INTERNATIONAL TRADE LAW, DOUBLE TAXATION AGREEMENTS AND THE PRINCIPLE OF NON-DISCRIMINATION*

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Abstract: International Trade Law, under the umbrella of the World Trade Organization ("WTO"), and Double Taxation Agreements ("DTA") share the goal of removing barriers to cross-border movement of goods, services, capital, labor and technology. However, they diverge in respect to the mean: in trade, through the reduction of tariffs and other barriers; in taxation by the splitting of the income tax base between source and residence countries. Even though these two branches of International Law developed in separate paths, they have some areas where they overlap. This paper analyses one of them: the relationship between International Trade Law and DTAs with respect to the principle of non-discrimination, namely its sub-principles of National Treatment and Most Favored Nation ("MFN"). Firstly, it explains the objectives of both regimes in a comparative perspective; subsequently, it analysis the National

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Treatment and the MFN clauses under each regime; lastly, it explores the need of coordination between International Trade Law and DTAs.

Keywords: WTO; International Trade Law; Double Taxation Agreements; International Taxation; Non-discrimination; National Treatment Principle; Most Favored Nation Principle.

Resumo: O Direito do Comércio Internacional, sob a égide da Organização Mundial do Comércio ("OMC"), e as Convenções para evitar a Dupla Tributação ("CDTs") partilham o objectivo de remover as barreiras ao movimento transfronteiriço de bens, serviços, capital, mão-de-obra e tecnologia. No entanto, divergem quanto aos meios: no comércio, através da redução das tarifas e outros entraves; na fiscalidade, por meio da repartição da base tributável entre os países da fonte e da residência. Apesar de esses dois ramos do Direito Internacional se terem desenvolvido por caminhos separados, eles apresentam áreas de sobreposição. Este artigo analisa uma delas: a relação entre o Direito Comercial Internacional e as CDTs no que se refere ao princípio da não-discriminação, nomeadamente quanto aos subprincípios do Tratamento Nacional e da Nação Mais Favorecida ("NMF"). Ele explica, em primeiro lugar, os objectivos de ambos os regimes numa perspectiva comparativa; segue-se uma análise das cláusulas de Tratamento Nacional e de NMF sob cada regime; finalmente, explora a necessidade de coordenação entre o Direito do Comércio Internacional e as CDTs.

Palavras-Chave: OMC; Direito do Comércio Internacional; Convenções para evitar a Dupla Tributação; Fiscalidade Internacional; Não discriminação; Princípio do Tratamento Nacional; Princípio da Nação Mais Favorecida.

I. INTRODUCTION

The history of International Trade Law began with the General Agreement on Tariffs and Trade ("GATT") foundation in 1948 [the predecessor of the World Trade Organization ("WTO")], with the institution of a new multilateral trading system. Under the umbrella of the WTO, other international trade agreements have been established, each addressing the free movement of different types of trade[2]. These WTO/GATT agreements contain two types of non-discrimination requirements: National Treatment and Most Favored Nation ("MFN") Treatment.

On the other hand, the current International Tax Law in respect to income was created under the League of Nations after World War I, and was taken up by the Organization for European Economic Cooperation [later the Organization for Economic Cooperation and Development ("OECD")] after World War II. Currently, International Tax Law comprises more than 3000 bilateral treaties[3], the so-called Double Taxation Agreements ("DTAs")[4]. DTAs are based on several fundamental principles, such as the mitigation of double taxation through the distribution of income tax bases between source and residence countries. DTAs also contain the principle of non-discrimination, namely source-country National Treatment.

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2 Free trade can be disturbed by any type of barriers such as tariffs, quotas, technical barriers, voluntary import and export restraints, import expansions and export subsidies.

3 FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 9.

4 Several expressions have been used to name this type of International Tax Agreements. The most common expressions are Double Taxation Agreements, Double Taxation Conventions and Double Tax Treaties.

"[International Trade Law] *clearly is not a supranational body of law, but it is an integral part of international law*". BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 261.

Even though these two branches of International Law developed in separate paths, they have some areas where they overlap[5]. This paper analyses one of them: the relationship between International Trade Law and DTAs in respect to the principle of non-discrimination, namely National Treatment and MFN.

All WTO/GATT agreements and DTAs contain a National Treatment clause. On the other hand, while MFN is paramount in WTO, MFN treatment is not always present in DTAs. This difference may be explained with the bilateralism in tax treaties, as opposed to the multilateralism under WTO. Therefore, this paper offers some insights on of the need to coordinate international trade and tax regimes.

Taking this into account, the paper is structured in the following manner: firstly, it explains the objectives of both regimes in a comparative perspective; then, it analyses the National Treatment and the MFN clauses under each regime; lastly, it explores the need of coordination between International Trade Law and DTAs.

II. THE OBJECTIVES OF INTERNATIONAL TRADE LAW AND DOUBLE TAXATION AGREEMENTS

A. INTERNATIONAL TRADE LAW

International Trade Law comprises the various agreements under the umbrella of the WTO Agreement, in addition to several supplementary bilateral and multilateral preferential trade treaties between subsets of countries[6]. The Marrakesh Agreement (which established the WTO) states in its preamble that trade and economic relations "(…) *should be conducted*

5 Appendix 1 explains briefly the historical interface between these two areas.

6 MITCHELL, ANDREW D. AND MUNRO, JAMES, *Can International Trade and Investment Law Protect Foreign Investments in the Resources Sector?* (November 15, 2012). [2012] AMPLA Yearbook 266; U of Melbourne Legal Studies Research Paper No. 644, p. 268.

with a view to raising standards of living, (…) *and expanding the production of and trade in goods and services,* (…) *by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international relations*".

One should note that the WTO objective is not global free trade, but trade liberalization through the "(…) *goals of reciprocity (i.e., "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade") and non-discrimination (i.e., "the elimination of discriminatory treatment in international commerce*")"[7]. And indeed, some even state that "[t]*he current belief* (…) *is that countries would agree to concessions or compromises in a multilateral arrangement that they would never have made in a narrower context of a bilateral network*"[8].

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7 BAGWELL, KYLE AND STAIGER, ROBERT W., "Reciprocity, Non-Discrimination and Preferential Agreements in the Multilateral Trading System", *NBER Working Paper* No. w5932, 1997, p. 1.

8 BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 266. Notwithstanding, others say that this willingness to conclude agreements in a multilateral context is being challenged by the proliferation of Preferential Trade Agreements ("PTAs"), which are treaties between two or more states granting preferential market access and therefore advancing trade liberalization and economic integration among parties.

According to the WORLD TRADE ORGANIZATION, *World Trade Report 2011, The WTO and preferential trade agreements: From co-existence to coherence*, 2011, p. 54, "PTA participation has accelerated over time and become more widespread. From the 1950s onwards, the number of active PTAs increased more or less continuously to almost 70 in 1990. Thereafter, PTA activity accelerated noticeably, with the number of PTAs more than doubling over the next five years and more than quadrupling until 2010 to reach close to 300 PTAs presently in force".

MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, pp. 86-87, state that this proliferation is marked by the following trends: (i) PTAs are increasingly formed between developing countries; (ii) "cross-regional PTAs" are becoming more common; (ii) bilateral PTAs are increasingly prevalent (about 60%); (iv) PTAs covering trade in goods are more common than those addressing trade in services; and (v) PTAs increasingly involve "deep integration" among members, which includes

These mutual concessions are a method by which governments seek reciprocal tariff reductions from their trading partners, neutralizing the world-price effects of their own liberalization[9]. Since trade restrictions often arise when governments set policies unilaterally, the effect of the GATT/WTO Agreements is to provide WTO Members a way to escape the "Prisoners' Dilemma"[10].

The pillars of WTO are market access and non-discrimination, since they are the principal drivers behind the trade lib-

PTAs covering not only what WTO called WTO+ areas (those already covered by WTO agreements, such as industrial and agricultural tariffs) but also WTO-X areas (those not currently covered by WTO agreements, including competition policy, environmental laws and labour market regulation).

One possible justification for this proliferation is a functional response to difficulties advancing and sustaining trade liberalization through the multilateral trading system. Scholars have directly attributed the rising number of PTAs to the deadlock in the WTO Doha Round. However, several other possible explanations have been advanced and no single explanation can account for the said proliferation (*v.* MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, pp. 87-89). Furthermore, 40% of the PTA are plurilateral, i.e. they are also multilateral arrangements. Lastly, it is worth noting that the increase of bilateral PTAs may be connected to the increase in cross-regional agreements.

9 BAGWELL, KYLE AND STAIGER, ROBERT W., "Reciprocity, Non-Discrimination and Preferential Agreements in the Multilateral Trading System", *NBER Working Paper* No. w5932, 1997, p. 19.

10 The Prisoners' Dilemma is a situation in which two individuals or entities need to make a decision, but to pursue the best individual option (in a selfish sense, i.e., at the expense of the other) will lead to a result that is not the ideal outcome for both of them. Consequently, these individuals or entities will be worse off than if they had cooperated with each other.

Trade agreements provide a tool for WTO members to avoid this type of situation, through mutually beneficial reciprocal reductions in trade barriers.

See e.g., DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 548; HORN, HENRIK AND MAVROIDIS, PETROS C., "Still Hazy After all These Years: The Interpretation of National Treatment in the GATT/WTO Case-Law on Tax Discrimination", *European Journal of International Law*, Vol. 15, February 2004, pp. 53 and following; RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, p. 398.

eralization project that serves as the *raison d'être* of International Trade Law. Market access "(…) *refers to the ability of exporters, importers and service suppliers of one country to access the domestic markets of another country and engage in international trade*"[11].

The second pillar for trade liberalization is the *principle of non-discrimination* (the focus of this paper). It comprises *National Treatment* (WTO members cannot discriminate against the goods, services and service suppliers of other members in comparison to their local equivalents[12]) and *MFN Treatment* (WTO members cannot discriminate between the goods, services, and service suppliers of other members, i.e., other members must have equal access among them to the local market)[13].

