

Non-discrimination and Trade in Services

Catherine A. Brown

Non-discrimination and Trade in Services

The Role of Tax Treaties

 Springer

Catherine A. Brown
Faculty of Law
University of Calgary
Calgary, AB
Canada

ISBN 978-981-10-4405-2 ISBN 978-981-10-4406-9 (eBook)
DOI 10.1007/978-981-10-4406-9

Library of Congress Control Number: 2017935956

© Springer Nature Singapore Pte Ltd. 2017

This work is subject to copyright. All rights are reserved by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed.

The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.

The publisher, the authors and the editors are safe to assume that the advice and information in this book are believed to be true and accurate at the date of publication. Neither the publisher nor the authors or the editors give a warranty, express or implied, with respect to the material contained herein or for any errors or omissions that may have been made. The publisher remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.

Printed on acid-free paper

This Springer imprint is published by Springer Nature
The registered company is Springer Nature Singapore Pte Ltd.
The registered company address is: 152 Beach Road, #21-01/04 Gateway East, Singapore 189721, Singapore

Foreword

The principle of non-discrimination in tax matters has been a focus of multinational enterprises, tax and trade law lawyers, government negotiators and academics since before the World Trade Organization agreement was signed in 1992. The principle has been enshrined in fundamental trade agreements and in recent years has found its way into agreements to liberalize the cross-border trade in services. Commitments in these treaties include undertakings by signatory governments to provide national treatment or most favored nation treatment to enterprises of the partner jurisdiction, transparency undertakings and a host of other State obligations to facilitate the cross-border trade in services. The notable omission from the trade agreements is a commitment to non-discriminatory income tax measures.

In one sense, the absence of any income tax non-discrimination rules in services trade issues seems odd. Trade experts focus on reducing or eliminating measures that can be viewed as barriers to trade and discriminatory taxation, particularly income taxation, can be a significant barrier to open international trade. There is an almost universal expectation, however, that tax matters belong in tax treaties, not trade treaties. If this sentiment were to shift, it is conceivable a solution to the problem could be found by adding income tax clauses to non-discrimination articles in trade treaties. If this view does not change, a solution would have to be found in the context of tax treaties.

This path to full non-discrimination is not inconceivable. Already many tax treaties have non-discrimination articles. But viewed from the perspective of non-discrimination rules in trade treaties, existing tax treaty articles are truly inadequate. Whether they can and should be modified to provide protection against discriminatory income taxes is the central question explored in this volume.

The issue is explored in three stages. The first investigates the extent to which non-discrimination obligations currently apply to a non-resident service provider under tax and trade agreements. The second considers the extent to which current non-discrimination obligations in tax and trade agreements can or cannot adequately address the potential for the discriminatory use of tax measures in the cross-border trade in services. Given the likelihood that final solutions are more likely to come via changes to tax treaties rather than trade agreements, the third

stage asks whether the OECD and the UN should make changes to the non-discrimination obligations in the OECD and UN Model Tax Treaties to respond to the growing global trade in services and, if so, what form changes might take.

A unique and valuable feature of the book is its analysis of the interaction between non-discrimination principles and trade related treaties including multi-lateral treaties (the WTO treaty), regional treaties (NAFTA and AANZTA) and bilateral free trade agreements. It also analyzes the concept of non-discrimination in tax matters from the perspectives of interaction between domestic law and bilateral tax treaties, regional trade agreements and, where relevant, the GATS international agreements in North America, Australia, the EU and the UK.

The proliferation of global trade and free trade arrangements has left income taxation as one of the few remaining means available to states to protect indirectly national enterprises. In the absence of any non-discrimination obligation with respect to tax measures that apply to a non-resident service provider, income taxation may be an effective tool to undermine the spirit of trade obligations. As this book shows, tax barriers to trade may come in many forms including laws, regulations, informal policies and practices.

The proposal for inclusion in tax treaties of a new and more effective non-discrimination obligation that extends to all aspects of income tax law and practice and more closely parallels the non-discrimination obligations in trade agreements provides a welcome blueprint for reform. Changes derived from the recommendations in this book have the potential to greatly enhance global welfare.

