

**Non-Discrimination and Trade in Services: Should
Tax Treaties Play a Broader Role in the Global
Trade in Services?**

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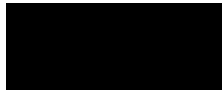
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However I am the only person responsible for any errors in this thesis.

Declaration

The thesis contains no material which has been accepted for the award of any other degree or diploma in any university or other institution and affirms that to the best of my knowledge the thesis contains no material previously published or written by another person, except where due reference is made in the text of the thesis.



Definitions:

Contracting State

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

Cross Border Trade in Services

See Trade in Services

Direct Taxes

The meaning of direct taxes is borrowed from the GATS Article XXVIII(O). “Direct taxes” comprise all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

Discrimination

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

Foreign or Non-resident Service Provider

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

Indirect Taxation

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

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

Most Favored Nation Treatment

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

National Treatment

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

Non-Discrimination

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

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

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

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

important point is that discrimination is determined contextually. Non-discrimination is the absence of discrimination based on the applicable criteria or principles.⁵

The non-discrimination obligations in the OECD Model Tax Treaty take the form of prohibitions designed to prevent source countries from discriminating against “foreigners” with sufficient nexus to the source country.⁶ The goal of these provisions is to ensure no less favorable tax treatment for similarly situated persons and businesses.

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

Source (or Host) Country

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

Taxation Measure

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

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

⁶ Depending on the context, the non-discrimination principles found in trade agreements may apply to determine if the host country is guilty of discrimination in the area of taxation.

the form of a law, regulation, rule, procedure, decision, administrative action, or any other form.”

Trade Barrier

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

Trade in Services

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

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

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

national of a Party in the territory of another Party (e.g., an on site visit to the service recipient by a non resident service provider.⁷ Unlike the GATS, which includes in the definition of the supply of a service, services provided by a service supplier of one Member through a commercial presence in the other, the NAFTA addresses this mode of supply through the investment provisions in Chapter 11 (Investment).

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

Residence Country

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

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

Table of Contents:

Title page	
Declaration	
Definitions	
Part I: Introduction	1
Chapter 1: Tax Discrimination and Global Trade	2
A. Overview	2
1. General Topic	2
2. General Questions	2
3. The Issue	3
4. Background	4
B. The Study	7
1. Summary	7
2. Limitations in the Research	14
3. Approach	15
Part II: Non-Discrimination Obligations in Tax and Trade Agreements	16
Chapter 2: Setting the Stage: Non-Discrimination Obligations in Trade and Tax Agreements	17
A. Overview	17
B. Non-Discrimination and Trade Agreements: The World Stage	17
1. The General Agreement on Trade in Services (GATS)	18
(i) Overview	18
(ii) General Obligations (Most Favoured Nation Treatment)	20
(iii) National Treatment and Market Access: Specific Commitments	21
(iv) Taxation Measures	22
2. The OECD and UN Model Tax Treaties: The Taxation of Non-Resident Service Providers and Tax Treaty Non-Discrimination Obligations	27
(i) Taxation of Service Providers	28
(a) Business Profits	29
(b) Permanent Establishments	29
(c) Independent Personal Services	33
(ii) Non-Discrimination Obligations	34
(a) Overview	34
(b) Non-Discrimination and the Taxation of Tax Resident but Foreign-Owned Corporations	36
(c) Non-Discrimination and the Taxation of Permanent Establishments	37
(d) Non-Discrimination and the Taxation of Non-Residents (Including Foreign-Owned Enterprises)	38
C. Non-Discrimination and Non-Resident Service Providers - The Bottom Line	39
1. Tax and Trade Agreements: Non-Discrimination Obligations Compared	40
2. The Interaction of Tax and Trade Agreements	42
D. Conclusions	45
Appendix 1	46
Appendix 2	48
Chapter 3: Non-Discrimination Obligations in Free Trade Agreements and Bilateral Tax Treaties in Regional Trade Blocks	50
A. Overview	50
B. The North American Free Trade Agreement	51
1. Overview	51
2. Taxation Measures	54
(i) Overview	54
(ii) Services	55
(a) Performance Requirements	57
C. The NAFTA and the Tax Treaties between the NAFTA Parties	60
1. Overview	60
2. The NAFTA Tax Treaties	62

3. Applicable Treaty Provisions.....	63
(i) Articles 7 and 14: Business Income and Independent Personal Services.....	63
(ii) Article 15: Dependent Personal Services (Income from Employment).....	68
(iii) Article 24: Non-Discrimination.....	71
4. Non-Discrimination, Taxation Measures and Treaty Interpretation.....	74
5. Potential Tax Discrimination: Some Examples.....	78
(i) Most Favoured Nation Treatment.....	78
(ii) National Treatment.....	80
6. Non-Discrimination Obligations: The NAFTA and the GATS Compared.....	83
(i) Most Favoured Nation Treatment.....	83
(ii) National Treatment.....	84
D. The ASEAN–Australia–New Zealand Free Trade Agreement (AANZFTA).....	86
1. Overview.....	86
2. Most Favored Nation Treatment.....	87
3. National Treatment.....	89
4. Differing Levels of Protection.....	92
E. Conclusions.....	93
Chapter 4: Non-Discrimination Obligations in Bilateral Free Trade Agreements and the Role of Tax Treaties.....	96
A. Overview.....	96
B. Canada’s Bilateral Free Trade Agreements.....	96
1. Trade Obligations.....	97
2. Taxation Measures.....	99
3. The Impact of Tax Treaties.....	102
4. Dispute Resolution.....	104
C. Australia’s Bilateral Free Trade Agreements.....	104
1. Overview.....	104
2. The Impact of Tax Treaties.....	107
D. Conclusions.....	109
Chapter 5: The WTO, NAFTA and the TFEU: Regional Perspectives by WTO Members on Non-Discrimination Obligations.....	110
A. Overview.....	110
B. Background.....	111
C. International Trade Agreements Affecting Trade in Services in the NAFTA Block.....	112
1. A Canadian Perspective.....	113
(i) Overview.....	113
(ii) The General Agreement on Trade in Services (GATS).....	113
(iii) The North American Free Trade Agreement (NAFTA).....	115
D. International Trade Agreements Affecting Trade in Services in the European Union.....	121
1. A United Kingdom Perspective.....	121
2. Services and Direct Taxation in the European Union.....	122
3. European Union Cases on Direct Taxation and Services.....	124
(i) Deductibility of Expenses (Administrative Presumptions).....	125
(ii) Access to Domestic Tax Credits.....	126
(iii) Cross-Border Services and Withholding Taxes.....	127
4. The Relationship of Bilateral Tax Treaties to European Union Law.....	135
(i) Case Law on Bilateral Tax Treaties and Discrimination.....	135
(ii) Impact of Tax Treaties on Justifications for Discriminatory Measures.....	138
(iii) Most Favoured Nation as a Principle of European Union Law.....	139
E. Tax Discrimination? Some Comparative Examples.....	141
1. Example 1.....	141
2. Example 2.....	143
3. Example 3.....	145
F. Conclusions.....	147

Part III: Are the Current Non-Discrimination Obligations in Tax and Trade Agreements Adequate?.....	149
Chapter 6: Part III Overview.....	150
Chapter 7: Tax Treaties: The Potential for Discriminatory Tax Treatment Based on Structural Elements in OECD and UN Based Tax Treaties.....	153
A. Overview.....	153
B. The Tax Treaty Allocation Rules.....	155
C. The Treatment of Services in Tax Treaties: A Survey of Country Practices.....	157
1. The Regular UN Provisions Dealing with Services.....	158
2. The Regular OECD Approach (not containing specific provisions on services).....	160
3. The OECD Optional Services Provision Included in the Commentaries (2008).....	161
4. The Inclusion of (Types of) Services in the Royalty Article.....	162
5. Separate Treaty Article for Services (Technical Services).....	163
6. The ‘Other Income’ Article.....	164
D. The Basis of Taxation.....	165
E. The Method of Collecting Tax.....	166
1. Self Assessment.....	166
2. Withholding Tax.....	166
3. When Are Withholding Taxes Imposed?.....	168
4. The Obligation of the Withholding Agent.....	171
5. Summary.....	172
F. Differing Non-Discrimination Obligations.....	172
1. Business Profits.....	174
2. Independent Personal Services.....	176
3. Royalties.....	177
4. Other Income.....	177
G. An Example.....	177
H. Conclusions.....	179
Chapter 8: Tax Treatment where Services Income is Subject to Withholding Tax	181
Overview.....	181
B. Taxation of Services - Applicable Domestic Law.....	183
1. Country Examples.....	184
(i) Canada.....	184
(ii) The Mercosur Countries and Associated Members.....	190
(iii) Withholding Tax Practices in Other Countries.....	197
C. Conclusions.....	200
Chapter 9: Are the Current Non-Discrimination Obligations in Trade and Tax Agreements Sufficient: the FATCA Example?.....	201
A. Overview.....	201
B. Foreign Account Tax Compliance Act.....	203
1. International Response to the FATCA.....	205
2. Non-Discrimination Obligations Under the WTO Agreement.....	205
C. Non-Discrimination Obligations under the OECD Model Tax Treaty.....	208
1. The North American Free Trade Agreement.....	209
2. How does the NAFTA Apply to the FATCA Measures?.....	212
(i) Are the FATCA Measures Taxation Measures for Purposes of the NAFTA?.....	212
(ii) Article 2103(4).....	213
(iii) If the Measure Falls Within Article 2103(4), does the Canada-US Tax Treaty ‘Trump’ the National Treatment Obligation?.....	215
(iv) If the FATCA Measure Falls Within Article 2103(4) and the Tax Treaty does not Trump the NAFTA, do the NAFTA Exceptions in Article 2103(4) (d) or (g) Apply to Negate the National Treatment Obligation in Article 1405?.....	217
D. Conclusions.....	218
Part IV: Reconciling Non-Discrimination Obligations in Tax and Trade Agreements.....	219
Chapter 10: Part IV Overview.....	220

Chapter 11: Are There Compelling Reasons to Include in Tax Treaties Protection for Non-Resident Service Providers against Discriminatory Tax Measures?.....	223
A. Overview.....	223
B. Differing Levels of Protection.....	225
C. The Do Nothing Option.....	227
D. The Do Something Option.....	228
1. Non-Discrimination Principles?.....	228
2. The Search for a Non-Discrimination Standard.....	230
(i) The General Trade Law Approach.....	230
(ii) Investment Agreements.....	232
(iii) The Treaty for the Functioning of the European Community (TFEU).....	236
(iv) New Tax Treaty Standard.....	237
E. The GATTs Comparison.....	243
F. Why Would Tax Treaty Partners Agree to an Expanded Non-Discrimination Obligation?.....	245
G. Conclusions.....	246
Chapter 12: Refining the Non-Discrimination Obligation, its Violation and the Process of Resolution.....	247
A. Introduction.....	247
B. What the Non-Discrimination Obligation Might Look Like.....	248
1. Creating an Obligation.....	249
2. Too Broad.....	251
3. Further Refinements.....	254
4. A Proposed Non-Discrimination Obligation.....	256
C. What Remedy.....	257
D. Dispute Resolution.....	257
1. The Mechanics.....	257
2. Effect of Restricting Dispute Resolution Options.....	261
E. Proposed Commentary to Article 24.....	262
F. Limitations of the Proposed Non-Discrimination Obligation.....	264
G. A More Modest Proposal.....	266
H. Conclusions.....	269
Chapter 13: Conclusions.....	270
A. Introduction and Some Observations.....	270
B. What Non-Discrimination Obligations Apply to a Non-Resident Service Provider Under Tax and Trade Agreements?.....	271
C. Do the Current Non-Discrimination Obligations in Tax and Trade Agreements Adequately Address the Potential for the Discriminatory use of Tax Measures in the Cross Border Trade in Services?...275	275
D. Should the OECD and the UN make Changes to the Non-Discrimination Obligations in the OECD and UN Model Tax Treaties to Respond to the Growing Global Trade in Services? If so, what Changes?.....	277
E. Proposed Solutions.....	278
Bibliography.....	280

Part I: Introduction

Chapter 1: Tax Discrimination and Global Trade

A. Overview

1. General Topic

The subject of this study is “Tax Discrimination and the Global Trade in Services: The Case of Non-Resident Service Providers”. This study examines the current non-discrimination obligations in tax and trade agreements and the impact these non-discrimination obligations have on non-resident service providers.