When any WTO agreement is violated States can resort to the Dispute Settlement Mechanism ("DSM"). The WTO DSM was already classified as a "quasi-judicial legalistic system"[14], since it generates decisions that cannot be blocked by

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11 MITCHELL, ANDREW D. AND MUNRO, JAMES, *Can International Trade and Investment Law Protect Foreign Investments in the Resources Sector?* (November 15, 2012). [2012] AMPLA Yearbook 266; U of Melbourne Legal Studies Research Paper No. 644, p. 268.

Obstacles to market access or trade restrictions may be tariff barriers or non-tariff barriers. See e.g. GUZMAN, ANDREW T., AND PAUWELYN, JOOST H. B., *International Trade Law*, 2nd edition, Wolters Kluwer, 2012, pp. 219-221.

12 National Treatment requires solely that imported products do not receive less favourable treatment *vis-à-vis* similar national products, but it does not prevent that imported products from receiving a more favourable treatment. (e.g. LANOSZKA, ANNA, *The World Trade Organization: Changing Dynamics in the Global Political Economy*, Lynne Rienner Publishers, 2009, p. 111). Although it may be a rare situation, it could happen for instance due to technology transfer reasons. Also defending this interpretation, v. Panel Report in the case *United States – Section 337 of the Tariff Act of 1930, Report of the Panel, L/6439 - 36S/345 (7 November 1989), para. 5.11.*.

13 MITCHELL, ANDREW D. AND MUNRO, JAMES, *Can International Trade and Investment Law Protect Foreign Investments in the Resources Sector?* (November 15, 2012). [2012] AMPLA Yearbook 266; U of Melbourne Legal Studies Research Paper No. 644, p. 271.

14 GREEN, ROBERT A., "Antilegalistic Approaches to Resolving Disputes Between Governments: a Comparison of the International Tax and Trade Regimes", *Yale Journal of International Law*, Vol. 23, Issue 1, Winter 1998, p. 80.

the losing party. Under the Dispute Settlement Understanding ("DSU"), the complaining party may request the establishment of a panel to adjudicate the dispute. Subsequently, the Dispute Settlement Body ("DSB") must set up a panel unless there is a consensus in the DSB not to do so – the so-called "reverse consensus"[15]. A party has the right to appeal a panel decision to the Appellate Body ("AB"), whose rulings are also subject to the reverse consensus rule.

However, only States can be a party in a Dispute (DSU, Article 4(3)). Consequently, the only "remedy" available to an injured company is the initiation of a dispute by its government. This may generate some constraints to the effective protection of the former because "[w]*hereas a company only has its commercial interests at stake, a government must weigh those interests against its broader trade, diplomatic and strategic priorities*"[16].

B. DOUBLE TAXATION AGREEMENTS

DTAs are usually based on formal models, such as the *OECD Model Tax Convention on Income and on Capital* ("OECD MC") and the *United Nations Model Double Taxation Convention between Developed and Developing Countries* ("UN MC").

The OECD MC states that "*it is scarcely necessary to*

15 Since the complaining party can prevent the formation of this "reverse" consensus, that party effectively has a right to the establishment of a panel.

16 MITCHELL, ANDREW D. AND MUNRO, JAMES, *Can International Trade and Investment Law Protect Foreign Investments in the Resources Sector?* (November 15, 2012). [2012] AMPLA Yearbook 266; U of Melbourne Legal Studies Research Paper No. 644, p. 274. Notwithstanding, the authors explain that "(…) *this constraint on the protection offered by international trade law can be overstated* (…). *Indeed, there are a number of WTO disputes that have been driven by the private sector. Molinuevo notes that "practice shows that a number of governments and private economic operators have built smooth cooperative mechanisms surrounding trade disputes that have effectively brought private actors to the stage before WTO judges*".

stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries"[17] and its main purpose is to "[provide] *a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation*"[18]. In addition, the UN MC affirms that it "*forms part of the continuing international efforts aimed at eliminating double taxation*"[19]. Furthermore, "[t]*he similarities between these two leading Models reflect the importance of achieving consistency where possible*"[20].

Following the mentioned Model Conventions ("MCs"), the relief from international double taxation takes the form of a foreign tax credit or of exemptions[21]. DTAs allow the establishment of these forms of double taxation relief in a bilateral basis, through the negotiation between the "source" and "residence"

17 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 7.

18 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 9; Double taxation here is used in the sense of juridical double taxation. Economic double taxation is not covered by DTAs. "*Double taxation is juridical when the same person is taxed twice on the same income by more than one state. Double taxation is economic if more than one person is taxed on the same item*." (OECD, *Glossary of Tax Terms*, available at http://www.oecd.org/ctp/glossaryoftaxterms.htm#D). An example of juridical double taxation is the situation in which a corporate income is taxed by the country of residence and by the country of source. An example of economic double taxation is that of the taxation of corporate profits and, later on, of the dividends, when distributed to shareholders.

19 UNITED NATIONS, *Model Double Taxation Convention between Developed and Developing Countries*, 2011, p. vi.

20 UNITED NATIONS, *Model Double Taxation Convention between Developed and Developing Countries*, 2011, p. vi.

21 Foreign Tax Credit is a "*method of relieving international double taxation. If income received from abroad is subject to tax in the recipient's country, any foreign tax on that income may be credited against the domestic tax on that income. The theory is that this means foreign and domestic earnings of an entity will as far as possible be similarly taxed, although usually the credit allowed is limited to the amount of domestic tax, with no carry over if tax is higher abroad*." (OECD, *Glossary of Tax Terms*). Unilateral relief of double taxation may also take the form of foreign tax credit or of exemption.

countries. Therefore, such reduction of double taxation tends to be more effective than in a unilateral basis.

For this purpose of mitigating double taxation, DTAs allocate taxing rights among the Contracting States, by establishing which one has the primary taxation right over each type of income. Consequently, the distinction between the country in which income is produced (*the country of source*) and the country to which the income is distributed (*the country of residence*) is essential. Traditionally, the source country has primary jurisdiction over corporate business income, while the residence country has jurisdiction over investment income, such as interest, dividends, and royalties[22].

Under DTAs, most countries reserve the right to impose withholding taxes on interests, dividends, royalties and capital gains (Articles 10-13 of the MCs). DTAs provide for reciprocal reductions from the statutory rates of withholding tax[23]. However, the actual rates of withholding tax vary in each DTA, depending on the negotiations between the Contracting States. Therefore, this reduction of withholding taxes is based on reciprocity.

Moreover, DTAs intend to avoid double non-taxation and tax evasion[24]. For these purposes, some DTAs provide for

22 See, for e.g., JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, p. 40; WARREN, ALVIN C., "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131, 2001, p. 132. The later author also presents some alternative divisions (p. 134).

23 The OECD MC limits the source country tax on dividends to 5 percent for parent companies of 25 percent or more of the subsidiary company, and 15 percent otherwise, and on interest to 10 percent.

24 CHOUDHURY, HAFIZ AND OWENS, JEFFREY, "Bilateral Investment Treaties and Bilateral Tax Treaties", *International Tax and Investment Center Issues Paper*, 2014, p. 2; UNITED NATIONS, *Model Double Taxation Convention between Developed and Developing Countries*, 2011, p. vii; DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 548; In this respect, it is extremely important the current work made by OECD under the Base Erosion and Profit Shifting Action Plan – (BEPS Action Plan). For details, consult http://www.oecd.org/tax/beps.htm.

exchange of tax information and for assistance in collection of the tax debts owed to the other Contracting State[25]. In addition, DTAs aim foreign investment facilitation, through the prevention of discriminatory treatment of foreign investors, by providing a level playing field and offering more certainty to taxpayers as to the consequences of an investment decision[26].

Neutrality of treatment of taxpayers is another goal of DTA's[27]. There are two types of neutrality as a basis for international taxation: Capital Export Neutrality ("CEN") and Capital Import Neutrality ("CIN"). CEN subjects investors to the same tax rate on all income from capital, whether invested at home or abroad. Under CEN, double taxation is relieved by the credit method. On the other hand, CIN requires that all investments in a country bears the same marginal tax for both domestic and foreign investors and double taxation is relieved through the exemption method[28]. Therefore, double taxation relief is a prerequisite for cross-border neutrality, whether under CEN or CIN. However, a pure CIN or CEN would require a complete harmonization of tax systems, which is clearly an unrealistic option at

25 See e.g. CHOUDHURY, HAFIZ AND OWENS, JEFFREY, "Bilateral Investment Treaties and Bilateral Tax Treaties", *International Tax and Investment Center Issues Paper*, 2014, p. 2; Article 26 of the OECD MC provide for exchange of information on tax matters. OECD developed a Model agreement on exchange of information on tax matters, which can be consulted at http://www.oecd.org/ctp/harmful/taxinformationexchangeagreementstieas.htm.

26 See e.g. CHOUDHURY, HAFIZ AND OWENS, JEFFREY, "Bilateral Investment Treaties and Bilateral Tax Treaties", *International Tax and Investment Center Issues Paper*, 2014, pp. 1-2; DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 554.

27 CHOUDHURY, HAFIZ AND OWENS, JEFFREY, "Bilateral Investment Treaties and Bilateral Tax Treaties", *International Tax and Investment Center Issues Paper*, 2014, p. 2.

28 AULT, HUGH J. AND SASSEVILLE, JACQUES, "Taxation and Non-Discrimination: A Reconsideration", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 102; DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 549; JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, pp. 40-41.

the present[29].

CIN essentially corresponds to a territorial tax system whereas CEN corresponds to a worldwide basis tax system. In the *FSC case*[30], the AB stated that WTO laws do not have any preference for one or another. Therefore, WTO Members are free to maintain a worldwide basis, a territorial or any other tax system.