Richard Krever
Monash Business School
Monash University

Preface

This book is the product of three decades of observation on the developments in tax and trade law on the cross-border trade in services. The developments in both areas are not surprising given the dramatic increase in the importance of services in the global economy. What is surprising is the lack of integration between basic trade law non-discrimination obligations and those that apply in tax matters. The result is that taxation remains one of the few unregulated barriers to trade. The book offers a solution that many may dismiss as unworkable. Nonetheless it is hoped that it may serve as a starting point in a meaningful search for a bridge between tax and trade obligations that will benefit the global trade in services.

I wish to acknowledge and thank a number of groups and individuals who have helped in the final work. These include the Faculty of Law at the University of Calgary, the Department of Business Law and Taxation at Monash University, the Social Sciences and Humanities Research Council of Canada and the many students from the University of Calgary who provided research assistance. Although I will no doubt forget some, I would like to especially thank Veronica Pinero, Julia McGraw and Trent Blanchette. I would also like to thank Angela Bott (Monash University) and Sue Parsons (University of Calgary) for their unfailing help with the manuscript. Finally I would like to thank Professor Richard Krever of Monash University for encouraging me to commit my thoughts to writing.

Calgary, Canada

Catherine A. Brown

Contents

1 Introduction	1
1.1 Overview	1
1.2 Background	2
1.3 Structure	6
1.4 Observations	10
1.5 Conclusions	14
References	15
2 The General Agreement on Trade in Services	19
2.1 Overview	19
2.2 Non-discrimination and Trade Agreements: The World Stage	20
2.2.1 The General Agreement on Trade in Services (GATS)	21
2.2.2 The OECD and UN Model Tax Treaties: The Taxation of Non-resident Service Providers and Tax Treaty Non-discrimination Obligations	29
2.3 Non-discrimination and Non-resident Service Providers—The Bottom Line	40
2.3.1 Tax and Trade Agreements: Non-discrimination Obligations Compared	42
2.4 Conclusions	47
References	48
3 Regional Free Trade Agreements	51
3.1 Overview	51
3.2 The North American Free Trade Agreement	53
3.2.1 Overview	53
3.2.2 Taxation Measures	55
3.2.3 The NAFTA and the Parties' Tax Treaties	62

3.3	The ASEAN–Australia–New Zealand Free Trade Agreement (AANZFTA)	85
3.3.1	Overview	85
3.3.2	Most Favoured Nation Treatment	86
3.3.3	National Treatment	88
3.3.4	Differing Levels of Protection	90
3.4	The Trans-Pacific Partnership Agreement	91
3.5	Conclusions	93
	References.	96
4	Bilateral Free Trade Agreements	99
4.1	Overview	99
4.2	Canada’s Bilateral Free Trade Agreements	100
4.2.1	The Canada-Colombia Free Trade Agreement (CCFTA) and the Canada-Panama Free Trade Agreement (CPFTA)	100
4.2.2	The CETA.	106
4.3	Australia’s Bilateral Free Trade Agreements.	110
4.3.1	Overview	110
4.3.2	Singapore-Australia Free Trade Agreement	111
4.3.3	Australia-U.S. Free Trade Agreement	111
4.3.4	Australia-Chile Free Trade Agreement	113
4.3.5	Australia-Thailand Free Trade Agreement	113
4.3.6	Australia-Malaysia Free Trade Agreement.	113
4.3.7	Australia-Korea Free Trade Agreement	115
4.3.8	Australia-Japan Free Trade Agreement	115
4.3.9	Australia-China Free Trade Agreement	116
4.3.10	The Impact of Tax Treaties	117
4.4	Conclusions	120
	References.	123
5	The WTO, NAFTA and the TFEU: Regional Perspectives by WTO Members on Non-discrimination Obligations	125
5.1	Overview	125
5.2	Background	126
5.3	International Trade Agreements Affecting Trade in Services in the NAFTA Block	127
5.3.1	A Canadian Perspective.	127
5.4	International Trade Agreements Affecting Trade in Services in the European Union	135
5.4.1	United Kingdom Perspective.	135
5.4.2	Services and Direct Taxation in the European Union	136
5.4.3	European Union Cases on Direct Taxation and Services	138