2. General Questions

This study seeks answers to three questions:

1. What non-discrimination obligations apply to a non-resident service provider under tax and trade agreements?
2. Do the current non-discrimination obligations in tax and trade agreements adequately address the potential for the discriminatory use of tax measures in the cross border trade in services?
3. Should the Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) make changes to the non-discrimination obligations in the OECD and UN Model Tax Treaties to respond to the growing global trade in services? If so, what changes should they make?

The conclusion reached is that current tax and trade agreements provide insufficient protection against discrimination. The study recommends modification of the Model Tax Treaties to provide non-resident service providers with a more appropriate level of protection against discriminatory tax measures.

3. The Issue

Trade and tax experts approach the relationship between trade and tax issues from different perspectives. Tax experts are primarily concerned with tax policies and administrative rules that raise revenues in a fair and equitable way. Trade experts focus on reducing or eliminating measures that can be viewed as barriers to trade. Taxation, and in particular direct (or income) taxation, is, by definition, a barrier to international trade.⁸ However, the elimination of income taxes in the near future is very unlikely. The result is an incompatibility between tax policies and the administration of tax systems on the one hand and the objectives of trade agreements on the other. This incompatibility is the subject of this study.

The expansion of trade obligations in multilateral, regional and bilateral free trade agreements to include services and service providers signaled a global will to reduce or eliminate barriers to trade in services. Tax barriers to trade may come in many forms including laws, regulations, informal policies, practices, or procedures and may unfairly or unnecessarily restrict trade in services. Notwithstanding, non-discrimination obligations in respect of tax measures were largely carved out of trade agreements in favour of bilateral tax treaties.⁹

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.¹⁰ The absence of a non-discrimination obligation with respect to tax measures that applies to a non-resident service provider, may, therefore, significantly undermine trade obligations.¹¹

The challenge lies in balancing trade principles with the sovereign right to tax.

⁸ Yariv Brauner, "International Trade and Tax Agreements May Be Coordinated, But Not Reconciled" (2005) 25 Va Tax Rev 251.

⁹ The potential gains from protectionism are increasing with globalization. It is therefore likely that countries will try to employ protectionist techniques that escape the tight WTO grip, such as income tax measures. *Ibid.*

¹⁰ *Ibid.*

¹¹ At present, there are few limitations on a country's tax practices. Customary international law provides virtually no protection against tax discrimination and constitutional or national limitations on tax discrimination against non-residents are rare. The primary restraint against egregious tax practices is international goodwill, limitations imposed in integrated agreements such as the Treaty on the Functioning of the European Community or in limited circumstances, bilateral tax treaties.

4. Background

Beginning in the 1990s the liberalization of trade in services became a focal point in trade negotiations. The reason was predictable. According to the World Trade Organization (WTO), services represent the fastest growing sector of the global economy and accounts for two thirds of global output, one third of global employment and nearly twenty percent of global trade. The WTO estimates that by 2020, services will represent fifty percent of world trade.

Consensus was quickly reached that efforts should be made to reduce or eliminate non-tariff barriers to trade in services. These efforts are reflected in multilateral agreements such as the General Agreement on Trade in Services¹² (GATS), part of the WTO Agreement¹³, and in regional agreements like the North American Free Trade Agreement¹⁴ (NAFTA), and more recently in the ASEAN–Australia New Zealand Trade Agreement¹⁵ (AANZFTA). One issue that could not be readily agreed on during the negotiations under the GATS was how the matter of taxation should be resolved.

The reasons underlying the disagreement about the inclusion of direct tax measures were understandable. Tax law and trade law were historically viewed as distinct. Their parallel existence created few frictions because each dealt with separate areas of taxation; bilateral tax treaties dealt with direct tax matters such as income tax, and trade agreements like the General Agreement on Tariffs and Trade¹⁶ (GATT), primarily dealt with indirect taxes and customs duties. The expanding scope of non-discrimination obligations in trade agreements

¹² The *General Agreement on Trade in Services* (15 April, 1995) is part of the World Trade Organization Agreement, Annex 1B [hereinafter the GATS].

¹³ WTO, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, 15 April 1994 [hereinafter WTO Agreement].

¹⁴ *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico, and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289 (entered into force January 1, 1994) [hereinafter NAFTA].

¹⁵ The *ASEAN–Australia New Zealand Trade Agreement between The Governments of Brunei Darussalam, the Kingdom of Cambodia (Cambodia), the Republic of Indonesia (Indonesia), the Lao People's Democratic Republic (Lao PDR), Malaysia, the Union of Myanmar (Myanmar), the Republic of the Philippines (Philippines), the Republic of Singapore (Singapore), the Kingdom of Thailand (Thailand) and the Socialist Republic of Viet Nam (Viet Nam)*, 27 February 2009, (entered into force on 1 January 2010 for eight Parties: Australia, New Zealand, Brunei, Burma, Malaysia, the Philippines, Singapore and Vietnam). Thailand implemented the FTA from 12 March 2010, Cambodia, Indonesia and Laos have yet to ratify) [hereinafter the ASEAN–Australia New Zealand Trade Agreement].

¹⁶ *General Agreement on Tariffs and Trade*, 30 October 1947, 58 UNTS 187, Can TS 1947 No 27 (entered into force 1 January 1948) [hereinafter GATT].

made it clear that the lines between tax and trade obligations can no longer be clearly drawn. One of the obvious areas of overlap was with respect to tax measures and their potential impact on the cross-border trade in services.¹⁷

This did not mean that tax and trade law experts were not in full agreement that tax discrimination would challenge competitiveness and economic efficiency in world trade. There was also no debate about whether tax measures could have a significantly negative impact on the cross-border trade in services. The issue was how best to address the problem. Trade proponents argued that tax issues should be included in trade agreements. Tax experts pointed to the existing network of bilateral tax treaties and urged that matters of taxation were best left to that bilateral network.

In the end, trade discipline over direct taxation (income tax) was for the most part carved out of GATS, the first global free trade agreement to include trade in services.¹⁸ This was not without considerable controversy. It was widely recognized throughout the negotiations for the GATS for example, that discrimination in direct tax matters could have just as deleterious affects on the cross-border trade in services as the non-tariff barriers under review.¹⁹ Nonetheless in hotly disputed negotiations, resolved virtually on the eve of the deadline for signing the WTO Agreement, most obligations with respect to non-discrimination in direct matters were effectively removed from the GATS.²⁰ Instead bilateral tax treaties, generally

¹⁷ See e.g., Joel Slemrod, "Tax Cacophony and the Benefits of Free Trade", in Jagdish Bhagwati and Robert E. Hudec (eds.) *Fair Trade and Harmonization: Prerequisites for Free Trade?* (Cambridge: MIT Press, 1996) at 283, 304; Alvin C Warren Jr., "Income Tax Discrimination Against International Commerce" (2001) 54 Tax L Rev 131 at 131-46; Catherine Brown & Martha O'Brien, "Tax Discrimination and the Cross Border Provision of Services," in Christopher PM Waters (ed.), *British and Canadian Perspectives on International Law* (The Netherlands: Martinus Nijhoff Publishers, 2006) at 317, 323; Kees van Raad, "Non-Discrimination from the Perspective of the OECD Model and the EC Treaty-Structural and Conceptual Issues," in Reuven Avi-Yonah Jr., James R Hines, Jr., & Michael Lang (eds.), *Comparative Fiscal Federalism: Comparing the European Court of Justice and the US Supreme Court's Tax Jurisdiction* (Kluwer: The Netherlands, 2007) at 55, 62.

¹⁸ The arguments by tax experts for excluding direct tax measures in particular, from the discipline of trade agreements were threefold. First, many of the countries that would join the WTO had already entered bilateral tax agreements. It was unpalatable that bilateral concessions made under these tax treaties should extend to all WTO signatories under the most favored nation obligation. Second, the national treatment obligation was incompatible with important policy reasons for distinguishing between residents and nonresidents in tax matters. Third, the issue of non-discrimination was already addressed in tax treaties leaving open the potential of jurisdictional conflict between tax and trade agreements.

¹⁹ Tycho HE Stahl, "Liberalizing International Trade in Services: The Case For Side Stepping the GATT" (1994) 19 Yale J Int'l 405 at 429.

²⁰ See Kai Mander, The Institute for Agriculture and Trade Policy, Trade News Bulletin, "U.S. Wants Out of GATT Services Tax Proposal U.S., EU Fail to Achieve Breakthrough, Farmers To Protest Mexican Senate Approves NAFTA" (24 November 1993), online:

patterned on the Models established by the OECD²¹ or UN²², were left to discipline the imposition of direct taxes under the flagship agreement.

This strategy to carve out tax measures in favour of tax treaties was also adopted, and in many cases expanded, in other regional trade agreements like the NAFTA and AANZFTA, and a host of bilateral free trade agreements.²³ It is a precedent that trade negotiators appear determined to follow in trade agreements at least with respect to the trade in services.²⁴

The decision to largely carve out direct tax measures from the GATS and other trade agreements and to provide primacy to tax treaties did not make the issue of tax discrimination go away.²⁵ Academics quickly noted that there was very little protection in bilateral tax treaties against potentially tax discriminatory practices in respect of non-residents, particularly if the non-resident did not have a commercial presence in the host country.²⁶ Further, the existence of a tax treaty between Member States negated even the limited non-discrimination obligation under the GATS that otherwise subjected any direct tax measure imposed by a Member State to the requirement that it did not constitute “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised

<<https://groups.google.com/forum/#!topic/misc.activism.progressive/X33mE5HpmQE>>. See also Robert Green “Antilegalist Approaches to Resolving Disputes Between Governments: A Comparison of the International tax and Trade Regimes” (1998) 23 Yale J Int'l 79 at notes 63-75.

²¹ OECD, Committee on Fiscal Affairs, *Model Tax Convention on Income and Capital* (Paris: 22 July 2010) [hereinafter OECD Model Tax Treaty]. The Fiscal Committee of the OECD produced the first draft convention for double taxation in 1963. The OECD Model Treaty currently impacts more than 3,000 bilateral tax treaties that are based on it.

²² United Nations, Department of Economic and Social Affairs (UN DESA), *Model Double Taxation Convention between Developed and Developing Countries*, (New York: 2011) [hereinafter UN Model Tax Treaty], which are substantially similar to those found in the OECD Model Treaty.

²³ See e.g., the *Free Trade Agreement Between Canada and the Republic of Colombia*, 21 November 2008, Can TS 2011 No 11 (entered into force 15 August 2011) [hereinafter the Canada-Colombia Free Trade Agreement] and the *Free Trade Agreement Between Canada and the Republic of Panama*, 14 May, 2010, Can TS 2013 No 9 (entered into force 1 April 2013) [hereinafter the Canada-Panama Free Trade Agreement].

²⁴ As will be discussed in Chapters 3 and 4, these later trade agreements have expanded the carve out for tax measures to include all tax measures, an open ended expression that appears to exclude only customs and related duties affecting the trade in goods.

²⁵ For example, Michael Daly of the WTO released a paper in June 2005, Michael Daly “The WTO and Direct Taxation” (Paper delivered at the High Level Scientific Conference, Department of Austrian and International Tax Law, University of Vienna, 8-11 July 2004), which identifies the potential impact of direct taxation in trade and outlines the role of the WTO in resolving disputes about WTO-inconsistent direct tax measures. Michael Lang and others published the proceedings of a Global Conference on “WTO and Direct Taxation” in 2005, which brought together 70 experts to discuss the relations between the WTO Agreement, domestic tax law, tax treaty law and European Community law.

²⁶ Article 24 of the OECD and UN Model Tax Treaties include a non-discrimination principle if the non-resident service provider has a permanent establishment in the source state.

restriction on trade in services.”²⁷ It also became evident that very different non-discrimination principles could apply to a non-resident service provider depending on what combination of tax and trade agreements were in place between the service provider’s home country and the (source) country paying for the non-resident’s services.

It is therefore of little surprise that more than two decades after the GATS was signed, the issue of what non-discrimination principles if any should apply to tax measures remains under debate.²⁸ The expanding non-discrimination obligations in trade agreements also call into question whether the limited non-discrimination principles in bilateral tax treaties, in particular as they affect the taxation of non-resident services and service providers, remain adequate.²⁹

B. The Study

1. Summary

This study examines how current non-discrimination principles impact non-resident service providers.³⁰ It does so by providing a framework within which the non-discrimination principles that currently apply in regulating the treatment of non-resident service providers in tax and trade agreements are systematically investigated. The goal of the study is to objectively determine if the status quo, that is if the current non-discrimination obligations in international trade and tax agreements that discipline tax measures impacting trade in services, are good enough. The preliminary conclusion is that they are not. This study also concludes that tax treaties rather than trade agreements provide the best option for introducing appropriate non-discrimination principles in the tax treatment of a non-resident service provider. Finally, the study concludes that the OECD and UN should respond to fill

²⁷ The GATS Article XIV (d).