Just like under WTO, DTAs provide a dispute resolution mechanism (Article 25 of the OECD MC and UN MC). However, this mechanism consists in a "mutual agreement" between the competent authorities of each contracting state[31]. This procedure is considered more diplomatic than legal because these authorities are the tax administrations of the signatory countries[32]. Nevertheless, the Mutual Agreement Procedure ("MAP") has the advantage of allowing taxpayer initiation (still, after its initiation, the taxpayer is not directly involved). On the other hand, this method of dispute resolution may be seen as a device for facilitating international cooperation by changing the politi-

29 "*As regards foreign income of a resident, full capital export neutrality would require that that income be taxed by the country of residence at the same time as domestic income (i.e. no deferral) and that that country provide full credit against the domestic tax liability for the tax paid in the state of source (refunding the excess foreign tax if necessary). As regards domestic income of non-residents, full capital import neutrality would require that the country of source tax the domestic income of residents and non-residents in exactly the same way and that there be no additional tax levied in the country of residence*". AULT, HUGH J. AND SASSEVILLE, JACQUES, "Taxation and Non-Discrimination: A Reconsideration", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 102.

30 *United States – Tax Treatment for Foreign Sales Corporations 'FSC' – Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002), par. 139.

31 The competent authority's functions are set forth in three clauses of Article 25, commonly known as the "specific case" provision, the "interpretative" provision, and the "legislative" provision.

32 See e.g., DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 554; WARREN, ALVIN C., "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131, 2001, p. 140.

cal context in which sovereign governments make self-interested decisions[33].

Moreover, some DTAs also provide for arbitration (voluntary in some cases and mandatory in others). Since 2008, Article 25(5) of the OECD MC allows the taxpayer to request mandatory arbitration of issues arising from cases which the states are unable to resolve within two years under the MAP. Nevertheless, binding dispute settlement remains the exception, since this new provision needs to be added in new DTAs or in their revisions.

Additionally, "(…) *due to the immediacy of some of the subject matter of DTAs, they have been more frequently litigated in national courts*"[34]. This immediacy is explained by the fact that DTAs are usually incorporated or deemed as part of the domestic law. Thus, taxpayers can invoke the treaty and have a court decision that effectively binds the State.

C. RECAPITULATION

International Trade Law and DTAs share a similar goal: the removal of barriers to cross-border movement of goods, services, capital, labor and technology. "*Indeed, two fundamental features of international tax policy – relief of double taxation and non-discrimination – are broadly consistent with global free trade*"[35]. The difference exists however in respect to the means

33 GREEN, ROBERT A., "Antilegalistic Approaches to Resolving Disputes Between Governments: a Comparison of the International Tax and Trade Regimes", *Yale Journal of International Law*, Vol. 23, Issue 1, Winter 1998, p. 80.

34 CHOUDHURY, HAFIZ AND OWENS, JEFFREY, "Bilateral Investment Treaties and Bilateral Tax Treaties", *International Tax and Investment Center Issues Paper*, 2014, p. 2; also in the same sense, AULT, HUGH J. AND SASSEVILLE, JACQUES, "Taxation and Non-Discrimination: A Reconsideration", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 124; DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 554.

35 FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 7.

of pursuing it: in trade through the reduction of tariffs and other barriers; in taxation by splitting the income tax base between source and residence countries)[36].

It is also interesting to note the differences with respect to dispute resolution. While WTO agreements are subject to binding dispute settlement, DTAs contain a form of diplomatic procedure as only recent DTAs include arbitration clauses. On the other hand, private entities have rights under DTAs, while in the WTO only States can be parties to the DSM[37].

III. DOUBLE TAXATION AS A RECOGNIZED BARRIER TO INTERNATIONAL TRADE

Double taxation has long been recognized as an obstacle to international trade[38], in the sense that double taxation of foreign-source income would discourage foreign production over domestic production. Indeed, the OECD MC refers to "[double taxation's] *harmful effects on the exchange of goods and services and movements of capital, technology and persons*"[39].

36 WARREN, ALVIN C., "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131, 2001, p. 149.

37 According to GREEN, ROBERT A., "Antilegalistic Approaches to Resolving Disputes Between Governments: a Comparison of the International Tax and Trade Regimes", *Yale Journal of International Law*, Vol. 23, Issue 1, Winter 1998, pp. 81-82, "*The "legalistic" model favors clearly defined rules and third party adjudication procedures that can apply such rules objectively in disputed cases. The "antilegalistic" model views rules merely as guidelines and favors the diplomatic resolution of disputes through intergovernmental consultation and negotiation*". The author adds "(…) *that legalistic dispute settlement could impose significant costs in the international tax context and that these costs probably would exceed those of the international trade context. Given the different balances between benefits and costs in the two areas, the legalistic dispute settlement procedures that have evolved under trade agreements should not be assumed to be the best model for resolving disputes under income tax treaties*."

38 DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 528, fn. 3.

39 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 7.

Consequently, mitigation or elimination of double taxation is extremely important to cross border transactions[40].

This recognition lead several of the WTO multilateral agreements concluded in the Uruguay Round in December 1993 to address indirect as well as direct taxation, such as the Agreement on Subsidies and Countervailing Measures ("SCM"), the Agreement on Agriculture and the General Agreement on Trade in Services ("GATS").

Under Article 1 of the SCM Agreement, a measure qualifies as a *subsidy* if four cumulative conditions are satisfied: (i) it is a financial contribution (as defined in Article 1.1.(a)(1) of the SCM Agreement), (ii) provided by a government or another public body[41], (iii) that confers a benefit to the recipient, and (iv) the benefit conferred has a specific character (as defined in Article 2 of the SCM Agreement)[42].

Under Article 1.1(a)(1)(i) to (iii), there are three types of financial contributions: (i) direct transfer of funds or liabilities (e.g., a loan or loan guarantee); (ii) government revenue that would otherwise be due is foregone (e.g. a tax credit); or (iii)

40 Several economists assert that the disparity of income tax policies around the world poses significant risks of distorting international commerce. They believe that income tax policies that are designed to boost foreign investment may have the same economic impact on international trade as trade policies. JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation,* Vol. 16, No. 3, March, 2005, p. 38.

41 Taking into account Article 1.1(a)(1)(iv), a subsidy may also be conferred by a private body under certain circumstances. Indeed, the panel in *Korea – Measures Affecting Trade in Commercial Vessels* (7 March 2005) WTO Doc. WT/DS273/R (Panel Report), in paras 7.50. defended that "*an entity will constitute a 'public body' if it is controlled by the government (or other public bodies). If an entity is controlled by the government (or other public bodies), then any action by that entity is attributable to the government, and should therefore fall within the scope of Article 1.1(a)(1) of the SCM Agreement*.".

42 V. INTERNATIONAL FISCAL ASSOCIATION, *IFA Research Paper: Tax Aspects of International Non-Tax Agreements*, by Alexia Kardachaki IFA Research Associate, 2012-2013, pp. 13-14, GUZMAN, ANDREW T., AND PAUWELYN, JOOST H. B., *International Trade Law*, 2nd edition, Wolters Kluwer, 2012, pp. 426-428; MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, pp. 367-375.

government provision of goods or services (e.g. provision by government of a cheap product) or purchasing of goods (e.g. government buying a product above market price)[43].

The SCM agreements divides subsidies into *permissible* (which may be actionable or non-actionable[44]) and *prohibited* subsidies. Both export subsidies (contingent on export performance) and subsidies contingent on the use of domestic over imported goods are prohibited, which means that, under Article 3(1), they are not subject either to the specificity test or to the injury test, since they are considered to be inherently trade distorting.

Annex I of the SCM contains an illustrative list of export subsidies. Item (e) of the list refers to measures involving "*full or partial exemption, remission, or deferral specifically related to exports, of direct taxes*"[45]. However, its footnote 59[46] clarifies

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43 GUZMAN, ANDREW T., AND PAUWELYN, JOOST H. B., *International Trade Law*, 2nd edition, Wolters Kluwer, 2012, p. 434; MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, p. 368.

44 "(…) *actionable subsidies, are specific subsidies that adversely affect the interest of another member. "Specific" here refers to subsidies that pertain to particular enterprises or industries. In the case of prohibited or actionable subsidies, the injured country has the choice of either bringing an action under the Subsidies Code or using countervailing duties.* (…) [N]*onactionable subsidies,* [are] *subject to neither countervailing duties nor a WTO complaint. This category includes nonspecific subsidies, as well as certain subsidies for research activities, regional development, and environmental adaptation.*". WARREN, ALVIN C., "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131, 2001, p. 143.
Under Article 31, the classification of non-actionable subsidies expired at the beginning of the year 2000.

45 The equivalence of production subsidies and tax incentives is uncontroversial. Therefore, both are subject to the WTO Subsidies Code. See WARREN, ALVIN C., "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131, 2001, p. 148.

46 "*The Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any Member may draw the attention of another Member to administrative or*

that item (e) is not intended to prevent Members from taking measures *to avoid double taxation of foreign source income*. Measures to avoid double taxation, as explained above, may be unilateral national measures or derive from DTAs.

This footnote is in accordance with the goal of International Trade Law and DTAs: elimination of barriers to international trade. Export subsidies (including total or partial tax exemptions) are only prohibited as long as they are intended to restraint the international commerce. Since these tax measures are specifically intended to reduce or eliminate double taxation, which constitutes a barrier to trade, it would be illogical and a countersense to prohibit them[47].

A controversial WTO case law on the issue of foregone "*government revenue that is otherwise due*" is the *FSC Case*: "*FSCs are foreign corporations responsible for certain sales-related activities in connection with the sale or lease of goods produced in United States for export outside the United States. The FSC measure essentially exempts a portion of an FSC's export-related foreign-source income from United States income tax*"[48]. According to the Panel (upheld by the AB), revenue "otherwise due" is established under a "but for" test, involving a comparison between the fiscal treatment being provided by a

other practices which may contravene this principle and which result in a significant saving of direct taxes in export transactions.
In such circumstances the Members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultation created in the preceding sentence.
Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member."