5.4.4	The Relationship of Bilateral Tax Treaties to European Union Law	148
5.5	Tax Discrimination? Some Comparative Examples.	153
5.5.1	Example 1	153
5.5.2	Example 2	155
5.5.3	Example 3	156
5.6	Conclusions	158
	References.	159
6	The Potential for Discriminatory Tax Treatment Based on Structural Elements in OECD and UN Based Tax Treaties.	163
6.1	Overview	163
6.2	The Tax Treaty Allocation Rules	164
6.3	The Treatment of Services in Tax Treaties: A Survey of Country Practices	166
6.3.1	UN Model Tax Treaty Approach—Specific Provisions on Services	167
6.3.2	OECD Model Tax Treaty Approach—No Specific Provisions on Services.	169
6.3.3	The OECD Optional Services Provision Included in the Commentaries (2008)	170
6.3.4	The Inclusion of (Types of) Services in the Royalty Article	171
6.3.5	Separate Treaty Article for Services (Technical Services)	172
6.3.6	The ‘Other Income’ Article	173
6.4	The Basis of Taxation	174
6.5	The Method of Collecting Tax	174
6.5.1	Self Assessment	175
6.5.2	Withholding Tax	175
6.5.3	When Are Withholding Taxes Imposed?	177
6.5.4	The Obligation of the Withholding Agent	179
6.5.5	Summary	179
6.6	Differing Non-discrimination Obligations	180
6.6.1	Business Profits	182
6.6.2	Independent Personal Services.	183
6.6.3	Royalties	183
6.6.4	Other Income	184
6.7	An Example	184
6.8	Conclusions	185
	References.	186

7	The Potential for Discriminatory Tax Treatment Based on Domestic Law	189
7.1	Overview	189
7.2	Non-resident Service Providers and Withholding Tax	190
7.2.1	Country Examples	192
7.2.2	Conclusions	206
7.3	The FATCA Example	207
7.3.1	Foreign Account Tax Compliance Act	208
7.3.2	International Response to the FATCA	210
7.3.3	Non-discrimination Obligations Under the WTO Agreement	211
7.3.4	Non-discrimination Obligations Under the OECD Model Tax Treaty	213
7.4	Conclusions	221
	References	222
8	Towards a New Non-discrimination Obligation—Policy Considerations	225
8.1	Overview	225
8.2	Recommendation	227
8.3	Option 1: The Status Quo	228
8.4	Option 2: Trade Agreement Reform	229
8.5	Option 3: Tax Treaty Reform	230
8.5.1	Which Non-discrimination Principle?	230
8.5.2	Trade Law Principles	232
8.5.3	Investment Agreement Principles	233
8.5.4	Treaty for the Functioning of the European Community Principles	235
8.5.5	A New Tax Treaty Standard	236
8.5.6	Designing a Tax Treaty Non-discrimination Obligation	238
8.5.7	Structural Issues	239
8.5.8	The Proposed Non-discrimination Obligation	245
8.5.9	Dispute Resolution (Mutual Agreement Procedure)	246
8.5.10	Additional Commentary to Article 24	252
8.5.11	Limitations of the Proposed Non-discrimination Obligation	253
8.5.12	A More Modest Proposal	254
8.5.13	Why Would Tax Treaty Partners Agree to an Expanded Non-discrimination Obligation?	256
8.5.14	Conclusions	257
	References	258
	Appendix	261

Abbreviations

AANZFTA	ASEAN–Australia–New Zealand Free Trade Agreement
ACFTA	ASEAN–China Free Trade Area
ASEAN	Association of Southeast Asian Nations
ATFTA	Australia–Thailand Free Trade Agreement
AUSFTA	Australia–United States Free Trade Agreement
BEPS	Base Erosion and Profit Shifting
BIAC	Business and Industry Advisory Committee to the OECD
BIT	Bilateral Investment Treaties
CCFTA	Canada–Colombia Free Trade Agreement
CETA	Comprehensive Economic and Trade Agreement
CJEU	Court of Justice of the European Union,
COB	Carrying on Business
COFINS	Contribuição para o Financiamento da Seguridade Social (Contribution for Social Security Financing)
CPFTA	Canada–Panama Free Trade Agreement
CRA	Canada Revenue Agency
CRS	Common Reporting Standard
DESA	United Nations Department of Economic and Social Affairs
ECJ	European Court of Justice (ECJ), now the Court of Justice
FATCA	Foreign Account Tax Compliance Act
FDAP	Fixed, Determinable, Annual or Periodic Income
FFI	Foreign Financial Institutions
FTA	Free Trade Agreements
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GST	Goods & Services Tax
IBFD	International Bureau of Fiscal Documentation
ICJ	International Court of Justice
IFA	International Fiscal Association
IGA	Intergovernmental Agreements