²⁸ See *Non-discrimination at the Crossroads of International Taxation*, Cahiers De Droit International, 62nd Congress of the International Fiscal Association, Brussels 2008 volume 93a (The Netherlands: Sdu Fiscale Financiële Uitgevers), the ongoing work of the OECD on Article 24 of the OECD Model Tax Treaty and Jennifer Farrell, *The Interface of International Trade Law and Taxation*, IBFD Doctorial Series 26 (The Netherlands: IBFD Publications BV, 2013).

Although economists are only now formalizing the connection between taxes and competitiveness, noneconomists have long been concerned with considerations of competitiveness, including how taxation can tilt the playing field between residents and nonresidents. Ruth Mason & Michael S Knoll “What Is Tax Discrimination?” (2012) 121 Yale LJ 1014.

³⁰ See note 21, *supra*.

the void left by trade agreements for tax measures by expanding the non-discrimination obligations in the OECD and UN Model Tax Treaties.

The issue of non-discrimination and the taxation of trade in services remains important and timely. As trade negotiators continue to rely on the precedent set in early trade agreements like the GATS and the NAFTA, it is clear that tax measures will continue to be carved out of trade agreements and that tax treaties will continue to be the primary tool in providing protection from potentially discriminatory tax practices in the cross-border provision of services. The 2013 negotiations for a new Trade in Services Agreement (TISA)³¹ provides a timely reminder to revisit the important issue of what non-discrimination principles should apply in the tax treatment of non-resident service providers. It also provides an opportunity to provide a better precedent for the negotiators as these trade negotiations move ahead.

The Study proceeds as follows:

Part I: Part I provides a general introduction. The study deals with income derived from the provision of services by a non-resident. For purposes of the study, the term “services” is generally used to describe work done for another for an explicit or implicit fee. The services may be provided by an individual, an employee or an agent. The study focuses on conventional service activities and assumes that the work is performed at a particular location by an individual, rather than the electronically through computers or other telecommunication facilities. Conventional service activities would include, for example, providing assistance or advice, construction activities, engineering services, acting as a broker or financial planner or as a medical or legal consultant. Under the OECD Model Tax Treaty, the taxation of income by an enterprise from the provision of services would fall within the scope of Article 7 (Business Profits) if earned in the other Contracting State. However, as will be discussed throughout the study, there is a wide range of other possibilities for the tax treatment of income from services under bilateral tax treaties based on the OECD and UN Models.

³¹ The TISA consists of more than 20 trading partners including Canada, the United States, Mexico, the European Union, Switzerland, Japan, Korea, Hong Kong and Australia. Together these partners are responsible for more than 70 percent of global services trade. The TISA negotiations were borne out of frustration felt by certain WTO Members when negotiations to liberalize services trade became a casualty of the stalled Doha round of WTO negotiations. The TISA is being negotiated outside of the WTO by a subset of WTO Members committed to services trade liberalization. Expectations for the TISA are that it will reflect new types of services that have emerged since the GATS was negotiated some 20 years ago, lock-in liberalization undertaken unilaterally by parties since the GATS came into force and expand commitments among the parties on market access and non-discrimination.

Part II: Part II of the study supplies both the required background and the global framework for examining what non-discrimination principles apply to non-residents. This framework includes a broad overview of the non-discrimination obligations that currently apply to services and service providers in multilateral, regional and bilateral trade agreements, starting with the GATS. It also includes an overview of the non-discrimination obligations found in Model Tax Treaties, specifically the OECD and UN Model Tax Treaties and in select bilateral tax treaties. The background information is necessary to make plain the differing non-discrimination obligations that apply in tax and trade agreements. The global framework is required if one is to examine the interface between tax treaties and trade agreements globally, regionally and bilaterally and how this interface determines what non-discrimination obligations, if any, apply to tax measures that impact a non-resident service provider.

Chapter 2 begins with an overview of the non-discrimination obligations in the multilateral GATS, including national treatment and most favored nation treatment and examines how the GATS non-discrimination obligations interrelate with the OECD and UN Model Tax Treaties. It highlights, for example, that there is no violation of the most favored nation obligation under the GATS if the difference in tax treatment is based on the provisions of a tax treaty or convention. It also makes clear that many differences in tax treatment that might otherwise contravene the national treatment obligation under the GATS are also accepted under the GATS. Further, any challenge that a tax measure violates the national treatment obligation under the GATS may be restricted by a tax treaty. Finally the chapter discusses the limited non-discrimination obligation in respect of tax measures under the GATS if there is no tax treaty between the Member States.

The purpose of the discussion in Chapter 2 is twofold. The first is to make plain the differences in non-discrimination principles that emerge in tax and trade agreements as they apply to non-resident services and service providers. The second is to illustrate the permitted differences in the tax treatment of non-resident service providers under the GATS due to the carve out of tax measures from trade obligations. As will be seen, derogations from the most favored nation obligation are acceptable if the difference is based on a tax treaty. In contrast acceptable derogations from the national treatment obligation are the result of carve outs in the trade agreement.

The discussion then moves to regional trade agreements in Chapter 3, drawing on provisions from the NAFTA and the AANZFTA for examples. This portion of the study examines the interface between the tax treatment of service providers and non-discrimination obligations assumed under these regional trade agreements and trade obligations assumed by the signatories under the GATS and under bilateral tax treaties within each free trade region. The purpose of the discussion is firstly to outline the non-discrimination obligations that apply to non-resident service providers in areas other than taxation in these regional free trade agreements and secondly, to demonstrate that there are significant differences in the non-discrimination obligations to which the signatories are subject within these small free trade zones even in similar circumstances. It is easy to understand derogations from the most favoured nation treatment that result from bilateral tax treaty negotiations. It is more difficult to rationalize the potential differences in the derogation from the national treatment obligation under both the NAFTA and the GATS because of differences in how the non-discrimination article in the tax treaties entered into between the NAFTA parties is interpreted and applied.

In Chapter 4, the discussion turns to the interaction of tax and trade obligations in bilateral free trade agreements using as examples some of the bilateral free trade agreements entered into by Canada and Australia.³² Bilateral Free Trade Agreements present their own set of issues and interpretation problems and result in widely varying non-discrimination obligations in tax matters. For example, the free trade agreements entered into by Australia provide in general, that “nothing in the free trade agreement shall affect the rights and obligations of either Party under any tax convention, and that in the event of any inconsistency relating to a taxation measure between the Agreement and any tax convention, the latter shall prevail to the extent of the inconsistency.” Australia rarely includes a non-discrimination article in its tax treaties³³ and did not include a non-discrimination article in the majority of its tax treaties with the Parties with whom it currently has a free trade

³² In the case of Canada, the Canada-Columbia Free Trade Agreement and Canada-Panama Free Trade Agreement and applicable tax treaties are examined as these are the two most recent free trade agreements that Canada has entered into that have come into force. At the time of writing, there was not text available for the Canada-EU Free Trade Agreement. In the case of Australia, the Free Trade Agreements with Singapore, Thailand, the United States, Chile and Malaysia are examined.

³³ Until 2008 Australia reserved its position on Article 24 in para 85 of the Commentary on Article 24 of the OECD Model Treaty. This reservation was replaced in 2008 as follows: Australia reserves the right to propose amendments to ensure that Australia can continue to apply certain provisions of its domestic law relating to deductions for R & D and withholding tax collection.” para 86 OECD Model Commentary on Article 24.

agreement.³⁴ Based on the language in the trade agreement it appears that no non-discrimination obligation will apply with respect to direct tax measures under Australia's free agreements.³⁵

Finally Chapter 5 addresses applicable non-discrimination principles impacting two WTO Members, Canada and the UK, as a consequence of their respective memberships in the NAFTA and in the European Union (EU). It will be no surprise that notwithstanding that both Canada and the UK are WTO Members, the non-discrimination obligations in tax matters splinter again when one looks at the operation of an integrated trade agreement. In Europe, direct tax measures are filtered through the lens of the free trade principles of the Treaty of Rome.³⁶ EU members who are signatories to the GATS are subject to very different non-discrimination obligations with respect to tax measures when operating in a State that is a signatory to the Treaty on the Functioning of the European Union (TFEU)³⁷ than, for example a service provider from a NAFTA Party operating in the same state. The non-discrimination obligations if any, that apply to a service provider from a State that is a GATS Member may therefore vary widely when providing services in another Member State depending on whether there is an additional integrated trade agreement like the TFEU with the source State. The non-discrimination obligations affecting service providers from EU Member State may also vary depending on the terms of the tax treaty between the EU Member States. The purpose of this Chapter is not to suggest that the same non-discrimination obligations should apply to a non-resident service provider regardless of the existence of integrated or regional trade agreements, but rather to examine other approaches to the matter of non-discrimination in tax matters. The second purpose of the chapter is to point out that there will be no minimum common standard of tax treatment for many non-residents without a non-discrimination obligation in a tax treaty.

³⁴ The exceptions are the tax treaties with the United States and Chile. A non-discrimination obligation is also included in the *Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 31 January 2008, [2008] ATS 21 (entered into force 3 December 2008) [hereinafter the Australian-Japan Tax Treaty]. See the Explanatory Memorandum of Article 26 of the Australia-Japan Tax Treaty, Chapter 1 2008 Australia-Japan Convention, International Tax Agreements Amendment Bill (No. 1) 2008 circulated by the authority of the Treasurer, the Hon Wayne Swan MP, online: <<http://law.ato.gov.au/atolaw/view.htm?DocID=NEM%2FEM200827%2FNAT%2FATO%2F00003>>.

³⁵ A potential exception is an indirect obligation that results from the non-discrimination clause in the tax treaties with the United States and Chile as it applies to the deductibility of amounts paid to a non-resident.

³⁶ See Leslie Samuels, "Treatment of Tax Measures under International Trade and Investment Agreements: The GATS Compromise" (2008) 102 Am Soc Int'l L Rev 51.

³⁷ EU, *Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union*, 26 October 2012, OJ C 326/01.

Part III: Part III of the study focuses on the role of the national treatment obligation under trade agreements in regulating host country behaviour in the trade in services and the lack of any parallel non-discrimination in tax treaties and poses some specific questions. First, is there potential for differences in tax treatment between resident and non-resident service providers? Second, is there evidence of differences in the tax treatment of resident and non-resident service providers? Third, do these differences in treatment affect the competitive position of non-resident service providers and can these differences be viewed as discriminatory?

Chapter 7 examines the general provisions in the OECD and UN Model Tax Treaties that are employed by bilateral tax treaty partners in the taxation of non-resident service providers and how these are interpreted and applied. It draws from two main sources: first, research on the use of the UN Model Tax Treaty provisions in services in tax treaties that was carried out by the International Bureau of Fiscal Documentation (IBFD) at the request of the Committee of Experts on International Co-Operation in Tax Matters³⁸ in 2011 and 2012 and second the 2012 International Fiscal Association study on Enterprise Services (2012 IFA Report) which included reports from 38 jurisdictions about how their income tax rules are applied under a tax treaty.³⁹

The purpose of Chapter 7 is to demonstrate that the manner in which a country interprets and applies the OECD and UN tax treaty provisions that apply to services, varies widely by country and can result in the imposition of very onerous withholding taxes and/or administrative and compliance issues. The evidence presented in the 2012 IFA Report also suggests that a significant number of countries apply withholding taxes to services income including services related to transfers of technology or know-how, technical services and personal or professional services. Aside from withholding tax issues there is also a comparability issue. Specifically, there is no requirement that the characterization of income from services in respect of a non-resident under a tax treaty be consistent with the treatment of a similar payment under domestic law.

³⁸ As reported in W Wijnen, J de Goede & A Alessi, “United Nations/OECD - The Treatment of Services in Tax Treaties” (2012) 66:1 Bulletin for International Taxation [hereinafter the “Wijnen Study”]. This paper provides a detailed study of the service provisions employed in tax treaties between 1997 and 2011.

³⁹ IFA, 2012 Congress Boston, “Enterprise Services” 66th Boston Congress 2008, Cahiers de droit fiscal International, v.97a.