47 However, "false "measures to avoid double taxation" might violate the SCM if they are specific (…), in the sense that they are tied to *exports only*, and not to *foreign source income in general*". MOTA, PEDRO INFANTE AND BORGES, RICARDO HENRIQUES DA PALMA, "National Report Portugal", in *WTO and Direct Taxation* (Org. Lang, Michael), Linde Verlag, Vienna, and Kluwer, London, 2005, p. 606.

48 *United States – Tax Treatment for Foreign Sales Corporations 'FSC'*, Report of the Appellate Body, WT/DS108/AB/RW (24 February 2000), para. 11.

Member in a particular situation and the tax regime otherwise applied by that Member. It would imply to determine the "general tax rules" and if the measure at stake was as exception to those rules.

However, this "but for" test raises some problems, namely that "(…) *a new tax exemption may involve the adoption of a new general principle, and this dynamic "historic development" is hardly dealt with the apparently static "dilemmatic assessment" of the test*"[49]. Additionally, the AB itself, in a latter decision, stated that "[g]*iven the variety and complexity of domestic tax systems, it will usually be very difficult to isolate a "general" rule of taxation and "exceptions" to that "general" rule*"[50]. Instead, a "general-specific, comparable income" test was adopted[51].

Also in the *FSC Case*, the United States argued that the mentioned footnote 59 provided an exception to the "subsidy" definition under Article 1.1. However, the AB clarified that even if an FSC measure was not considered an "export subsidy" per this footnote, it could still be considered a "subsidy" under Article 1.1.[52]. In addition, the AB considered that the FSC measure was not limited to foreign-source income and consequently, did not fall within the justification provided by this Footnote[53].

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49 MOTA, PEDRO INFANTE AND BORGES, RICARDO HENRIQUES DA PALMA, "National Report Portugal", in *WTO and Direct Taxation* (Org. Lang, Michael), Linde Verlag, Vienna, and Kluwer, London, 2005, p. 596.

50 *United States – Tax Treatment for Foreign Sales Corporations 'FSC' – Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002), para. 91.

51 "*Instead, we believe that panels should seek to compare the fiscal treatment of legitimately comparable income to determine whether the contested measure involves the foregoing of revenue which is "otherwise due," in relation to the income in question*". *United States – Tax Treatment for Foreign Sales Corporations 'FSC' – Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002), para. 91.

52 *United States – Tax Treatment for Foreign Sales Corporations 'FSC' – Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002), para. 93.

53 *United States – Tax Treatment for Foreign Sales Corporations 'FSC' – Recourse*

Regarding the Agreement on Agriculture, Article 1 (Definition of Terms) of the "budgetary outlays" or "outlays" include revenue forgone. Consequently, tax measures are covered by the Agreement insofar as they constitute export subsidies (Articles 3(3) and 8) and the same logic of the SCM agreement applies, *i.e.*, it does not prevent DTAs because both mitigate barriers to trade.

With reference to GATS, tax measures that deviate from the MFN treatment obligation (Article II) are permitted if they are the result of a DTA or similar binding provisions in other international agreements (Article XIV(e)). Furthermore, Article XXII(3) does not allow for the WTO dispute settlement mechanism on income tax issues that would fall within the scope of an international agreement relating to the avoidance of double taxation.

In fact, the problem of double taxation is largely alleviated through DTAs, under which, as we saw above (II.B.) double taxation is limited and taxing rights over various types of income are assigned between the source and residence countries. Therefore, these exceptions under WTO/GATT agreements for DTAs are in accordance with the trade liberalization goal.

IV. THE NATIONAL TREATMENT PRINCIPLE

A. UNDER INTERNATIONAL TRADE LAW

Article III of the GATT is the cornerstone for National Treatment in International Trade Law. Article III(2) states that "(…) *products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal*

to Article 21.5 of the DSU by the European Communities, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002), paras 184–6.

charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1 [i.e., to afford protection to domestic production by altering the conditions of competition]".

This means that imported goods must receive a treatment no less favorable than domestically produced goods, which prevents discriminatory internal taxes to be used as substitutes for tariffs[54]. National Treatment covers *indirect taxes* applied *"directly"* to products as well as *indirect taxes* applied *"indirectly"* to products (e.g. during the production process). In addition, the traditional interpretation is that this principle is applicable only to taxes on products (*indirect taxation*) and not to income taxes (*direct taxation*) because taxes on products tend to affect internal consumption to a greater extent than taxes on the income of foreign producers[55]. Nevertheless, one could conceive examples in which taxes on the income of foreign producers could affect in-

54 "*A complaining party alleging a violation of Article III.2 thus has two possible routes. One is to argue that: (i) the domestic and the foreign products are like; and (ii) the latter is taxed in excess of the former. The other is to claim that: (iii) the two products are directly competitive or substitutable (DCS); (iv) the two products are* not similarly taxed: *(v) the dissimilar taxation operates so as to afford protection (SATAP) to domestic production.*" HORN, HENRIK AND MAVROIDIS, PETROS C., "Still Hazy After all These Years: The Interpretation of National Treatment in the GATT/WTO Case-Law on Tax Discrimination", *European Journal of International Law*, Vol. 15, February 2004, p. 41.
In *EC – Asbestos Case* (Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R (adopted Apr. 5, 2001), four criteria are used in the analysis of "likeliness": *"(i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumer's tastes and habits; and (iv) the tariff classification of the products*" (para. 85).
55 This is usually pointed as the reason why the GATT does not contain a general carve-out for income tax measures. COCKFIELD, ARTHUR J. AND ARNOLD, BRIAN J., "What can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 142.

ternal consumption in the same extent than taxation on products[56].

Under Article XVII of GATS, National Treatment involves non-discrimination based on the origin of the *services* and of the *service suppliers* themselves. Hence, Foreign Direct Investment is covered by the GATS insofar as it involves a commercial presence for the delivery of services[57]. "*Less favourable treatment*" is defined as the one that modifies the competition conditions in favor of the member's own services or service suppliers compared to like services or service suppliers of any other member (Article XVII(3)). Nevertheless, under GATS, different treatment is permitted as long it is aimed *inter alia* at the effective collection of direct taxes (Art. XIV(d))[58]. "Direct taxes" for this purpose covers all taxes on income or capital.

B. UNDER DOUBLE TAXATION AGREEMENTS

The overwhelming majority of DTAs, following the

56 AULT, HUGH J. AND SASSEVILLE, JACQUES, "Taxation and Non-Discrimination: A Reconsideration", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 120; MOTA, PEDRO INFANTE AND BORGES, RICARDO HENRIQUES DA PALMA, "National Report Portugal", in *WTO and Direct Taxation* (Org. Lang, Michael), Linde Verlag, Vienna, and Kluwer, London, 2005, p. 582; Indeed, there is several WTO case law on direct taxation. See e.g. FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, pp. 69-74; Additionally, the fact that DTAs (which refer to income taxation) have a specific National Treatment clause (see below IV.B.), prohibiting taxation which is other or more burdensome than the one applied to nationals, shows that it is possible for the national legislator to discriminate with respect to income tax provisions.

57 DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 535.

58 "*A footnote to this provision lists broad categories of discriminatory income tax measures that will not be considered to violate the national treatment obligation*". GREEN, ROBERT A., "Antilegalistic Approaches to Resolving Disputes Between Governments: a Comparison of the International Tax and Trade Regimes", *Yale Journal of International Law*, Vol. 23, Issue 1, Winter 1998, p. 93.

MCs, contain in their Article 24 or equivalent (Non-discrimination), a National Treatment obligation[59] which states:

"1. Nationals of a Contracting State 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 of that other State *in the same circumstances*, in particular with respect to residence, are or may be subjected" (italics added)[60].

According to this rule, the source country should tax all income at the same rate, whether received by their residents or residents of the other contracting state[61]. This National Treatment is extended to stateless persons who are residents of a Contracting State (Article 24(2))[62]. Furthermore, it covers permanent establishments of foreign firms, and enterprises that are

59 "*Article 24 of the United Nations Model Convention, except for reference to a different paragraph of Article 12 in paragraph 4, reproduces Article 24 of the OECD Model Convention*", UNITED NATIONS, *Model Double Taxation Convention between Developed and Developing Countries*, 2011, p. 339.
One should note that since these are Model Conventions, they are soft law and consequently they do not create actual obligations.

60 According to Article 3(1)(f) of the OECD MC, "*the term "national", in relation to a Contracting State, means: (i) any individual possessing the nationality or citizenship of that Contracting State; (ii) any legal person, partnership or association deriving its status as such from the laws in force of that Contracting State*". The provisions of Article 24 of the MCs are applicable to taxes of every kind and description (Article 24(6)).

61 Under Article 4(1) of the OECD MC "*the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein*".

62 "*The purpose of paragraph 2 is to limit the scope of the clause concerning equality of treatment with nationals of a Contracting State solely to stateless persons who are residents of that or of the other Contracting State*", OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 355.

wholly or partly owned or controlled by one or more foreign residents (Article 24(3)(5))[63].

Article 24 "(…) *seek*[s] *to balance the need to prevent unjustified discrimination with the need to take account of these legitimate distinctions*"[64]. The expression "in the same circumstances" (Article 24(1)(2)) is paramount in this context, as well as those of "carrying on the same activities" (Article 24(3)) and "similar enterprises" (Article 24(5)). It requires substantially similar circumstances from a legal and factual point of view[65].

In fact, this rule does not prohibit discriminatory income taxation of *nonresident investors*: Article 24(1) of the MCs prohibits discriminatory taxation of nationals of the other treaty country "in the same circumstances" and it is generally understood that nonresident investors are not in the same circumstances as domestic taxpayers[66]. On the other hand, Article 24(1)

63 Payments of interest, royalties and other disbursements to foreign residents are, for the purposes of determining taxable income, to be deductible under the same conditions as payments to domestic residents. However, this paragraph allows some exceptions to the determination of taxable income, such as Control Foreign Companies and Transfer Pricing rules.

64 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 349.

65 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 351.

66 See for instance, JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, p. 42; DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 551.

