under the GATS, but who are not in the same*

115. "Fair game" is used in this context to refer to a person that is considered a reasonable target for any type of treatment, including discriminatory treatment.

circumstances with respect to residence, shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals who provide services in that other State in the same circumstances, are or may be subjected.

(b) Subject to the requirement that such measures are not 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 in services, nothing in this paragraph shall be construed to prevent the adoption or enforcement by any Contracting State of measures aimed at ensuring the equitable or efficient imposition of direct tax measures.

(c) For this purpose "equitable or effective imposition of taxes" includes measures taken by a Member under its taxation system that:

(i) apply to non-resident service suppliers in recognition of the fact that tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory (for example, withholding taxes);

(ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or

(iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or

(iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or

(v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or

(vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches or between related persons or branches of the same person, in order to safeguard the member's tax base.

(d) Nothing in this Article relates to any provision of the taxation laws of a Contracting State:

(i) in force on the date of signature of this Convention;

(ii) adopted after the date of signature of this Convention but which is substantially similar in general purpose or intent to a provision covered by sub-paragraph (i); or

(iii) reasonably designed to prevent the avoidance or evasion of taxes; provided that, with respect to provisions covered by sub-paragraphs (ii) or (iii), such provisions (other than provisions in international agreements) do not discriminate between citizens or residents of the other Contracting State and those of any third State.

(e) Where one of the Contracting States considers that the taxation measures of the other Contracting State infringe the principles set forth in this paragraph, the Contracting States shall consult together in an endeavor to resolve the matter.