Chapter 8 looks at the tax treatment of a non-resident under Canadian domestic law, and the domestic law of a number of countries including those in the Mercouser Group. The Chapter demonstrates that significant differences in the tax treatment of resident and non-resident service providers result from the domestic laws or administrative practices of many countries. These differences clearly affect the competitive position of non-resident service providers. It is often not always evident that the differences in tax treatment can be justified as a means of protecting the country's tax base. There is clearly room to argue that some differences in tax treatment operate as a disguised restriction on trade. Thus the specific question posed in this study: if trade agreements contain non-discrimination obligations in respect of trade in services but relegate these non-discrimination obligations with respect to tax matters to tax treaties, should tax treaties include a parallel non-discrimination obligation? The research concludes that the answer is yes.

Chapter 9 examines other uses of tax measures that may affect the competitive position of non-resident service providers, but which are also not subject to any non-discrimination obligation under a tax treaty. Specifically, it examines the US *Foreign Account Tax Compliance Act*⁴⁰ (FACTA) provisions that impose financial penalties in the form of gross withholding tax on foreign financial institutions (FFI) if the FFI does not agree to report US investors. It is argued that the non-discrimination obligation in tax treaties should also be broad enough to prevent the use of tax measures as a form of economic blackmail, in particular when such measures impact the competitive position of a non-resident service provider.

Part IV: Part IV of the paper begins by exploring the questions: what principles should inform how non-residents are taxed? Should non-residents be fair game for source state tax authorities? It questions whether the current assumptions around differences in tax treatment between residents and non-residents can still be justified.

Part IV also provides suggestions for an appropriate standard for the tax treatment of non-resident service providers to be included in a tax treaty. These suggestions are at best a compromise. The research undertaken for this study reveals that there are no easy solutions for filling in the gap left in trade agreements in respect of non-discrimination obligations and

⁴⁰ *Foreign Account Tax Compliance Act*, 26 USC (2010) Pub L No 111-147.

tax measures. As one author has noted, international trade and tax agreements may be coordinated but not reconciled.⁴¹ Given the primacy given to tax treaties in trade agreements the obvious place for such a non-discrimination obligation is in a tax treaty. However this suggestion ignores the elephant in the room. Why would a sovereign State agree to the inclusion of a new tax treaty obligation? The non-discrimination obligations in the OECD Model Tax Treaty are a product of consultation, compromise and a consensus that was reached in the 1950s. Any new tax treaty non-discrimination obligation will only be achieved through a similar process and not through the musings of an over zealous academic. Nonetheless Part IV explores a number of options for a non-discrimination obligation drawing from trade and investment agreements. It also attempts to incorporate a GATS variant of the non-discrimination obligation into the current tax treaty structure. As will be seen this is at best an unruly exercise that vividly highlights the chasm between the positive non-discrimination obligations in trade agreements and the negative approach to non-discrimination obligations adopted in tax treaties. It also makes clear that if a non-discrimination obligation is to be included in tax treaties it will require substantial political will and that it will only occur if ‘the bargain’ is considered worth it by the Contracting States.

2. Limitations in the Research

This research does not examine all of the specific provisions of the trade agreements under review including the WTO Agreement, the NAFTA and the AANZFTA and other various free trade agreements, nor does it examine all of the specific provisions in tax treaties that address trade in services. Rather the research focuses on the general non-discrimination obligations with respect to trade in services as they impact a non-resident service provider. For example, although it reviews the general obligations in the NAFTA with respect to the cross border trade in services, it does not review in detail the specific provisions that relate to financial services. Similarly, in the discussion of tax treaties, although the general provisions that impact trade in services are examined, the provisions affecting specific types of services such as, for example, services provided by artists and athletes, directors or government workers are not examined, nor are specific issues with respect to the trade in services such as

⁴¹ See Yariv Brauner *supra* note 1.

ecommerce. The tax provisions in investment treaties and the investment chapters in free trade agreements like the NAFTA are also omitted from this study.

In the tax treaty context, the research focuses on the lack of a non-discrimination obligation with respect to a non-resident service provider, not with respect to non-residents in general. This is not to suggest that a general non-discrimination obligation with respect to non-residents should not be considered under a tax treaty. It is simply beyond the scope of this study. Issues with respect to the current non-discrimination obligation in the tax treaty once the threshold for a permanent establishment is crossed are also considered beyond the scope of this study.

The study focuses on issues with respect to direct (income) taxes rather than indirect taxes such as sales and value added taxes. It is acknowledged that indirect tax measures may also affect the competitive position of a non-resident service provider. Accordingly, reference is made to the non-discrimination obligations in tax and trade agreements to the extent that they apply to indirect tax measures and trade in services.

In the discussion of tax treaties, the primary focus is on the OECD Model Tax Treaty although reference is also made throughout the study to the UN Model Tax Treaty.

3. Approach

The research adopts a doctrinal policy-based approach to the literature and an empirical approach in the collection of case law and data in the area of non-discrimination and tax matters affecting WTO Member countries. It adopts a practical approach in the form of a proposed non-discrimination paragraph to be added to the OECD and UN Model Tax Treaty. Among the outcomes of this research is the identification of potential conflicts between and among tax and trade agreements and recommendations about proposed changes to the OECD and UN Model Tax Treaties to adapt to developments in global trade and in particular trade in services.

Part II: Non-Discrimination Obligations in Tax and Trade Agreements

Chapter 2: Setting the Stage: Non-Discrimination Obligations in Trade and Tax Agreements

A. Overview

Chapter 2 examines the key provisions in the multilateral General Agreement on Trade in Services (GATS) and in the OECD and UN Model Tax Treaties that apply to the trade in services. The chapter begins with an overview of the principal non-discrimination obligations found in the GATS, including the national treatment and most favoured nation obligations that a Member must accord to the services and service providers of other Member States with respect to measures covered by the agreement. It then examines the exceptions to these obligations, in particular those that relate to direct tax measures. Because the exceptions to the general non-discrimination obligations in the GATS include matters that are the result of, or fall within, the scope of an agreement on the avoidance of double taxation ('tax treaty'), a discussion of the provisions of the OECD and UN Model Tax Treaties that impact non-resident service providers including the tax treaty non-discrimination obligations follows.⁴² These tax treaty non-discrimination obligations are reviewed in light of the non-discrimination obligations found in the GATS. Finally the chapter comments on the potential for differing non-discrimination obligations among WTO Members as a result of the interaction between the GATS and the OECD and UN Model Tax Treaties. The chapter is designed to provide the global framework within which the issue of non-discrimination and the taxation of non-resident service providers can be initially examined.

B. Non-Discrimination and Trade Agreements: The World Stage

The 1990s witnessed the first significant global cooperation to facilitate the cross-border trade in services. The GATS came into force on January 1, 1995 as part of the Agreement Establishing the World Trade Organization (WTO) with some 127⁴³ initial Members⁴⁴ and

⁴² The OECD and UN Model Treaty non-discrimination obligations are viewed as integral to the study as these are the provisions upon which most bilateral tax treaties are based.

⁴³ As of June 26, 2014 this number has now expanded to 160 Member governments accounting for over 90% of the world's trade.

laid the groundwork for most favoured nation and national treatment for services and service providers on a global scale.

The immediate discussion focuses on the GATS, in particular on the provisions of the GATS that affect service providers and tax measures. An examination of the OECD and UN Model Tax Treaties, including the specific provisions that impact the cross-border trade in services and the tax treaty non-discrimination provisions follows.

1. The General Agreement on Trade in Services (GATS)

(i) Overview

The GATS marks the first global attempt to establish a multilateral understanding and agreement covering trade in services. The agreement entrenched major trade obligations for Member States including the obligation to accord most favoured nation and national treatment to the services and service suppliers of other Member States. This was an important and highly significant step forward in the international arena to liberalize the trade in services.

The most favoured nation obligation in Article II of the GATS requires that with respect to any measure covered by the GATS that each Member “shall accord immediately and unconditionally to services and service providers of any other Member, treatment no less favorable than that it accords to like services and service providers of any other country.” The national treatment obligation requires that each Member “shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services,

⁴⁴ Further negotiations unfortunately ground to a halt in the Doha Round. A number of countries including Canada, the United States, Mexico, Switzerland, Japan, Korea, Hong Kong, Australia, and the European Union are negotiating a new international instrument to further liberalize trade in services. The instrument will be called the Trade in Services Agreement (TISA). Parties to the negotiations are responsible for some 70 percent of global services trade. The TISA negotiations were borne out of the frustration felt by certain WTO Members when negotiations to liberalize services trade became a casualty of the stalled Doha Round of WTO negotiations. The TISA is to be negotiated outside of the WTO by a subset of WTO Members committed to services trade liberalization. Expectations for the TISA are that it will reflect new types of services that have emerged since the WTO’s GATS (WTO, *General Agreement on Trade in Services* (April 15, 1995) is part of the World Trade Organization Agreement, Annex 1B [herein GATS]) was negotiated some 20 years ago, lock-in liberalization undertaken unilaterally by parties since the GATS came into force, and expand commitments among the parties on market access and non-discrimination.

treatment no less favourable than that it accords to its own like services and service suppliers.”⁴⁵ As originally envisioned, these non-discrimination obligations applied to all measures under the GATS agreement including both direct and indirect tax measures to the extent that they affected trade in services. However, as will be seen, the national treatment obligation would remain subject to negotiation and both the national treatment and most favoured nation obligations were made subject to qualifications and exceptions, in particular with respect to direct tax matters.

The GATS applies to all WTO Member countries. The final Agreement consists of “a framework text setting out general multilateral rules governing trade and investment in services”⁴⁶ plus a series of annexes and understandings that deal with such matters as movement of personnel, transport, financial and aviation services and access to telecommunication networks.⁴⁷

The GATS covers four basic modes of service delivery: (1) cross-border services supplied from the territory of one party to the territory of another (e.g., cross-border software support); (2) services supplied in the territory of one party to the consumers of any other (e.g., tourism); (3) services provided through the presence of service-providing entities of one party in the territory of any other (e.g., banking); and (4) services provided by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member (e.g., construction projects or consultancies).⁴⁸

The scope and coverage of the GATS is reliant on basic definitions about who is a service supplier and what is considered a measure “affecting trade in services.”⁴⁹ Specifically, the

⁴⁵ The GATS, Article XVII.

⁴⁶ See HG Broadman, “International Trade and Investment in Services: A Comparative Analysis of the NAFTA” (1993) 27 Int'l Law 623 at 627.

⁴⁷ The GATS *supra* note 6.

⁴⁸ The GATS Article 1 at para 2.

⁴⁹ The *European Communities – Regime for the Importation, Sale, and Distribution of Bananas (Complaint by Ecuador, Guatemala, Honduras, Mexico, and the United States)* (1997), WTO Doc WT/DS27/R/USA at para 7.285 (Panel Report) defined the scope of application of the in the following terms: “[N]o measures are excluded a priori from the scope of the GATS as defined by its provisions. The scope of the GATS encompasses any measure of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services.” The Appellate Body upheld this finding and held that no provision of the Agreement “suggest[s] a limited scope of application for the GATS.” *European Communities - Regime for the Importation, Sale and Distribution of Bananas (Complaint by Ecuador, Guatemala, Honduras, Mexico, and the United States)* (1997), WTO Doc WT/DS27/AB/R at para 220 (Appellant Body Report). See also discussion below at note 13.

GATS applies to measures by Members “affecting”⁵⁰ trade in services. A measure is broadly defined as “any measure by a Member, whether in the form of a law, regulation, procedure, decision, administrative action, or any other form that affects the trade in services”⁵¹ Trade in services is defined simply as the “supply of a service.”⁵²

The commitments by WTO Members with respect to measures “affecting trade in services” may be categorized into two broad groups: first, general obligations, which apply directly and automatically to all Members and services sectors, and second, specific commitments concerning market access and national treatment in designated sectors. These specific commitments are set out in individual country schedules, whose scope may vary widely between Members.⁵³

(ii) General Obligations (Most Favoured Nation Treatment)

The general obligations assumed under the GATS include a commitment to most favoured nation treatment with respect to all measures affecting services and service providers of other Members (“non-resident service providers”), transparency with respect to measures of general application, the establishment of national inquiry points to respond to other Members information requests, the establishment of administrative review and appeal procedures, and discipline on the operation of monopolies and exclusive suppliers.