"*The expression "in the same circumstances" would be sufficient by itself to establish that a taxpayer who is a resident of a Contracting State and one who is not a resident of that State are not in the same circumstances.* (…) *However, in revising the Model Convention, the Committee on Fiscal Affairs felt that a specific reference to the residence of the taxpayers would be a useful clarification as it would avoid any possible doubt as to the interpretation to be given to the expression "in the same circumstances" in this respect*" in OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 351.

A good example is the following: "*Since the application of progressive rates of taxation only makes sense if the overall ability to pay of the taxpayer can be measured, it is not surprising that tax treaties do not require that rates applicable to residents and non-residents be the same. One exception is that applicable to the profits attributable*

applies to nationals who are residents of a Contracting State as well as to all nationals of each Contracting State, who are not residents of one of these States[67].

The MCs also use the expression "other or more burdensome" (or "less favorably levied" in respect to Permanent Establishments). This means that for nationals and foreigners under the same circumstances the tax imposed must be the same with respect to the basis of charge, method of assessment, tax rate and formalities (such as returns, payments and prescribed times)[68].

It is widely agreed that these terms should be interpreted with some flexibly, considering the totality of the circumstances, including limited enforcement and collection mechanisms. Since this clause focuses on non-discrimination based on nationality, it is often termed "ownership" non-discrimination[69]. In addition, in some circumstances, a Contracting State may be allowed to apply discriminatory taxes to a nonresident taxpayer from the other Contracting State. For instance, if there is no corporate tax double taxation, a Contracting State is allowed not to extend the benefits to its nonresident investors[70].

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to a permanent establishment of a non-resident: in that case, Art. 24(3) requires that taxation [*sic*] *not be less favourable than that on a domestic enterprise. Para. 56 of the Commentary on Art. 24 confirms that this requires the application of the same rate of tax, but suggests that if the rates are progressive, the state of source could determine the applicable rate by reference to the worldwide profits of the non-resident*", in AULT, HUGH J. AND SASSEVILLE, JACQUES, "Taxation and Non-Discrimination: A Reconsideration", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 108.

67 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 351.

68 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 352.

69 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, p. 42.

70 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation,* Vol. 16, No. 3, March, 2005, p. 64; "*A State is not obligated to extent special taxation privileges that were given to its own public bodies or services as such, or private institutions not for profit, for instance*", OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 351.

Since there is no international dispute settlement body with authority to decide whether foreign and domestic producers are in different circumstances, the source country is often free to reach its own conclusion about whether such differential treatment is justified. Consequently, this National Treatment protection can be more limited in practice than might be suggested by the DTAs' language[71].

C. RECAPITULATION

The GATT applies to products and GATS applies to both services and service providers, whereas DTAs, in respect to National Treatment, are applicable to income of nationals of the Contracting States, stateless persons, permanent establishments, disbursements and debts and capital enterprises. Under International Trade Law and DTAs, "*the application of the NT standard necessarily entails a comparative analysis between, on the one hand, the treatment granted by the host country to its domestic subjects and, on the other hand, the treatment granted by that host country to the subjects of the contracting party. Such analysis does not aim at determining whether the treatment is identical, but rather whether foreign subjects receive a treatment no less favourable than domestic subjects*"[72].

However, the wording is not the same and therefore different interpretations are possible. Indeed, "(…) *it is generally understood that the NT principle* [under WTO agreements] *is of a more generous character than the non-discrimination principle of Art. 24 (1) of the OECD MC, as the latter applies only when the requirement of the "same circumstances" is fulfilled. Despite the fact that also the NT standard, as discussed above,*

71 WARREN, ALVIN C., "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131, 2001, pp. 150-151.

72 INTERNATIONAL FISCAL ASSOCIATION, *IFA Research Paper: Tax Aspects of International Non-Tax Agreements*, by Alexia Kardachaki IFA Research Associate, 2012-2013, p. 40.

may be inherently limited (most often) to "like situations" or "similar situations" or "like circumstances", it is understood that such limitation is weaker than the one imposed by Art. 24 (1) of the OECD MC"[73].

Notwithstanding, one should recall that residence (along with source) is a jurisdictional basis for taxation[74]. Still, the National Treatment under Article 24 of the MCs is too narrow and ineffective to prevent cases where income taxes *unduly* discriminate against non-resident taxpayers, allowing discrimination against foreign businesses and foreign investors. Therefore, there is potential to distort cross-border trade and investment[75].

V. THE MOST FAVORED NATION PRINCIPLE

A. UNDER INTERNATIONAL TRADE LAW

The MFN principle is established in Article I:1 of the GATT, which states that "(…) *any advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties*"[76].

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73 INTERNATIONAL FISCAL ASSOCIATION, *IFA Research Paper: Tax Aspects of International Non-Tax Agreements*, by Alexia Kardachaki IFA Research Associate, 2012-2013, pp. 45-46.

74 FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 89.

75 COCKFIELD, ARTHUR J. AND ARNOLD, BRIAN J., "What can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 149.

76 "*There are six central issues surrounding the legal interpretation of Article I:1: (1) the provision's object and purpose; (2) its scope of coverage; (3) the meaning of 'any advantage, favour, privilege or immunity'; (4) the meaning of 'accorded … unconditionally'; (5) the interpretation of the concept of 'like product'; (6) its application to both de jure and de facto trade discrimination.*" MICHAEL TREBILCOCK, ROB-

This means that WTO members cannot discriminate between trading partners' goods, i.e., concessions accorded to one country's goods should be granted to those of all countries. Therefore, discrimination of imported products or services per their country source is prohibited. This clause covers both *de jure* and *de facto* discrimination[77].

The MFN goal is to avoid trade diversion: "[a] *main argument against bilateral or regional trade agreements is that they could divert more trade than they create and thus be detrimental to global efficiency. While the ultimate goal of multilateral negotiations at the WTO is presumably to eliminate tariffs as well as non-tariff barriers to trade, in the meantime, the MFN principle governs the manner in which such barriers to imported goods and services may be used*"[78].

Just like in the National Treatment, MFN is traditionally considered to be applicable only to indirect taxes. Notwithstanding, "*one should consider that cases where a direct tax benefit is granted so as to provoke a more favourable treatment of the products of a certain country in prejudice of another country's*

ERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, p. 60.

"*Articles I:2 and I:4 create an MFN exception for historical preferences in force at the time of the coming into effect of the GATT, subject to the requirement that the margin of preference cannot subsequently be altered in such a way as to exceed the difference between the MFN rate and preferential rates existing as of 10 April 1947. These provisions contemplate that the absolute, not proportional, difference between MFN and preferential rates must be maintained when MFN rates are reduced or raised*." MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, p. 80.

77 In *Canada – Autos Case* (Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R (adopted June 19, 2000)), it was stated that "[n]*either the words "de jure" nor "de facto" appear in Article I:1. Nevertheless, we observe that Article I:1 does not cover only "in law", or de jure, discrimination. As several GATT panel reports confirmed, Article I:1 covers also "in fact" or de facto, discrimination*" (par. 78).

78 DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 550.

products (…) *should be thoroughly analysed* (…)"[79].

GATS contains a MFN treatment obligation in its Article II, stating that "(…) *each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country*".

A permitted exception to MFN are the Free Trade Agreements ("FTAs")[80], which may be regional (such as the North American Free Trade Agreement ("NAFTA")) or bilateral. There are other exemptions, such as the PTAs and the Enabling Clause, which provides for special treatment of developing countries, or Article XX of the GATT[81].

B. UNDER DOUBLE TAXATION AGREEMENTS?

Under the MCs and most the DTAs, there is no general MFN "obligation". This absence is generally explained by the DTAs bilateralism, since they establish taxation rights between

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79 MOTA, PEDRO INFANTE AND BORGES, RICARDO HENRIQUES DA PALMA, "National Report Portugal", in *WTO and Direct Taxation* (Org. Lang, Michael), Linde Verlag, Vienna, and Kluwer, London, 2005, p. 571.
In the same sense, JENNIFER E. FARRELL states "(…) *taxes fall under the term "charges of any kind" and there is nothing explicit in the wording of article I that excludes direct taxes from the MFN obligation. Although, a case would have to be very persuasive to establish that a direct tax is imposed "on or in connection with" the exportation or importation of a good. Therefore, the application of MFN to direct taxes is generally regarded as "remote"* (…). [after giving several examples, she continues] *These examples rebut any argument that it is practically impossible to devise discriminatory income tax rules that would be imposed according to the origin of imported products*." FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, pp. 56-57.
80 See for instance, GUZMAN, ANDREW T., AND PAUWELYN, JOOST H. B., *International Trade Law*, 2nd edition, Wolters Kluwer, 2012, pp. 332 and following.
For some of main advantages and disadvantages of FTAs see e.g. MOSQUERA VALDERRAMA, IRMA JOHANNA, *The International Tax Policy in the Context of Integration and Trade in Latin America* (October 20, 2006), pp. 5-6.
81 See for instance, MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, pp. 80 and following.

the Contracting States, based on the reciprocity principle. Indeed, historically there was always a rejection of MFN in DTAs[82].

Consequently, for the historical drafters of the OECD MC "(…) *there was no expectation for global convergence of tax treatments since each bilateral setting should produce a different negotiated outcome that presumably maximizes the benefits to the participating countries in that particular situation. In reality, the development and crystallization of the current international tax regime and the relative convergence of the rules along the lines of the OECD model have produced an outcome that is close to, albeit not actually, a global level playing field*"[83].

Notwithstanding, the general absence of MFN clauses leads to actual differences of withholding tax rates in each DTA, depending on the negotiations between the Contracting States. Consequently, "(…) *bilateral tax treaties create the potential for diversion of international capital flows, which would counteract the benefits from any increased capital flows. To the extent that more foreign investment is diverted from one destination to another than is created, such treaties could conceivably contribute to an inefficient world-wide allocation of capital*"[84].