INPI	Instituto Nacional de la Propriedad Industrial
IRS	Internal Revenue Service
ITA	Income Tax Act, Canada
ITO	International Trade Organization
JAIPA	Japan–Australia Economic Partnership Agreement
KAFTA	Korea–Australia Free Trade Agreement
MAFTA	Malaysia–Australia Free Trade Agreement
MERCOSUR	Mercado Común Del Sur (Southern Common Market)
MFN	Most Favored Nation
MST	Minimum Standard of Treatment
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
PIS	Programa de Integração Social, also known as Social Integration Program
SAARC	South Asian Association for Regional Cooperation
SAFTA	Singapore–Australia Free Trade Agreement
TEC	Treaty of the European Community, now known as TFEU
TFEU	Treaty for the Functioning of the European Union, formerly TEC, Treaty of the European Community
TISA	Trade in Services Agreement
TPP	Trans-Pacific Partnership Agreement
USD	US dollars
USFI	US Financial Institution
VAT	Value Added Taxes
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

Definitions

Contracting State

The term Contracting State is used in this work to refer to a Party to a tax treaty under the OECD and UN Model Tax Treaty and the tax treaties based on those Models.

Cross Border Trade In Services

See Trade in Services.

Direct Taxes

The meaning of direct taxes is borrowed from the GATS Article XXVIII(O). “Direct 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.

Discrimination

Discrimination in the international trade context has been defined as “treating persons unfavorably for reasons that are unreasonable, arbitrary or irrelevant.”¹

¹See Brian Arnold, *Tax Discrimination Against Aliens, Non-Residents, and Foreign Activities: Canada, Australia, New Zealand the United Kingdom and the United States*, Canadian Tax Foundation, (Toronto: Canadian Tax Foundation, 1990).

Foreign or Non-resident Service Provider

The terms foreign or non-resident service provider in this work are used to refer to a service provider who is not a tax resident of the country in which the payer is tax resident or liable to tax under the domestic law of that country.

Indirect Taxation

Indirect tax generally includes value added tax (VAT), sales tax or goods and services tax (GST). The tax is generally collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). Indirect tax can be contrasted with direct tax which is collected directly by government from the persons (legal or natural) on which it is imposed.

Most Favored Nation Treatment

Under the most favored nation rule a host country is required to extend to service providers from one foreign country treatment no less favorable than it accords to service providers from any other country.

National Treatment

According to the national treatment principle, the host country is required to treat non-resident service providers in the same or comparable way as a domestic service provider. In this way the national treatment standard seeks to ensure a degree of competitive equality between domestic and non-resident service providers. The scope of the most favored nation and national treatment provisions in any trade agreement depend on the extent of the exceptions attached to them. In general countries are unwilling to grant national treatment without qualifications, especially when it comes to tax measures.

Non-discrimination

Discrimination has as its core unjustified differences in treatment.² To determine whether discrimination has occurred one must apply the relevant criteria or principles. These vary widely depending on the context. For example, the non-discrimination principles underlying trade agreements like the WTO Agreement are national treatment and most favored nation treatment.³ These principles extend to both services and service providers in the GATS and to goods under the GATT. Bilateral Investment Treaties (BITS) also introduce the notion of “fair and equitable treatment”⁴ to describe the appropriate standard of treatment for investors. This may be contrasted with the non-discrimination principles underlying human rights agreements that focus on ethics or general behaviors rather than economic factors. The important point is that discrimination is determined contextually. Non-discrimination is the absence of discrimination based on the applicable criteria or principles.⁵

The non-discrimination obligations in the OECD Model Tax Treaty take the form of prohibitions designed to prevent source countries from discriminating

²One might also ask to who or what the criteria should be applied. This might include goods, activities or persons.

³Most favored nation treatment is the principle under which a state must treat all states with which it has trade agreements equally. National treatment is the principle under which a state agrees to treat imported goods or services as equal with domestic goods or services.

⁴Fair and equitable treatment has been described as “an “absolute”, “non-contingent” standard of treatment, i.e., a standard that states the treatment to be accorded in terms whose exact meaning has to be determined, by reference to specific circumstances of application, as opposed to the “relative” standards embodied in “national treatment” and “most favored nation” principles which define the required treatment by reference to the treatment accorded to other investment.” See OECD, Directorate For Financial And Enterprise Affairs, *Fair And Equitable Treatment Standard In International Investment Law*, Working Paper No 2004/3 (2004) and *Investor-State Dispute Settlement and Impact on Investment Rulemaking*, UNCTAD, UN Doc ITE/IIA/2007/3 (2007).