These general obligations, and in particular obligations with respect to most favoured nation treatment are, however, subject to limitations.⁵⁴ Member countries could deviate from the most favoured nation obligation in the “Annex on Article II Exemptions” if the conditions for

⁵⁰ The Appellate Body, *ibid* also made the following comment: “[t]his Agreement applies to measures by Members affecting trade in services. In our view, the use of the term ‘affecting’ reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word ‘affecting’ implies a measure that has ‘an effect on’, which indicates a broad scope of application.”

⁵¹ The GATS, Article XXVIII (a); In *Canada – Certain Measures Affecting the Auto Industry (Complaint by Japan)* (2000), WTO Doc WT/DSI39/AB/R at para 151-152 and 155 (Appellate Body Report) the Appellate Body held that whether a measure “affects” trade in services must be assessed before any further consistency of a measure with other GATS provisions is considered.

⁵² The GATS Article XXVIII (b): the “supply of service” includes, but is not limited to the “production, distribution, marketing, sale and delivery of a service.”

⁵³ The GATS Article XX.

⁵⁴ The wording “treatment no less favourable” in the GATS Article II(1) has been interpreted broadly by the WTO Appellate Body to include both *de facto* as well as “*de jure* discrimination.” See e.g., the Appellate Body Report, *supra* note 50 at para 234.

such exemptions were met.⁵⁵ This flexibility was considered necessary in order to maintain existing regulations or agreements inconsistent with the most favoured nation obligation and to preserve the prospective right to use reciprocal or unilateral liberalization measures. Almost all countries have claimed some most favoured nation exemptions in areas such as civil and maritime aviation, telecommunications and financial services.⁵⁶ Similar exemptions have also been claimed with respect to national treatment. However, if an exemption was not claimed, the most favoured nation obligation applies unconditionally to any measure affecting trade in services, unless, as discussed below, the difference in tax treatment is the result of a tax treaty.

(iii) National Treatment and Market Access: Specific Commitments

In addition to the general obligations described above, the GATS sets out a framework within which the terms of each Member's specific commitments to liberalize the trade in services on a sector-by-sector basis are recorded. This portion of the GATS is often referred to as a "bottom-up" agreement. This reference recognizes that each Member could choose the service sector(s) it wished to open up to foreign service providers, for example tourism, or to exclude by omission, for example, health care.

As a result of the GATS approach to the liberalization of trade in services, market access was, and continues to be, a negotiated commitment in specified sectors,⁵⁷ as is the commitment to provide national treatment to the services and service providers of other

⁵⁵ Members were allowed to seek such exemptions before the Agreement was entered into force. New exemptions can only be granted to new Members at the time of accession or, in the case of current Members, by way of a waiver under Article IX:3 of the WTO Agreement. All exemptions are subject to review, and should in principle not last longer than 10 years. Further, the GATS allows groups of Members to enter into economic integration agreements or to mutually recognize regulatory standards, certificates and the like if certain conditions are met.

⁵⁶ See Schedules to the GATS to view a specific country's schedules. For Canada see WTO, *Canada Final List of Article II (MFN) Exemptions* (15 April 1994) WTO Doc GATS/ EU16, online WTO <<http://docsonline.wto.org>>. Canada has claimed exemptions for film, video and television co-production, with respect to fishing, banking, trust and insurance services, air and marine transport, and for certain services related to agriculture.

⁵⁷ Further, market access commitments may be made subject to various types of limitations that are enumerated in Article XVI (2). For example, limitations may be imposed on the number of services suppliers, service operations or employees in the sector, the value of transactions, the legal form of the service supplier, or the participation of foreign capital.

Members.⁵⁸ The extension of national treatment in any particular sector could be made subject to conditions and qualifications. Each country's commitments thus tend to reflect national policy objectives and constraints, overall and in individual sectors.⁵⁹ However, once committed, a Member may not impose discriminatory measures benefiting domestic services or service suppliers.

The national treatment obligation is met if a Member accords the services and service suppliers of any other Member, treatment no less favourable than that it accords to its own like services and service suppliers. This can be achieved through formally identical or different treatment, but the treatment would be considered less favourable if it modified in law or in fact, the conditions of competition in favour of the Member's own service industry. The concept of what are "like services and service suppliers" under the GATS is still to a large extent uncharted territory."⁶⁰

(iv) Taxation Measures

Taxation measures, to the extent that they affect services or service providers are also subject to the national treatment⁶¹ and most favoured nation obligations. Some countries therefore claimed national treatment⁶² qualifications or most favoured nation exemptions.⁶³ Canada for

⁵⁸ The GATS Article XVII provides that "each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers." The GATS limits the application of this standard to those sectors specified in each Member's Schedule of Concessions, and allows Members to set forth any applicable conditions.

⁵⁹ The existence of specific commitments triggers further obligations concerning, inter alia, the notification of new measures that have a significant impact on trade (GATS Article III) and the avoidance of restrictions on international payments and transfers (GATS Article XI).

⁶⁰ See Mireille Cossy, "Determining 'likeness' under the GATS: Squaring the Circle" (September 2006) Staff Working Paper, World Trade Organization - Economic Research and Statistics Division.

⁶¹ See the GATS Article XVII.

⁶² See the WTO, *The United States of America Schedule of Specific Commitments (15 April 1994)*, WTO Doc GATS/SC/90, online WTO <<http://docsonline.wto.org>> at 9-10, setting forth limitations on national treatment for foreign employee benefit trusts and excise taxes on transfers to foreign entities. See also Jeffrey Lang & Robert Stack, "What Tax Lawyers Should Know About Trade Law" (2000) 29:10 *Tax Management International Journal* at 566-581.

⁶³ A quick review of the schedules reveals that many countries, including Canada, the US and Mexico, have claimed most favoured nation exemptions with respect to tax provisions. See e.g., *supra* note 13 at para 3 detailing the exemption from taxes on income of non-residents from international transport on the basis of reciprocity with the resident country. The US has also listed tax measures relating to favorable treatment for Mexican and Canadian residents, the Caribbean Basin Initiative, international transport income (including aircraft and rolling stock) derived by residents of countries with reciprocal measures, earnings from communication satellites and denials of deductions for residents of countries participating in international boycotts or maintaining discriminatory tax regimes. WTO, *United States*

example, listed a qualification to the national treatment obligation for tax measures that result in differences of treatment with respect to expenditures made on scientific research and experimental development services.⁶⁴ Further qualifications have been claimed at both the federal and sub-central level related to small businesses that are Canadian controlled private corporations.⁶⁵ Surprisingly few countries claimed most favoured nation exemptions and with exception of the United States drafted these exemptions very narrowly.⁶⁶ The specifics of each countries exemptions and qualifications can be found in each country's schedule to the GATS.⁶⁷

The most significant exclusion for tax measures from the non-discrimination obligations in the GATS are not the result of claims by Member countries, but rather are the result of specific provisions in the GATS.

The most favoured nation obligation is limited by Article XIV(e) of the GATS. It permits Members to adopt tax measures inconsistent with the most favoured nation requirement if “the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement (“tax treaty”) by which a Member is bound.” As a result preferential tax treatment of parties from one country over another is expressly authorized under the GATS provided it is the result of a tax treaty.⁶⁸

There is also a specific exception from the national treatment obligation as it relates to the tax treatment of services and service providers⁶⁹ listed under the General Exceptions to Article

of America Final List of Article II (MFN) Exemptions (15 April 1994), WTO Doc GATS/EU90, online WTO <<http://docsonline.wto.org>> at 2-11.

⁶⁴ See WTO, *Canada Schedule of Specific Commitments* (15 April 1994), WTO Doc GATS/SC/16, online: WTO <<http://docsonline.wto.org>>.

⁶⁵ *Ibid* under Part I Horizontal Commitments.

⁶⁶ Jennifer Farrell, *The Interface of International Trade Law and Taxation*, IBFD Doctorial Series 26 (The Netherlands: IBFD Publications BV, 2013) at Chapter 8.3.1.

⁶⁷ See WTO, *Schedules of Commitments and Lists of Article II Exemptions*, online: WTO <http://www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm>.

⁶⁸ Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.

⁶⁹ As discussed, the potential for discrimination in direct tax matters became a major issue in the final days of negotiating the WTO Agreement in the Uruguay Round. The US strongly opposed the inclusion of direct taxes in the national treatment requirements under the GATS. See Stahl, Tycho HE, “Liberalizing International Trade in Services: The Case For Side Stepping the GATT,” (1994) 19 Yale J. Int'l 405 at chapter 1 footnote 19.

XIV of the GATS. Specifically Article XIV (d) provides that any Member may adopt or enforce direct ⁷⁰tax measures that are inconsistent with national treatment, “provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Member countries.” The meaning of the expression “equitable or effective” is defined in a footnote⁷¹ that provides illustrations of taxes and tax policies that may be excluded from national treatment obligation. These include, for example, the right to impose withholding tax, as well as to apply special provisions such as transfer pricing rules to prevent tax avoidance. The footnote further specifies that tax terms or concepts listed in the footnote describing the 'carve out' from the national treatment obligation are to be determined according to tax definitions and concepts or their equivalent under the domestic law of the Member taking the measure.⁷² This will serve to prevent debate about a Member government’s right to exercise wide powers under its domestic law to both safeguard the tax base and to define its scope.

Notwithstanding the breadth of the exception from the national treatment obligation for direct tax measures described above, it is important to keep in mind that the exception remains subject an overriding non-discrimination obligation in the GATS. Specifically, Article XIV of the GATS imposes the requirement that “such measures are not applied in a

⁷⁰ Direct taxes are defined in the GATS Article XXVIII(o) as “all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.”

⁷¹ Specifically, the footnote to the GATS Article (XIV) refers to the following activities: “Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:

- apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
- apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
- apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
- distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
- determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

Tax terms or concepts in the GATS Article XIV (d) and in the footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.”

⁷² The GATS Article XIV (d).

manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.” This non-discrimination obligation, which is basic to international trade law, imposes an important albeit limited restriction on the discretion of a Member State when imposing direct tax measures on the services or service providers of other Member States in contravention of the GATS national treatment obligation. Note however, that no justification is required under Article XIV unless the national treatment obligation is otherwise violated. To establish such a violation three conditions must be met; first the service provider must be like, second, the difference in treatment must be based on the national origin of the service or service provider and third the treatment must be less favourable.⁷³

Another issue of significance, for purposes of this study, is how the GATS addresses the national treatment obligation with respect to tax measures if a bilateral tax treaty is in effect between the Member countries.⁷⁴ As discussed, it became clear during negotiations for the GATS that the US was strongly of the view that disputes with respect to tax matters should be resolved solely under bilateral tax treaties, or more specifically through the bilateral competent authority procedure contained therein. Some 113 countries disagreed with the US position.⁷⁵ The final version of the GATS reflects a compromise of sorts. Under the Agreement, a Member may not invoke the national treatment obligation under either the consultation or dispute resolution provisions in the GATS with respect to a measure of another Member that fall within the scope of an international agreement related to the avoidance of double taxation.⁷⁶

If one accepts the widely held view that all matters of non-discrimination with respect to direct tax measures fall within the scope of a tax treaty,⁷⁷ it follows that any disputes relating

⁷³ See WTO, *Uruguay Round - Group of Negotiations on Services – The Applicability of the GATS to Tax Measures - Note by the Secretariat* (1 December 1993), WTO Doc MTN.GNS/W/210.

⁷⁴ The GATS Article XXII (3). See also WTO, *Uruguay Round - Group Of Negotiations on Services – Taxation Issues Related to Article XIV.D - Note by the Secretariat* (15 November 1993), WTO Doc MTN.GNS/W/178.

⁷⁵ J. Turro, “US Concerns Threaten GATT Talks” (1993) 61 Tax Notes 10 at 1151.

⁷⁶ The GATS Article XXII (3). In case of disagreement between Members as to whether a measure falls within the scope of such an agreement between them, it shall be open to either Member to bring this matter before the Council for Trade in Services. The Council shall refer the matter to arbitration. The decision of the arbitrator shall be final and binding on the Member.

⁷⁷ The OECD and UN Model Tax Treaties both include a non-discrimination Article. See Article 24(3). If there is a tax treaty between the Member States but it does not include a non-discrimination clause the issue is unclear. One argument is that that GATS obligations apply. The better argument is that no non-discrimination obligation applies if none is included in the tax treaty.

to an alleged violation of the national treatment obligation with respect to a tax measure must be resolved using the mechanism provided in the applicable tax treaty. This would clearly include any challenge with respect to direct taxes but could also include any challenge with respect to an indirect tax measure if indirect tax measures are addressed in the non-discrimination provisions in the tax treaty. As well, even the limited non-discrimination obligation under Article XIV of the GATS with respect to a direct tax measure in respect of a non-resident service provider is effectively eliminated.