However, the MCs do not preclude MFN provisions:

82 The historical rejection of MFN and multilateralism is described in FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, pp. 13- 14; The commentaries to the OECD MC actually state that "(…) *the provisions of the Article cannot be interpreted as to require most-favoured-nation treatment.* (…) *As tax conventions are based on the principle of reciprocity, a tax treatment that is granted* (…) *by reason of the specific economic relationship between those Contracting States* (…)" OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, 2014, p. 349; One should note, however, that the UN MC does not have any explicit rejection of MFN in its commentaries.

83 BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, pp. 266-267.

84 DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 550.

they simply do not include a MFN recommendation[85]. Therefore, States may include a MFN provision if they wish so, without contradicting the MCs[86]. In fact, several DTAs include MFN provisions, applicable to different types of income and with variable scope and wording[87]. For instance, some of them are "unilateral", in the sense that some MFN provision is only enforceable in respect to one of the Contracting States, i.e., only country X is bound by the MFN clause, while country Y is not[88].

In this respect, Ines Hofbauer conducted an interesting study in which she found 567 MFN clauses in DTAs[89]. As a re-

85 Still, it is important to note that "(…) *the OECD Commentary has accepted that single States may agree on most-favoured-nation clauses under specific circumstances. In the 1992 Commentary, this remark has been removed without justification. And neither are there model MFN provisions in the OECD Model Convention*" in HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax*, Vol. 33, Issue 10, 2005, p. 445.

86 MOSQUERA VALDERRAMA, IRMA JOHANNA, *The International Tax Policy in the Context of Integration and Trade in Latin America* (October 20, 2006), p. 10.

87 HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax*, Vol. 33, Issue 10, 2005, p. 449 and seq. contains a list of MFN clauses in DTAs organized according to type of income; In fact, "(…) *countries often include MFN-type provisions in their DTCs* (…) *in particular in relations between developed and developing countries and these provisions mostly relate to the withholding tax on passive income*" in INTERNATIONAL FISCAL ASSOCIATION, *IFA Research Paper: Tax Aspects of International Non-Tax Agreements*, by Alexia Kardachaki IFA Research Associate, 2012-2013, p. 47.

88 For examples of these unilateral MFN provisions, see e.g. MOSQUERA VALDERRAMA, IRMA JOHANNA, *The International Tax Policy in the Context of Integration and Trade in Latin America* (October 20, 2006), p. 11.

89This number includes MFN clauses in terminated or not-yet-in-force DTAs and taking into account that some DTAs contain more than one MFN clause. When the 1977 OECD Commentary was prepared, more than 30 MFN provisions were included in tax treaties (none by an OECD Member State). Therefore, it was not an issue requiring the OECD MC attention. In the next fifteen years, the number of MFN clauses included in DTAs rapidly increased, and even strongly throughout the 1990s, possibly also because of several interacting factors (including the termination of the WTO negotiations of the Uruguay Round, the general increase in the number of DTAs and the move towards economic globalization) HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax*, Vol. 33, Issue 10, 2005, p. 447.

sult, "[o]*ne should reject the statement that most-favoured-nation treatment is uncommon in tax treaty law* (…). *The countries with the highest number of such provisions can be found in all continents*"[90]. The author concludes that "[t]*hese provisions intend to change the words used in a bilateral tax treaty in order to grant additional treaty privileges, but rarely to withdraw these advantages, if another country is granted a specific treaty benefit by the other Contracting State. These provisions are therefore aimed at harmonising bilateral tax treaties to a certain extent*"[91].

C. RECAPITULATION

Under the MFN principle in WTO agreements, the host country has the obligation of treating the subjects from the other contracting country no less favorably than the subjects from any other third country. Consequently, WTO members cannot discriminate between trading partners' goods or services, either *de jure* or *de facto*. By contrast, the MCs and most the DTAs do not contain any MFN clause. This absence is generally explained by the DTAs bilateralism and the reciprocity principle. Notwithstanding, there is a gradual increase of MFN clauses in DTAs, applicable to different types of income and with variable scope and wording. Consequently, one may affirm that MFN is becoming an issue also under DTAs, despite the bilateral nature of these agreements.

VI. NEED OF COORDINATION BETWEEN INTERNATIONAL TRADE LAW AND DOUBLE TAXATION AGREEMENTS?

90 HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax,* Vol. 33, Issue 10, 2005, p. 448; See appendix 2 and 3.

91 HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax,* Vol. 33, Issue 10, 2005, p. 449.

A. GENERAL ASPECTS

One should recall the essential differences between International Trade Law and DTAs. The WTO/GATT agreements are multilateral, require National Treatment and MFN treatment and are subject to binding dispute resolution procedures. By contrast, DTAs are bilateral, require National Treatment, only part of them requires MFN (solely in respect to some types of income) and are mostly subject to diplomatic dispute resolution. Theoretically, International Trade Law could apply to International Taxation, but exemptions for income taxation exist in most agreements for DTAs. Consequently, the first question that one should ask is if it is even necessary to coordinate International Trade Law and DTAs.

In fact, "[s]*ome forcefully assert that it is simply wrong to try to find common ground for tax and trade policies. Fundamentally, tax issues are treated differently from other 'trade and' issues because while in theory it would be possible to eradicate all tariff and non-tariff barriers through multilateral trade negotiations, it would be unfeasible to eliminate (income) taxes altogether purely on the notion that they operate as impediments to international trade and investment*"[92].

International Trade Law and DTAs pursue the same goal of removing barriers to cross-border trade. However, International Trade Agreements have been negotiated in a multilateral manner under GATT and WTO. On the other hand, DTAs have been decided in a bilateral manner, although following MCs.

92 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation,* Vol. 16, No. 3, March, 2005, p. 38; "*The question, then, is how to design a tax system that raises the required revenue with the least distortion of the economy*." GREEN, ROBERT A., "Antilegalistic Approaches to Resolving Disputes Between Governments: a Comparison of the International Tax and Trade Regimes", *Yale Journal of International Law,* Vol. 23, Issue 1, Winter 1998, p. 114.

This multilateralism/bilateralism may lead to inconsistency between DTAs and WTO Agreements, or at least to undermine the desired level of non-discrimination and promotion of trade liberalization.

Yariv Brauner argues that coordination is necessary because "(…) *the use of tax systems to protect domestic interests may increase as a consequence of economic globalization. The proliferation of global trade and the increasing power of free trade arrangements leave income taxes as one of the few remaining measures that can potentially serve protectionist purposes*"[93].

Additionally, the National Treatment under DTAs prohibits a Contracting State to apply discriminatory taxes to a business enterprise operating within its territory that is carried on, owned, or controlled by residents of the other Contracting State. However, that Contracting State may apply discriminatory taxes to a nonresident taxpayer. Another example is the case in which there is no corporate tax double taxation, since a Contracting State may not extend the same benefits to its nonresident investors. Notwithstanding the fact that this is permitted under the DTA, that benefit may change the competition conditions, creating an unfair market advantage.

Another difficulty is the fact that most of the WTO attention has been directed to internal taxation, while international taxation has been overlooked. On the other hand, there are some exceptions under WTO/GATT agreements in respect to DTAs. Therefore, the main WTO's concern has been the internal taxation, since DTAs are considered to be "in charge" of removing obstacles to trade resulting from international taxation.

For all these reasons, one can conclude that coordination between International Trade Law and DTAs is indeed necessary. Consequently, the current multilateral/bilateral structure of the

93 BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 253.

agreements and the possible methods to achieve this coordination are analyzed.

B. MULTILATERALISM VS BILATERALISM

Multilateral agreements usually have a worldwide scope of application, aiming at the regulation of a field of common interest. "*It is logical that the achievement of a consensus in important economic areas, which are normally the subject of regulation of these agreements, is a hard task, due to the diversified and conflicting interests of the parties*"[94]. By contrast, bilateral agreements have a narrow scope and therefore it is easier to reach consensus on them.

Taking this into account, one should also bear in mind that reciprocity does exist both in International Trade Agreements and in DTAs, since reciprocity has the general meaning of "balance of concessions" that governments seek when they enter into negotiations[95].

However, the GATT/WTO Agreements' negotiations, based on mutual concessions, resulted in the MFN treatment, since this clause assures reciprocity among all the members of multilateral agreements. Moreover, Bagwell and Staiger found that there is an efficiency rationale for MFN on multilateral systems because together they eliminate the restrictions in trade caused by terms-of-trade motivations from each government's unilateral trade policy choices[96].

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94 INTERNATIONAL FISCAL ASSOCIATION, *IFA Research Paper: Tax Aspects of International Non-Tax Agreements,* by Alexia Kardachaki IFA Research Associate, 2012-2013, p. 11.

95 BAGWELL, KYLE AND STAIGER, ROBERT W., "Reciprocity, Non-Discrimination and Preferential Agreements in the Multilateral Trading System", *NBER Working Paper* No. w5932, 1997, p. 17.

96 BAGWELL, KYLE AND STAIGER, ROBERT W., "Reciprocity, Non-Discrimination and Preferential Agreements in the Multilateral Trading System", *NBER Working Paper* No. w5932, 1997, p. 4.

On the other hand, DTAs are bilateral and therefore reciprocity (i.e. mutual reduction of source country withholding taxes on income) is restricted to those two Contracting States in each DTA. Consequently, MFN clauses are not necessary for reciprocity purposes. Accordingly, the reciprocity application differs according to the bilateral or multilateral nature of the agreements, leading only in the last case to a MFN treatment. Indeed, tax reciprocity and bilateralism can be explained with the fact that "[t]*he parties to a tax treaty do not wish to extend the same benefits (reduction of source-based tax) to situations where the flow of capital is unbalanced, resulting in a net loss of revenue (because the reduced source-based tax is not accompanied by increased residence-based tax)*"[97].

Nevertheless, despite the bilateralism of DTAs, the exceptions under International Trade Law agreements make sense, since the former promote a progressive elimination of a barrier to trade. Actually, one can make an analogy with FTAs[98], because it is better to achieve some progressive liberalization of trade than no liberalization at all. On the other hand, the absence of MFN clauses allows differences of withholding rates and therefore some level of discrimination to persist.