⁵Non-discrimination and the principles upon which it is based is a concept that, as the following excerpt makes clear, is best described contextually. “Non-discrimination is a negative expression or statement of the equality principle which goes back to Aristotle (Nicomachean Ethics). For its formulation (equal treatment of equals) to be meaningful, it begs further definition of its essential elements, mainly determining the criterion of reference, the scope of application, the comparable circumstances and the justification, if any, of infringement. Applied to cross border situations, non-discrimination may be differently worded and construed depending on the (national, bilateral, regional, worldwide) instrument. It may also provide for implementation according to a variety of principles: National Treatment, Most Favored Nation, Capital Import Neutrality or Capital Export Neutrality in a perspective of inbound or outbound movement, different concepts of non-restriction of cross border investment or activity, level playing field, reciprocity and alignment of tax burdens according to capacity-to-pay. Still other non-discrimination principles are not primarily targeted on economic measures but are more ethical or general focused (Human Rights and Personal Freedoms, national Constitutions).” *Non-discrimination at the Crossroads of International Taxation*, Cahiers De Droit International, 62nd Congress of the International Fiscal Association, Brussels 2008 volume 93a (The Netherlands: Sdu Fiscale Financiële Uitgevers) at 50.

against “foreigners” with sufficient nexus to the source country.⁶ The goal of these provisions is to ensure no less favorable tax treatment for similarly situated persons and businesses.

The concept of non-discrimination as used in this paper includes concepts found in both tax and trade agreements but is not restricted to those concepts.

Services

For purposes of the book, the term “services” is generally used to describe work done for another for an explicit or implicit fee. The services may be provided by an individual, an employee or an agent. The book focuses on conventional service activities and assumes that the work is performed at a particular location by an individual, rather than electronically through computers or other telecommunication facilities. Conventional service activities would include, for example, providing assistance or advice, construction activities, engineering services, acting as a broker or financial planner or as a medical or legal consultant.

Source (or Host) Country

For purposes of this study the expression source or host country is used to describe the country that is the source of payment for the services provided. For simplicity, it is also assumed that this is the country which receives the services are provided.

Taxation Measure

A taxation measure generally includes laws, regulations and government practice. It is generally broadly defined in trade agreements. For example is given under the NAFTA Article 2017 defines it taxation measure by exclusion and indicates that it does not include customs duties and related measures. A measure under the General Agreement on Trade in Services (GATS) is defined in Article XXVIII(a) as “any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form.”

⁶Depending 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.

Trade Barrier

A trade barrier is broadly defined in this work as a foreign government policy, practice, or procedure that unfairly or unnecessarily restricts trade in services. Trade barriers may be imposed overtly, often for the purposes of shielding or artificially stimulating domestic industries, occur as a result of a government failure to provide the necessary infrastructure for competitive conditions or result from the failure of a government to live up to trade agreement obligations. Foreign trade barriers to the cross-border trade in services may come in the form of laws, regulations or informal policies, practices, or procedures.

Trade in Services

The expression trade in services is used to refer generally to the sale and delivery of a service between the service provider and the recipient of the services. Where the service provider and the recipient reside in different countries the expression international trade in services is used. What constitutes the international trade in service is described in international trade agreements in different ways. For example, international trade in services is defined in the GATS by the *Four Modes of Supply*:

- (Mode 1) Cross-border trade, which is defined as delivery of a service from the territory of one country into the territory of other country;
- (Mode 2) Consumption abroad this mode covers supply of a service of one country to the service consumer of any other country;
- (Mode 3) Commercial presence which covers services provided by a service supplier of one country in the territory of any other country, and
- (Mode 4) Presence of natural persons which covers services provided by a service supplier of one country through the presence of natural persons in the territory of any other country.

In contrast, international trade in services is referred to as the cross-border trade under the NAFTA as the cross-border trade in services. This is defined as providing a service: from the territory of one Party into the territory of another Party (e.g., cross-border), in the territory of one 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.⁷ 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

⁷See the definition of “cross-border provision of a service” in NAFTA Article 1213.

presence in the other, the NAFTA addresses this mode of supply through the investment provisions in Chapter 11 (Investment).

Reference should be made to the definitions in a particular trade agreement where the precise definition is important or relevant.

Residence Country

The residence country is the country tax residence for the non-resident service provider.