The language in the carve out in Article XXII(3) to prevent a challenge to the national treatment obligation was apparently not considered sufficient on its own to restrict discipline over tax matters to a tax treaty.⁷⁸ A footnote to Article XXII (3) of the GATS provides that if there is a disagreement about whether the matter falls within the scope of a tax treaty and the tax treaty was in existence at the time the WTO Agreement entered into force, one country cannot unilaterally challenge the issue of the tax treaty's scope under WTO procedures.⁷⁹ Both parties to the existing tax treaty must consent if the WTO dispute resolution procedure (rather than a tax treaty procedure) is to be engaged. However, if future tax treaties are silent on the issue, either treaty partner may unilaterally apply to determine whether a matter falls within the scope of a tax treaty before the WTO's Council for Trade in Services, which may then refer the matter to binding arbitration.⁸⁰

Based on the above analysis it is obvious that tax treaties will play a central role in determining what non-discrimination obligations apply to the tax treatment of a non-resident service provider. The analysis also leads to two further questions. First, how do the OECD and UN Model Tax Treaties allocate the right to tax income earned by non-residents between the source and resident country and second, what protection, if any, against non-discrimination do these tax treaties provide to a non-resident service provider? As will be discussed below, the most favourable non-discrimination obligation under a tax treaty for a non-resident arises in circumstances where the non-resident provides services to a tax treaty partner through a permanent establishment, although even that obligation is very limited.

⁷⁸ This exclusion would generally apply to direct tax measures. However it may also apply to indirect tax measures depending on the particular tax treaty.

⁷⁹ The GATS Article XXII (2).

⁸⁰ The GATS Article XXII (3).

2. The OECD and UN Model Tax Treaties: The Taxation of Non-Resident Service Providers and Tax Treaty Non-Discrimination Obligations

The OECD and UN Model Tax Treaties and the bilateral tax treaties based on these Models serve to prevent double taxation, provide for the exchange of information, and help to reduce fiscal evasion. The treaties operate by allocating the right to tax income to the resident or source state or in some cases, to both. Both Model Tax Treaties provide for the taxation of several broad categories of income, including income from business, real property, transportation, dividends, interest, royalties, gains from alienation, income from employment, directors fees, payments to artists and sportspersons, income from pensions and annuities, income from government services, payments to students, other income and in the case of the UN Model Tax Treaty, income from independent personal services.

Which tax treaty article applies is important in determining both host country tax liability and the applicable non-discrimination obligation, if any.⁸¹ As there can be considerable overlap among the tax treaty articles in the case of payments for services, a question frequently posed is whether, the payment for services represents business profits,⁸² royalties⁸³ or other income.⁸⁴ If the applicable tax treaty includes an independent personal services article that article would also be included. These tax treaty articles are discussed further in Part III. The important point being made in the immediate discussion is that any applicable non-discrimination obligation found in a tax treaty is determined by whether the non-resident meets the specific conditions outlined in the non-discrimination article. This in turn will depend on which of the allocation of income rules in the tax treaty is applied by the source country to the non-resident service provider.

⁸¹ Some assistance in resolving the distinction between these Tax Treaty articles can be found in the Commentary to the OECD Model Tax Treaty.

⁸² “Business profits,” a term undefined in the OECD Model Tax Treaty and most tax treaties, are not taxable in the host country unless the enterprise carries on business in that country through a permanent establishment. The OECD Model Tax Treaty provides that business profits do not include income dealt with separately in other treaty articles. Thus business profits would generally include amounts not specifically covered in the personal service income articles.

⁸³ In the past, a blurring has occurred between business profits, royalty income and income from personal services. The problem has been distinguishing a payment in respect of management or technical service fees, which may be exempt as business profit under the OECD Model Tax Treaty Article 7, or the OECD Model Tax Treaty Article 14 (Independent Personal Services), from a royalty for the transfer of know how, which is potentially subject to a withholding tax under the royalty provisions.

⁸⁴ OECD Model tax Treaty Article XXI.

(i) *Taxation of Service Providers*

Income earned from the provision of services by a non-resident under the OECD and UN Model Tax Treaties is generally subject to the business profits article, or in some cases the independent and dependent personal services articles in the applicable tax treaty. Payments for specific services such as those provided by directors or senior managers, government,⁸⁵ artists and sportspersons⁸⁶ or that affect students or apprentices,⁸⁷ may be subject to separate tax treaty provisions. The details of these tax treaty articles are not important to this part of the study and are not included in the discussion that follows.

In general payments made for services performed by a resident of one Contracting State on behalf of a resident of the other Contracting State are not taxable in the other State unless the service provider has or had a fixed base (or permanent establishment) in the other State. If so, payments are taxable only to the extent that the services are performed in the other State and profits are attributable to that fixed base (or permanent establishment).⁸⁸ As will be discussed, even if payments are exempt from host country taxation under a tax treaty, they may remain subject to interim or other taxes under the domestic law of that country, particularly if payment for the services is sourced there.

Both the OECD and UN Model Tax Treaties include a Business Profits article. Only the UN Model Tax Treaty continues to include an Independent Personal Services Article. The relevance of this difference between the OECD and UN Model Tax Treaties will soon become apparent. Business profits that are attributable to a permanent establishment benefit from a non-discrimination obligation under both Model Tax Treaties. There is no tax treaty non-discrimination obligation if the Independent Personal Services Article in a tax treaty applies.

⁸⁵ See e.g., Article 19 of the *Convention between the Government of Canada and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 12 September 2006, (entered into force 12 April 2007) [hereinafter the Mexico-Canada Tax Treaty].

⁸⁶ *Ibid*, Article 17.

⁸⁷ *Ibid*, Article 20.

⁸⁸ *Ibid*.

(a) Business Profits

Whether payments for the provision of services will be considered income from business will depend on the specific tax treaty. The answer may vary widely. There is good reason for this. The OECD Model Tax Treaty has undergone significant changes in the past two decades that have impacted how income from services may be taxed. Article 14, for example, which formerly governed the taxation of independent personal services under the OECD Model Tax Treaty, was removed from the Model Tax Treaty in 2000. Provision for these services was subsumed under the business profits article (Article 7).⁸⁹ Some countries followed the OECD lead and eliminated the independent services article from their tax treaties. However, many older tax treaties retain the independent personal services article, as do tax treaties based on the UN Model Tax Treaty. The independent personal services article is thus commonly found in OECD and UN based tax treaties and is the basis for taxing payments for services that in other tax treaties would otherwise fall under the business profits article.

(b) Permanent Establishments

Assuming the domestic tax law of the host country imposes tax on income from business activities in the host country, the right of the host country to tax business profits sourced within its borders depends on whether the individual or entity has a permanent establishment in the host country. The existence of a permanent establishment in the host country also engages one of the non-discrimination obligations in Article 24 of both Model Tax Treaties.

Both the OECD and UN Model Tax Treaties include specific provisions that are intended to clarify what is considered to be a permanent establishment for purposes of the Treaty. In summary, and beginning with Article 5(1) of the OECD Model Tax Treaty, a permanent establishment “means a fixed place of business through which the business of the enterprise

⁸⁹ Under the OECD Model Tax Treaty Article 14 (Independent Personal Services) was deleted from the Treaty on April 29, 2000, on the basis of the report OECD, *Issues Related to Article 14 of the OECD Model Tax Convention*, Issues in International Taxation, No 7 (2000) which was adopted by the Committee on Fiscal Affairs on January 27, 2000. According to the commentary there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. It was also thought it was unclear which activities fell within Article 14 as opposed to Article 7. The result of the deletion of Article 14 is that income derived from professional services on other activities of an independent character is now governed by Article 7 as business profits under the OECD Model Tax Treaty.

is carried on”⁹⁰ (‘the general rule’). The OECD Model Tax Treaty then provides an illustrative list in Article 5(2) of specific kinds of operations that *prima facie* come within this general rule, followed by specific deeming rules in Articles 3 through 7 to include or exclude certain activities within the meaning of permanent establishment. It ends with a general statement clarifying that the existence of a subsidiary corporation does not of itself create a permanent establishment for the parent corporation.

According to the illustrative list, the term “permanent establishment” includes especially a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. The illustrative list provides an indication that a permanent establishment may exist; it does not provide that one necessarily does exist. The OECD Commentary is clear that the condition in the general rule in Article 5(1) that there must be a fixed base through which the business is carried on must also be met before a permanent establishment exists.⁹¹ This proviso does not extend to “a building site or construction or installation project which also constitutes a permanent establishment under Article 5 (3) if it lasts for more than twelve months.”

The OECD Model also includes deeming rules that either exclude certain activities that would otherwise fall within the general meaning of permanent establishment or include activities that would otherwise fall outside it. For example activities that are considered to be largely of a preliminary nature such as collecting information, storage, advertising or displaying goods are excluded from the permanent establishment rule. In contrast the activities of dependent agents who habitually conclude contracts on behalf of that enterprise may result in a deemed permanent establishment under the Treaty.⁹²

The UN Model Tax Treaty further expands the permanent establishment concept to include broader host country taxation rights. Specifically, the UN Model Tax Treaty provides for a

⁹⁰ According to the OECD Commentaries, a general principle to be observed in determining whether a permanent establishment exists is that the place of business must be “fixed” in the sense that a particular building or physical location is used by the enterprise for the conduct of its business, and that it must be foreseeable that the enterprise’s use of this building or other physical location will be more than temporary; OECD, Committee on Fiscal Affairs, *Model Tax Convention on Income and on Capital*, (2008) at Article 5, paras 4-8.

⁹¹ *Ibid* at Article 5(2) para 12.

⁹² A third deeming rule in Article 5 provides that “an enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business”

six-month test to determine whether a building or construction site constitutes a permanent establishment as compared with the OECD Model Tax Treaty's twelve-month test and the UN Model Tax Treaty expressly includes supervisory activities. Other provisions⁹³ provide for a permanent establishment based on the activities of an independent agent⁹⁴ or the furnishing of services, including consultancy services, through employees or other personnel engaged by the enterprise, if the activities continue (for the same or a connected project) within a Contracting for more than six months in any twelve-month period.⁹⁵

In many cases the answer to the question “is there a permanent establishment?” is obvious. For example, based on the general rule and the illustrative list in Article 5, it is clear under both Model Tax Treaties that if an enterprise is operating a mine, an oil or gas well, a quarry or any other place of extraction of natural resources it will have a permanent establishment in the host country. The non-resident enterprise has a fixed place of business through which the business is carried on and will be taxable with respect to any profits attributable to that permanent establishment.

In other cases it is more difficult to determine if a permanent establishment exists. One such area is the provision of services.

As the result of the revisions to Article 5 of the OECD Model Tax Treaty in 2000, a non-resident service provider will have a permanent establishment in the host country if the non-resident meets the general rule in Article 5(1), that is if the non-resident service provider carries on business in the host country through a fixed place of business. There are no time tests associated with this provision.⁹⁶ It is simply a question of fact that will be determined

⁹³ The UN Model Tax Treaty Article 5(7).

⁹⁴ Other differences under the UN Model Tax Treaty that may affect whether a permanent establishment is found include the omission of the word delivery from Article 5 paragraph 4 with the result that delivery activities are not treated as ancillary and the expansion of the deeming rule with respect to when dependent agents will create a permanent establishment – to include cases where a dependent agent regularly maintains a stock and makes deliveries from it.

⁹⁵ The UN Model Tax Treaty Article 5(3)(b). A deemed service permanent establishment will exist in these circumstances even if an enterprise has no fixed place of business in the taxing state as required under Article 5(1). See the *Revision of the Manual for the Negotiation of Bilateral Tax Treaties*, UN Committee of Experts on International Cooperation in Tax Matters, 7th Sess, UN Doc E/C.18/2011/CRP.2/Add.1 (Geneva: 24-28 October 2011) at 12.

⁹⁶ This has been the subject of discussion by the OECD and the following revisions were released in the Draft Commentary in October 2011: “Whilst the practices followed by Member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months

under the domestic law of the host country. The issue of when a fixed place of business exists for a non-resident service provider is no doubt one that will remain subject to considerable uncertainty.

Both the OECD and UN Model Tax Treaties (or Commentaries) also offer optional provisions for the taxation of services that may be included under the permanent establishment article in the respective Model Tax Treaties.