Thomas Rixen and Ingo Rohlfing sought an explanation for the institutional difference between trade and tax regimes,

97 AVI-YONAH, REUVEN S. AND SLEMROD, JOEL B., "(How) Should Trade Agreements Deal with Income Tax Issues?", *Michigan Law and Economics Research Paper* No. 01-008, 2001, p. 20.

"*Nevertheless, in certain narrow cases, the use of MFN principles may be an appropriate way to modify the bilateral nature of tax treaties without the need to renegotiate all or many of a country's tax treaties.* (…) *MFN clauses may also be useful to trigger the renegotiation of treaties in certain circumstances*", COCKFIELD, ARTHUR J. AND ARNOLD, BRIAN J., "What can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model", *World Tax Journal*, Vol. 2, No. 2, 2010, pp. 150-151.

98 "*The efficiency properties of politically optimal MFN external tariffs are thus lost when a free trade agreement is in place*." BAGWELL, KYLE AND STAIGER, ROBERT W., "Reciprocity, Non-Discrimination and Preferential Agreements in the Multilateral Trading System", *NBER Working Paper* No. w5932, 1997, p. 32.

separating three stages of the cooperation process: (i) *bargaining*, referring to the negotiation of the terms of an agreement; (ii) *agreement*, where a binding decision is reached, formally concluding the bargaining period; and (iii) *enforcement*, referring to the *ex post* stage of the cooperation process in which countries ensure that all treaty partners comply with the agreement[99]. For these authors, the choice between bilateralism and multilateralism is made in each of these stages and therefore cooperation can be characterized by a mix of bilateral and multilateral elements.

These authors explain that in *bilateral bargaining*, concessions are exchanged within a dyad, while in multilateral bargaining all actors make the same concessions[100]. However, *multilateral bargaining* reduces transaction costs[101] and consequently, even in taxation there is some multilateralism in this stage, since the MCs are highly discussed among several States[102]. Secondly, the presence or absence of MFN obligations explains the difference in institutional choice in the *agreement stage*. MFN treatment opens the floor for free-riding and externalities[103], which can be countered by the multilateral nature of

99 RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, pp. 390-391; See appendix 4.

100 RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, p. 390.

101 Also mentioning the transactional costs, MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, p. 58.

102 An institutional history of the bargaining states in Trade and Taxation may be found in RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, pp. 392 and following; See appendix 5.

103 Also mentioning the risk of "free ride", GUZMAN, ANDREW T., AND PAUWELYN, JOOST H. B., *International Trade Law*, 2nd edition, Wolters Kluwer, 2012, p. 307; MICHAEL TREBILCOCK, ROBERT HOWSE AND ANTONIA ELIASON, *The Regulation of International Trade*, Abingdon, Oxon; New York: Routledge, 4th edition, 2013, p. 59.

agreements in International Trade Law, through mutual concessions under reciprocity. By contrast, States do not always consider MFN clauses in taxation because in this way free-riding is avoided (since the agreement is bilateral). Consequently, the inclusion of an MFN clause in the agreement stage would increase the transaction costs in the tax bargaining stage[104].

C. HOW TO ACHIEVE COORDINATION?

International Trade and Tax Law have historically developed along separate paths, but currently several authors discuss the different possibilities to achieve their coordination. These proposals can be grouped as (i) the WTO increase of scope and jurisdiction, covering international tax issues, through a WTO agreement on taxation; (ii) the creation of a multilateral tax agreement and organization; and (iii) institutional coordination between WTO and other international organizations, namely the OECD and UN[105].

Concerning (i), some support "(…) *a multilateral treaty similar to the GATT that will address tax as well as trade issues*

104 RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, p. 392; The same authors clarify that "[t]*he risk of retaliatory spirals inherent to trade cooperation is mitigated by unconditional MFN treatment. MFN obligations, in turn, make trade cooperation a public good which gives rise to free-riding that is countered by multilateral agreement. The absence of MFN treatment in the tax regime renders protection against free-riding unnecessary and agreement can thus be bilateral. Therefore, while the two regimes have the same economic rationale, i.e. economic liberalization, the domestic political structures connected to this goal are quite different in the two issue areas*." (p. 410)

105 FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, chapter 10, organizes the options in the following manner: (A) "Do nothing"; (B) Improve the existing WTO tax provisions; (C) A Committee on Trade and Tax; (D) Institutional dialogue; (E) A WTO agreement on taxation; (F) The creation of a global tax body; (G) The WTO as an "international tax organization".

For lack of availability to address properly all this options, only the most frequent proposals are analyzed.

and that will apply to subsidies for services as well as goods"[106]. This proposal is justified with the bilateral nature of DTAs, which still allows some form of discrimination. However, there are several arguments that can be made against this proposal.

Firstly, "[t]*here is no visible political consensus that would ignite a worldwide comprehensive negotiation* (…)"[107]. Furthermore, the proliferation of FTAs and the current difficulties of Doha negotiations result in less authority of the WTO to regulate trade. Consequently, the authority of the WTO as an institutional vehicle to achieve coordination is also diminished[108].

Secondly, "(…) *as for institutions, most international tax lawyers would prefer the OECD to the WTO, primarily because they are so familiar with the OECD's dispute resolution mechanism, which takes the form of bilateral negotiation*"[109]. Additionally, it has been said that trade and tax lawyers do not have sufficient knowledge of each other's field. Besides, the lack of tax expertise in the WTO is evident[110].

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106 AVI-YONAH, REUVEN S. AND SLEMROD, JOEL B., "(How) Should Trade Agreements Deal with Income Tax Issues?", *Michigan Law and Economics Research Paper* No. 01-008, 2001, pp. 23 and following.

107 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, pp. 63-64.

108 See e.g. MOSQUERA VALDERRAMA, IRMA JOHANNA, *The International Tax Policy in the Context of Integration and Trade in Latin America* (October 20, 2006), p. 13; BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 302; FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 228.

109 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, 63-64.

110 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation*, Vol. 16, No. 3, March, 2005, p. 64.

Indeed, a "(…) *clear lesson from the FSC decisions is that current WTO law and DSB practice are hardly capable of handling income tax related cases. Despite some direct references to income tax treaties in the WTO's primary legal sources, there is no developed doctrine or jurisprudence that could have assisted the panel and the AB in deciding these relatively easy cases.* (…) *WTO law does not rely on fiscal definitions and concepts, even when the subject matter is the income tax. This again demonstrates both the incongruity between the international trade and international tax regimes,*

Thirdly, "(…) *subjecting all of the detailed, intricate national income tax rules to the binding WTO dispute settlement mechanism would in all probability be the last undertaking to which countries would concede*"[111]. From a political point of view, "(…) *since a national tax system lies at the very heart of national sovereignty, it could be argued that national governments are not in the position to relinquish or compromise their taxing jurisdiction to international institutions*"[112]. Indeed, the diplomatic nature of MAPs and the very recent inclusion of mandatory arbitration in DTAs are an example of States' concerns with sovereignty. This indicates that States are not prepared or willing to submit international taxation issues under a dispute settlement mechanism with the characteristics of the WTO one.

As for (ii), another proposal is the creation of a *multinational tax organization*. The coordination between international trade and international tax law "(…) *would benefit from the establishment of an international tax organization, separate from the WTO, with responsibility for making the evolving international tax regime more compatible with the international trade*

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and the inability of the DSB to handle income tax matters. Second, the AB demonstrates a lack of understanding of the modern income tax system, which is built from a mesh of norms, some conflicting and some complementing each other norms that cannot be explained by a single grand theory". BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, pp. 303-304.

Also criticizing the Appellate Body for grossly neglecting the principles of International Tax Law, MOTA, PEDRO INFANTE AND BORGES, RICARDO HENRIQUES DA PALMA, "National Report Portugal", in *WTO and Direct Taxation* (Org. Lang, Michael), Linde Verlag, Vienna, and Kluwer, London, 2005, p. 607.

111 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation,* Vol. 16, No. 3, March, 2005, pp. 63-64.

112 JUNG, YOUNGJIN, "How far should the WTO reach into Income Tax Policies", *Journal of International Taxation,* Vol. 16, No. 3, March, 2005, p. 38; In the same sense, BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 302; COCKFIELD, ARTHUR J. AND ARNOLD, BRIAN J., "What can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model", *World Tax Journal*, Vol. 2, No. 2, 2010, p. 140.

regime"[113]. Yariv Brauner affirms that the current international tax law *status quo* is not sustainable because it lacks any guidance, and such organization will serve as a global policy forum with some interpretation authority. The process of increased international coordination of income tax policies will lead to an increased, if not a formal, harmonization of principles[114].

However, some of the main difficulties in the creation of a multilateral taxation agreement exist, such as "(…) *negotiation takes time which makes it difficult to introduce changes to the multilateral tax agreement* (…); *the applicability of unilateral tax provisions to cross-border transactions* (…); *the legal culture varies among the countries* [including differences on tax institutions and expertise]; [and] *the relationship of autonomy or dependency of tax law from other branches of law such as private law and accountancy law may result in the interpretation of the tax treaty being influenced by private law concepts (dependency) or tax law concepts (autonomy)*"[115]. In addition, there

113 BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 254.
"(…) [I]*n a nutshell, a global tax organization would seek to eliminate problems such as treaty shopping, international tax arbitrage, inappropriate transfer pricing and harmful tax competition, as well as provide an international tax court. Equally, a new international tax organization could facilitate conflicts between the WTO and tax matters*." FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 237.
114 BRAUNER, YARIV, "International Trade and Tax Agreements May Be Coordinated, but Not Reconciled", *Virginia Tax Review*, Vol. 25, Issue 1, 2005, p. 310; The author continues arguing "[t]*hat is where one can see a possibility of incorporation of international trade-related standards, such as the already acceptable nondiscrimination requirement, which is closely related to the WTO "national treatment" principle. Another obvious provision that could be incorporated is the prohibition of export tax subsidies. It is inconceivable that MFN-type provisions could be incorporated into such a solution in the short term, but one can think of several similar measures, such as the minimum and maximum rates provisions, harmonization, setting of a capped range of possibilities, thresholds, preferred rates - all of which may result in consequences that de facto approximate the effect of MFN provisions*". Note, however, that the number of MFN clauses in DTAs is increasing.
115 MOSQUERA VALDERRAMA, IRMA JOHANNA, *The International Tax Policy in the Context of Integration and Trade in Latin America* (October 20, 2006), p. 14.

is a risk that this international tax organization could prioritize national tax concerns over international trade ones[116].