The optional provision under the OECD Model Tax Treaty was added in 2008 and can be found in the OECD Commentaries. It includes two deeming rules for enterprises of a Contracting State that perform services in the other Contracting State. The first rule applies if services are provided through an individual who is present in the other State during a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 percent of the gross revenue attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual. The second rule applies if during a period or periods exceeding in the aggregate 183 days in any twelve month period, services are performed for the same project or for connected projects through one or more individuals who are performing such services in that other State or are present in that other State for the purpose of performing such services. In either case the activities carried on in the other State in performing these services are deemed to be carried on through a permanent establishment of that enterprise in the other Contracting State, unless these services are of a preparatory or ancillary nature.⁹⁷ The suggested wording in the Commentary is clear that these rules apply notwithstanding the requirements in Article 5(1).

The UN Model Tax Treaty suggested provision for services was added to Article 5 in the 2011 update to the Treaty for the benefit of those Contracting States that preferred to eliminate the independent personal services article. It varies from the OECD provision to reflect the fact that the UN Model Tax Treaty version of Article 14 explicitly applies to

(conversely, practice shows that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months).⁹⁷ It would appear therefore, that even if the provision exceeds six months that will not necessarily lead to a permanent establishment if the tax treaty does not include a time test.

⁹⁷ These activities are limited to those mentioned in Article 5(4) of the OECD Model Tax Treaty which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

individuals. The UN version therefore eliminates the language in the OECD Commentaries that requires that the services provided under the 183 day time test be for the same or connected project. The underlying logic for eliminating the “connected” requirement is that no similar limitation was imposed in Article 14. The concern was that if the “connected” language was included in the proposed services permanent establishment provision in Article 5 it would serve to limit the source country taxation rights otherwise applied to income subject to the Independent Personal Services Article.

To recap, the importance of determining whether a permanent establishment exists in the host country is first that it establishes the host country’s right to tax the income sourced in the host country based on the treaty provisions and second it engages the tax treaty non-discrimination obligation for any income attributable to the permanent establishment.

(c) *Independent Personal Services*

Article 14 of the UN Model Tax Treaty provides that income from professional and other independent services performed by a resident of one country in the other country may be taxed in the other country if the resident has a “fixed base” in the other country or if the resident’s “stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned.” As discussed above, Article 14 of the OECD Model Tax Treaty was deleted in 2000 but before its deletion it applied to income from services if the services were provided through a fixed base in the host country. Variations of Article 14 of the OECD Model Tax Treaty exist in many of the tax treaties entered into before the article was deleted. Some tax treaties also include a time test similar to the 183 day test found in the UN Model Tax Treaty.

Income from services under former Article XIV of the OECD Model Tax Treaty and under the current version of Article 14 of the UN Model Tax Treaty is broadly defined as income from professional services or other services of an independent nature.⁹⁸ A number of interpretative issues plagued the provision. Among these were questions about what services

⁹⁸ In Article 14 of the OECD Model Tax Treaty, the term "professional services" included especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

were included under Article 14 and not Article 7, the business profits article. There were also questions about whether Article 14 applied only to individuals and not to other legal entities and about how exactly host country taxation should be levied under Article 14. The answers to these questions could be important.

For example, in contrast to the business profits article in Article 7, Article 14 refers to income from independent personal services and not profit and does not include rules for how income is to be computed.⁹⁹ This may prove significant in the tax treatment of the non-resident. Unlike the tax treatment of business profits, which is subject to a tax treaty non-discrimination obligation if the services are attributable to a permanent establishment in the host country, there is no equivalent non-discrimination obligation that applies if the independent personal services article applies and the services are provided through a fixed base.¹⁰⁰ Thus any method of net or gross based taxation could be applied to the income generated by a non-resident. This issue is discussed further below.

(ii) Non-Discrimination Obligations

The discussion thus far addresses the general provisions under which a tax treaty partner is allocated the right to tax income from the provision of services earned by a non-resident in a treaty partner's country under the OECD and UN Model Tax Treaties. The following describes the tax treaty non-discrimination obligations in respect of a non-resident with a focus on the OECD Model Tax Treaty. The non-discrimination Articles of both the OECD and UN can be found in Appendix 2.

(a) Overview

The non-discrimination obligations in both the OECD and UN Model Tax Treaties take the form of prohibitions designed to prevent source countries from discriminating against

⁹⁹ The OECD, Centre for Tax Policy and Administration, *2008 Update to the OECD Tax Convention*, (18 July 2008) [hereinafter the 2008 OECD Commentary] on Article 14 at para 10 indicates that reference may be made to the computational rules in Article 7.

¹⁰⁰ If the non-resident service provider is subject to tax under the business profits article, the applicable non-discrimination article provides that the source state cannot levy tax less favorably than that levied on a domestic enterprise carrying on the same activities. See Article 24(4) of the OECD Model Tax Treaty.

“foreigners” with sufficient nexus to the source country.¹⁰¹ The goal of these provisions is to ensure no less favourable tax treatment for “similarly situated” persons and businesses. Specifically, the principle of non-discrimination as expressed in Article 24 of the OECD Model Tax Treaty prohibits differences in tax treatment in four major areas as follows.

A state shall not:¹⁰²

- Subject non-nationals to “other or more burdensome taxation” than nationals who are “in the same circumstances.” (Article 24(1))
- Levy tax on a permanent establishment of a foreign enterprise “less favourably” than a domestic enterprise of carrying on the same activities. (Article 24(3)).
- Prevent the deduction of interest, rents, royalties or other disbursements paid to a treaty partner if “paid under the same circumstances” and a deduction is available if paid to a resident. (Article 24(4)).
- Subject “foreign-owned enterprises” to taxation that is “other or more burdensome” than the taxation and connected requirements applicable to “similar” domestic enterprises. (Article 24(5)).

These prohibitions are negotiated on a bilateral basis, thus negating any obligation with respect to most-favoured nation treatment.¹⁰³ The OECD Commentary is also clear that unless the specific listed criteria are met, the non-discrimination clause does not become operative. Put differently, if unequal or arbitrary treatment results from matters not mentioned in Article 24, there is no tax treaty non-discrimination obligation. As the discussion below will demonstrate, the narrow scope of the non-discrimination article in the tax treaty results in a wide range of permitted differences in the tax treatment between foreign and domestic-source income and foreign (non-resident) and domestic (resident) taxpayers.¹⁰⁴

¹⁰¹ Depending on the context, the non-discrimination principles found in trade agreements may apply to determine if the host country is guilty of discrimination in the area of taxation.

¹⁰² The obligation applies to taxes of every kind and description (that is, to all direct and indirect taxes) levied by, or on behalf of, the State, its political subdivisions or local authorities. OECD Model Tax Treaty Article 24(6).

¹⁰³ The 2008 OECD Commentary confirms that Article 24 cannot be interpreted to require most favoured nation and should not be unduly extended to encompass indirect discrimination, i.e. discrimination that occurs where a provision of law indirectly favours residents over non-residents.

¹⁰⁴ The 2008 OECD Commentary clarifies that discrimination can only arise when all factors are equal and the different treatment is solely based on the difference that is prohibited by the relevant provision.

The discussion begins with the non-discrimination obligations currently included in the OECD Model Tax Treaty.

(b) Non-Discrimination and the Taxation of Tax Resident but Foreign-Owned Corporations

Foreign-owned resident corporations, including those providing services, potentially benefit from three non-discrimination provisions: Article 24(1) with respect to nationality,¹⁰⁵ Article 24(5) with respect to foreign ownership and Article 24(4) with respect to the deductibility of expenses paid to non-residents.

Article 24(1) prohibits discrimination based on nationality. It is framed in the negative. Nationals of a Contracting State may not be subjected in the other Contracting State to “any taxation or any connected requirements that are other or more burdensome” than those to which nationals of the other Contracting State in the same circumstances are subjected. The practical effect of this provision is that the source state must provide a form of equal or national treatment to resident nationals including corporations but may provide tax concessions or preferences that are not available to its own nationals.

Article 24(5) addresses non-discrimination in the context of foreign ownership of resident corporations and obligates the source state not to subject such corporations to “other or more burdensome taxation requirements” than domestically owned corporations. This obligation to provide equal treatment is subject to a number of important limitations. For example, as discussed further below, differences in treatment in related party transactions are permitted to prevent foreign-owned or controlled corporations from narrowing their tax base (i.e. thin capitalization rules).¹⁰⁶ The requirement of equality at source under the OECD Model Tax Treaty is also restricted to the activities of the corporation itself. As a result, it does not apply to issues relating to a group to which the enterprise belongs. For example, it does not extend to rules that allow consolidation, the transfer of losses or the tax-free transfer of property between companies under common ownership. It also does not extend to corporate distributions. This means that distributions to resident and non-resident investors may and

¹⁰⁵ See the definition of national in the OECD Model Tax Treaty Article 3(1)(g) that includes a corporation.

¹⁰⁶ See the OECD Model Tax Treaty Articles 7(2) and 24(4).

generally are treated differently in particular respect to withholding taxes and imputation systems.

Article 24(4) prohibits the source State from discriminating against non-residents by restricting the deductibility of payments made to them. This non-discrimination obligation ensures that a foreign-owned resident corporation, for example, may deduct amounts paid to its parent corporation head office if a deduction would be available if paid to a resident in the source country. This obligation is also subject to a number of limitations that are set out in other Tax Treaty provisions, specifically the arm's length rule in Article 9(1) and the provisions in Articles 11(6) and 12(4) with respect to the deduction of interest and royalty payments where there is a special relationship between the parties.

(c) *Non-Discrimination and the Taxation of Permanent Establishments*

Services may also be provided through a permanent establishment in the host country. The non-discrimination obligation with respect to permanent establishments in the OECD Model Tax Treaty requires that the source state not “levy tax less favourably” than that levied on a domestic enterprise carrying on the same activities. This obligation does not extend to personal allowances and benefits based on civil status or family responsibilities. The OECD Commentaries also make clear that this principle of equal treatment applies only to the taxation of the permanent establishment's own activities and is restricted to a comparison between the rules governing the taxation of the permanent establishment's own activities and those applicable to similar business activities carried on by an independent resident enterprise. This means that the requirement of equal treatment does not extend to rules that take into account of the relationship between an enterprise and other enterprises, for example rules that allow consolidation, transfer of losses or tax-free transfers of property between companies under common ownership. Transfer pricing restrictions may also be applied between a permanent establishment and its head office notwithstanding that such provisions are not applicable in a domestic context.¹⁰⁷ The obligation not to levy tax less favourably also does not extend to the distribution of profits by a resident enterprise to a permanent

¹⁰⁷ See the OECD Model Tax Treaty Article 7(2). The 2010 OECD Commentary indicates that this provision forms part of the context in which Article 24 (3) must be read. Commentary to Article 24 of OECD Model Convention para. 42.

establishment.¹⁰⁸ It clearly has no application if there is no permanent establishment. This non-discrimination obligation does prevent a Contracting State from subjecting the income of the permanent establishment to different tax treatment than a resident. The OECD Commentary is clear that a difference in treatment for practical reasons is not of itself discriminatory provided it does not result in more burdensome taxation.¹⁰⁹

(d) *Non-Discrimination and the Taxation of Non-Residents (Including Foreign-Owned Enterprises)*

Based on the foregoing it is obvious that the non-discrimination rules in Article 24 of the OECD Model Tax Treaty do not forbid all forms of source-based discrimination.¹¹⁰ Much latitude is permitted based on perceived differences. For example, there is no general non-discrimination obligation that applies to non-residents, including non-resident service providers. However, like corporations, individual service providers potentially benefit directly from the non-discrimination obligations included in Article 24(1) with respect to nationality and indirectly through the non-discrimination obligation in Article 24(4) with respect to the deductibility of expenses paid to a non-resident.

In order to determine whether a tax measure in the source State is discriminatory for purposes of Article 24(1) the applicable non-discrimination principle is based on comparability. The ‘national’ of the other state must be “in the same circumstances as the national of the source State, in particular with respect to residence.”¹¹¹

¹⁰⁸ The tax treatment of profits distributed to a permanent establishment has been a matter of recent controversy, particularly when shares form part of the holdings of the permanent establishment and are effectively connected with its activity. Member States disagree about whether the special rules that exist for the taxation of dividends distributed between companies should be extended to permanent establishments in these circumstances. See 2010 OECD Commentary to Article 24 at para. 50.