As for (iii), regarding the third option for coordination among these two areas, Jennifer Farrell proposes *the establishment of a WTO Committee on Tax and Trade*, in order to provide clarification/new guidance of tax-related trade rules. It would establish a formal dialogue between the WTO and international tax players (i.e., the OECD Committee of Fiscal Affairs and UN Committee of Experts on International Cooperation in Tax Matters)[117]. The Committee would be open to all WTO members and other international organizations as observers. This Committee could also work as a consultative and advisory body for WTO members with concerns in respect of possible conflicts between tax and trade law and policies.

An alternative manner to achieve the same level of dialogue (without implying the creation of a new Committee under WTO) could be using the WTO Trade Policy Review Mechanism[118] to create an institutional bridge between WTO on one hand and the OECD and the UN on the other hand. Another hypothesis is the creation of a common working group between the same institutions, which would have as the main advantage the fact that OECD and UN would not be mere observers.

This coordination would have to bear in mind that while WTO agreements constitute "hard law", the OECD and UN are

116 FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 237.

117 JENNIFER FARRELL, *The World Trade Organisation and Taxation*, Presentation for 65th IFA Congress in Paris (2011), slide 17; FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 231.

118 "*Such monitoring throws light on how tax measures not yet covered by WTO rules may nonetheless have economic effects equivalent to (or even worse than) tax or non-tax measures prohibited by existing WTO rules*" DALY, MICHAEL, "WTO Rules on Direct Taxation", *The World Economy*, Vol. 29, No. 5, May 2006, p. 530. The TPRM allows the regular collective appreciation and evaluation of these measures, without serving as a basis for the enforcement of specific obligations under the Agreements, or for dispute settlement purposes.

soft law providers, since their MC and respective commentaries are non-binding. Therefore, it seems prudent to keep this potential synchronization as soft law as well. Consequently, these three institutions could discuss efforts of coordination and try to reach a form of soft law, such as a common understanding of the principle of non-discrimination, taking into account the specific and common goals of international trade and tax regimes.

VII. CONCLUSIONS

International Trade Law and DTAs share the goal of removing barriers to cross-border movement of goods, services, capital, labor and technology. Differences exists however with respect to the means of pursuing it: in trade, through the reduction of tariffs and other barriers, and in taxation by the splitting of the income tax base between source and residence countries.

Double taxation has long been recognized as an obstacle to international trade, in the sense that double taxation of foreign-source income would discourage foreign production over domestic production. Consequently, mitigation or elimination of double taxation is extremely important to cross border transactions. This lead several of the WTO multilateral agreements to address indirect as well as direct taxation. However, the problem of double taxation is largely alleviated through DTA. Therefore, the exceptions under WTO/GATT agreements for DTAs are in accordance with the trade liberalization goal.

An example of this recognition is Annex 1 of the SCM Agreement, which contains an illustrative list of export subsidies, prohibited under WTO law. Item (e) of this Annex refers to measures involving full or partial exemption, remission, or deferral specifically related to exports, of direct taxes. However, since double taxation is a barrier to international trade, Footnote 59 clarifies that this item (e) is not intended to prevent WTO

Members from taking measures to avoid double taxation of foreign-source income. On the other hand, the *FSC Case* was an example of a measure that was not limited to foreign-source income and, consequently, did not fall within the justification provided by this Footnote.

Under both International Trade Law and DTAs, National Treatment is always applicable. It implies a comparison between the treatment granted by the host country to its domestic subjects and, on the other hand, the treatment granted by that host country to the subjects of the contracting party. However, the wording is not the same and National Treatment under WTO agreements is more protective than under DTAs. It is important to recall that residence (along with source) is a jurisdictional basis for taxation. Nevertheless, National Treatment under Article 24 of the MCs is too narrow and ineffective to prevent cases where income taxes *unduly* discriminate against non-resident taxpayers. Therefore, there is potential to distort cross-border trade and investment.

In WTO agreements, per the MFN principle, the host country has the obligation of treating the subjects from the other contracting country no less favorably than the subjects from any other third country. Consequently, WTO members cannot discriminate between trading partners' goods or services, either *de jure* or *de facto*. By contrast, the MCs and most the DTAs do not contain any MFN clause. This absence is usually justified with the DTAs bilateralism and reciprocity. Notwithstanding, there is a gradual increase of MFN clauses in DTAs. Consequently, it can be affirmed that MFN is becoming an issue also under DTAs, despite their bilateral nature.

One should also bear in mind that reciprocity does exist both in International Trade Agreements and in DTAs, since it has the general meaning of "balance of concessions" that governments seek when they enter into negotiations. However, the

GATT/WTO Agreements' negotiations, based on mutual concessions, resulted in the MFN treatment, since this clause assures reciprocity among all the members. On the other hand, DTAs are bilateral and therefore reciprocity (i.e. mutual reduction of source country withholding taxes on income) is restricted to the two Contracting States in each DTA. Consequently, MFN clauses are not necessary for reciprocity purposes. Accordingly, the reciprocity application differs depending on the bilateral or multilateral nature of the agreements, only in the last case leading to a MFN treatment.

Multilateral bargaining reduces transaction costs and consequently, even in taxation there is some multilateralism in the *bargaining stage*, since the MCs are highly discussed among several States. Secondly, the presence or absence of MFN obligations explains the difference in institutional choice in the *agreement stage*. MFN treatment opens the floor for free-riding and externalities, which can be countered by the multilateral nature of agreements in International Trade Law, through mutual concessions under reciprocity. By contrast, States do not always consider MFN clauses in taxation because in this manner free-riding is not an issue, since the agreement is bilateral. Consequently, the inclusion of an MFN clause in the agreement stage would increase the transaction costs in the tax bargaining stage.

With respect to the achievement of coordination, a multilateral agreement and organization on tax is desirable but unrealistic. Taxation is at the core of sovereignty and therefore it is difficult to reach this level of agreement in a multilateral manner, similar to the one of the WTO. It seems more feasible to create a formal or informal common understanding between WTO, OECD and UN on interpreting DTAs in a more international trade friendly manner, namely in respect of non-discrimination. Only when non-discrimination interpretation and application become consensual among the States may there be a more favorable political environment to a potential multilateral tax

agreement. The gradual inclusion of MFN clauses in DTAs may be a sign of such will.

A multilateral tax agreement seems more likely to occur under the OECD and/or the UN than under the WTO due to (i) the latter's (current) lack of tax expertise; (ii) tax experts and States being more familiar to tax harmonization under OECD and UN MC; and (iii) WTO dispute settlement being too "sovereignty threatening" for the generality of states.

VIII. APPENDIX

1. HISTORICAL INTERFACE OF INTERNATIONAL TRADE AND TAX[119]:

2. GEOGRAPHICAL DISTRIBUTION OF MFN CLAUSES IN DTA[120]:

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119 Source: FARRELL, JENNIFER E., *The interface of international trade law and taxation: defining the role of the WTO*, Amsterdam: IBFD Publications, 2013, p. 26.

120 Source HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax*, Vol. 33, Issue 10, 2005, pp. 445–453.

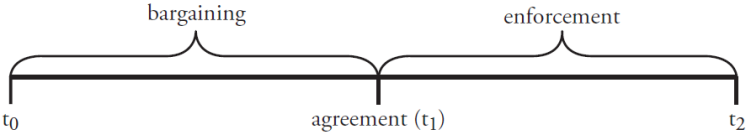
	Europe	NA	CA/SA	AUS	Africa	Arab. P.	Asia	
Europe	98							98
NA	56	2						58
CA/SA	55	17	7					79
AUS	33	5	6	0				44
Africa	22	18	0	6	1			47
Arab. P.	29	4	0	0	2	0		35
Asia	102	36	7	15	3	22	21	206
	395	82	20	21	6	22	21	567

3. ALLOCATION OF MFN CLAUSES IN DTA PER COUNTRY[121]:

Rank	Country	Number
1	Canada	105
2	Philippines	52
3	New Zealand	37
4	United States	35
5	Brazil	30
	France	30
7	The Netherlands	29
8	India	28
	Russia	28
	Soviet Union[17]	28
	Spain	28
12	Australia	27
	Kuwait	27
	Sweden	27
15	Belgium	25
16	Norway	21
17	Italy	20
	Switzerland	20
19	Denmark	19
20	Estonia	18
	Latvia	18
	Vietnam	18
23	Argentina	17
	Lithuania	17
25	Finland	16
	Poland	16
		736

121 Source: HOFBAUER, INES, "Most-Favoured-Nation Clauses in Double Taxation Conventions - A Worldwide Overview", *Intertax*, Vol. 33, Issue 10, pp. 445–453.

4. THREE STAGES OF COOPERATION PROCESS[122]:



5. INSTITUTIONAL CHOICE IN THE BARGAINING AND AGREEMENT STAGE IN TRADE AND TAXATION[123]:

	Trade	**Taxation**
Bargaining	mostly bilateral multilateral elements in Kennedy and Tokyo Round	bilateral on tax treaties multilateral on model convention
Agreement	multilateral	bilateral

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122 Source: RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, p. 391

123 Source: RIXEN, THOMAS AND ROHLFING, INGO, "The Institutional Choice of Bilateralism and Multilateralism in International Trade and Taxation" in *International Negotiation*, Vol. 12, 2007, p. 397.

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