¹⁰⁹ Paragraph 34 of the Commentary on Article 24 of the OECD Model Tax Treaty and paragraph 2 of the Commentary on Article 24 of the UN Model Tax Treaty quoting paragraph 34 of the Commentary on Article 24 of the OECD Model Tax Treaty.

¹¹⁰ Under the various provisions of the article, discrimination can only arise when all factors are equal and the different treatment is solely based on the difference that is prohibited by the relevant provision. Commentary to the article also clarifies that what is expressly mandated or authorized by other provisions of the Treaty cannot constitute a violation of the provisions of Article 24.

¹¹¹ This means differences in withholding taxes on dividend and interest income, for example, paid to a non-resident as compared to a resident are not considered discriminatory under the OECD or UN Model Tax Treaties. Non-resident investors are protected from discriminatory tax treatment only in so far as a maximum is set on withholding tax under other provisions in the OECD Model Tax Treaty. This more limited non-discrimination obligation is generally justified on the basis that withholding at source is necessary to ensure revenue collection. Withholding is also based on gross, not net, income. No attempt is made to rationalize gross taxation with the effective tax rates imposed on residents, a

Non-resident service providers are not viewed as being in the same circumstances as resident service providers. Therefore they cannot claim the protection of Article 24(1). Unlike enterprises with a permanent establishment in the source State they are not directly protected from discriminatory tax treatment. The only non-discrimination obligation provided under the OECD and UN Model Tax Treaties with respect to this group of non-residents operates indirectly through Article 24(4). Specifically the source State may not prohibit a deduction to its taxpayers for disbursements paid to a service provider of a treaty partner if a deduction is permitted when paid under the “same circumstances” to a resident.¹¹² Notwithstanding, a source State may impose more or different compliance requirements before permitting the deduction of payments made to non-residents.¹¹³

The application of the above noted tax treaty non-discrimination obligations to the four Modes of supplying services under the GATS can be seen in Appendix 1.

C. Non-Discrimination and Non-Resident Service Providers - The Bottom Line

According to the preamble to the GATS the vision was “to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries.” In some respects the vision was achieved. The goals of national treatment, most favoured nation treatment and transparency remain the cornerstone principles of the agreement. However tax measures were largely excepted from these trade commitments. The national treatment obligation must be accorded to the service providers of other Member States in all sectors in which commitments were made with the exception of direct tax measures aimed at ensuring the equitable or efficient imposition or collection of direct taxes. Most favoured nation treatment must be accorded to the service providers of other Member States unless the

reality that is often loosely justified based on the practical difficulties of finding an accurate comparison. This issue is discussed further in Part III.

¹¹² The OECD Model Tax Treaty Article 24(4) does not prohibit additional information requirements from being imposed with respect to payments made to non-residents, since such requirements are only intended to ensure similar levels of compliance between payments to residents and payments to non-residents.

¹¹³ Commentary to Article 24 of OECD Model Convention para.56.1.

complained of difference in tax treatment is the result of an agreement on the avoidance of double taxation.¹¹⁴ No challenge to the national treatment obligation in respect of direct tax measure is permitted under the consultation provisions in the GATS or under the dispute resolution procedures if the matter falls within the scope of a tax treaty. The result is very different non-discrimination obligations under trade agreements as compared to tax treaties.

1. Tax and Trade Agreements: Non-Discrimination Obligations Compared

The chart below provides a snapshot of the non-discrimination obligations owed to a non-resident service provider under the GATS and under the OECD and UN Model Tax Treaties in respect of direct taxes. In the case of the GATS the chart includes both the general non-discrimination obligations (national treatment¹¹⁵ and most favoured nation treatment) and the more limited non-discrimination obligations in respect of tax measures. Indirect tax measures are also subject to the GATS non-discrimination obligations.

Chart 1: Non-discrimination obligations under the GATS and OECD and UN Model Tax Treaties and their application a non-resident service provider.		
Measure under Review	GATS	OECD/ UN Model Tax Treaty

¹¹⁴ The language in Article XIV(e) is ambiguous about whether all matters that are included in an agreement for the avoidance of double taxation are exempted from the most favoured nation obligation under the GATS. For example while it is obvious that differences in withholding tax rates would fall within the exception, do differences in the imposition of indirect taxes fall within the exception if indirect taxes are included in a tax treaty? It would appear the answer to that question is yes based on the wording of the provision.

¹¹⁵ This assumes that resident and non-resident service providers are “like service providers” for purposes of the GATS. See *supra* note 60.

it applies to measures in Article XIV(d) is that the measure must not constitute “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.” Even this obligation is effectively negated if the measure falls within the scope of a tax treaty between the GATS Member States.¹¹⁷ Indirect taxes remain subject to the GATS national treatment obligation but access to the GATS consultation and dispute resolution process may be limited if the tax treaty non-discrimination provisions include indirect taxes.¹¹⁸

There is no most favoured national obligation under the OECD and UN Model Tax Treaties with respect to tax measures. The GATS requires that any differences in treatment among Member States must be the result of a tax treaty.

2. The Interaction of Tax and Trade Agreements

It is clear from the discussion thus far that the non-discrimination obligations in the OECD and UN Model Tax Treaties are significantly more limited in scope than those under the GATS and provide little or no protection to a non-resident service provider who does not take up tax residence or have a permanent establishment in the country where the income or profit is earned. This is of no surprise. It has been widely accepted that for tax purposes, and in particular tax treaty purposes, that non-residents may be treated differently than tax residents. The question is how differently and on what basis? That is the question that is being asked in this thesis and that has been under challenge for some time in the European Union.¹¹⁹

Let us take withholding tax as an example. The imposition of withholding tax on a non-resident service provider is typically justified as a way to protect the source country’s revenue base. Withholding tax ensures that the non-resident earning income in the source country cannot avoid paying applicable taxes. The use of withholding tax is further rationalized on the basis that amounts withheld are either fully credited against income taxes

modified the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member. This standard was one that many Member States hoped would apply to direct tax measures under the GATS.

¹¹⁷ Tax treaties have primacy over the GATS national treatment obligation in resolving disputes involving the taxation of services and service suppliers.

¹¹⁸ See OECD and UN Model Tax Treaties Article 24(6) and Appendix 2.

¹¹⁹ See e.g., Karin Simader, *Withholding Tax and the Fundamental Freedoms* (Kluwer Law Intl, 2013).

due or, as stated above, refunded. This in principle, it is argued, makes such withholding taxes non-distortionary. But is this true?

Reasonable people could agree that the logic used to conclude that withholding taxes are non-distortionary ignores the compliance costs associated with the imposition of withholding taxes. It also ignores the reality that withholding taxes often apply on gross rather than net income and therefore may add a significant tax cost to doing business. The end result is that a tax measure, including a withholding tax, may affect the conditions of competition and may effectively serve as a barrier to trade. It was this potential for the negative impact that tax measures could have on trade in services that was recognized in the negotiations under the GATS and has since been acknowledged in negotiating other trade agreements.¹²⁰

In the GATS, although measures aimed at ensuring the equitable or effective imposition or collection of direct tax were excepted from the national treatment obligation, a minimum non-discrimination obligation remained—that is the measure could not constitute “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.”

A preliminary consideration of the GATS exception for direct taxes against a list of common tax measures reveals that at least five broad categories of tax measures could violate this GATS national obligation if applied by a host country.

First, the domestic legislation of the host country may fall under the exception in Article XIV because the measure is arguably aimed at the effective imposition of direct taxes in respect of services or service suppliers in other Member States. Nonetheless the measure may operate as a disguised restriction on trade in services. For example, the host country may impose an excessive and arbitrary gross withholding tax.

¹²⁰ “In the context of the negotiation of the GATS, the European Energy Charter and of a draft multilateral investment on agreement, the Committee on Fiscal Affairs has done considerable work on the issue of the application of such agreements to taxation. This work has revealed that whilst there are good reasons for preventing, or at least limiting, the application of such agreements to tax measures, there is a concern that taxation may be used as a form of disguised discrimination and that the non-discrimination Article of tax treaties, in its present form, is not considered by trade or investment experts as an appropriate way to address this concern.” From the OECD, *Working Party No. 1 on Tax Conventions and Related Questions: Taxation and Non-Discrimination*, Doc No CTPA/CFA/WP1/WD (2005) 7 (2005).

Second, the domestic legislation may meet the exception in Article XIV but be administered in a manner that is a disguised restriction on trade. For example, the requirements of the source country to obtain a refund of withholding tax on amounts that are exempt under the tax treaty may be arbitrary or unduly onerous.

Third, the measure may fall outside the permitted list of exceptions in Article XIV and may not be listed as a qualification in the Member's schedule of commitments. For example, the source state could provide an additional tax credit to a tax resident that purchases services from a resident but not from a non-resident service provider.

Fourth, the measure may be a disguised tax measure in the form of a penalty, fee or charge. For example, there may be additional fees associated with non-resident filings or claims for refunds.

Finally, the measure may be in respect of indirect taxes. For example, the source country may impose different and discriminatory indirect taxes such as sales taxes, excise taxes, value added taxes-and tariffs or other similar charges on the services provided by a non-resident service provider.

Each of these measures may fall within the scope of a tax treaty. The non-discrimination articles in the OECD and UN Model Tax Treaties do not provide protection against differences in tax treatment in any of these circumstances. Further, the very existence of a tax treaty between two Contracting States effectively negates the GATS requirement that any differences based on effective enforcement and collection of direct taxes cannot be arbitrary or a disguised restriction on trade.¹²¹

One result is the potential application of different non-discrimination obligations to a non-resident service provider based on whether a tax treaty is in place between the GATS members. This is illustrated in the summary below. As can be seen, if there is a tax treaty between the Member States the non-discrimination obligations in the tax treaty will prevail. If there is no tax treaty, the GATS non-discrimination obligations and applicable exclusions

¹²¹ At present, there are also few limitations on a country's tax practices. Customary international law provides virtually no protection against tax discrimination and constitutional or national limitations on tax discrimination against non-residents are rare. The primary restraint against egregious tax practices is international goodwill or limitations imposed in integrated agreements.

apply. The other result, which follows from the above discussion, is that a non-resident service provider can anticipate that no non-discrimination obligation will apply if the income or profits are subject to a tax treaty based on the OECD or UN Model.

Summary of Applicable Non-Discrimination Obligations Under the GATS and the OECD/UN Model Tax Treaties in Respect of Non-Resident Service Providers with no Permanent Establishment:					
Agreements in Place:	GATS/ Tax Treaty	GATS	GATS Tax Treaty (no Art 24)	No GATS Tax Treaty	No GATS No Tax Treaty?
Non-Discrimination Obligation(s)	Tax Treaty *(none) other than indirect through Article 24(4)	GATS measures cannot be “arbitrary or a disguised restriction on trade”	GATS? measures cannot be “arbitrary or a disguised restriction on trade”	Tax Treaty (none) other than indirect through Article 24(1)	(none)

D. Conclusions

An examination of the GATS agreement and the OECD and UN Model Tax Treaties reveals that there are few limits on the tax measures that a country may impose on a non-resident service provider.¹²² In negotiations during the GATS it became clear that tax treaties were to assume primacy in tax matters. As seen, tax treaties provide little protection for a non-resident against discriminatory tax practices.

Is this important? What impact, if any, will the failure to provide adequate protection from discriminatory tax measures have on a non-resident service provider? As will be discussed later in this work, this question has not been the subject of extensive study. However there is significant evidence that the manner in which many countries employ their domestic law to tax income from the provision of services by a non-resident, in particular the manner in which withholding taxes are imposed, can result in a significant and unpredictable tax burden for a non-resident.¹²³

¹²² The precise scope of the non-discrimination obligations that may apply to non-residents under the GATS and with what effect at best remains unclear. See Jennifer Farrell, *The Interface of International Trade Law and Taxation*, IBFD Doctorial Series 26 (The Netherlands: IBFD Publications BV, 2013).

¹²³ See generally Part III, Chapters 6 and 7.

Appendix 1

(a) The Interaction of the GATS with the OECD Model Tax Treaty

<i>Summary of Modes of Supply in the GATS and OECD Non-Discrimination Obligations</i>		
<i>GATS MODE (1-4)</i>	<i>OECD Non-discrimination Obligation (Article 24)</i>	<i>Tax Measure Affected</i>
<p>Mode 1 – cross-border trade: from the territory of one Member into the territory of any other Member; E.G., a user in country A receives services from Country B via internet.</p>	<p>Indirect ...for the purpose of determining the taxable profits of such enterprise, amounts must be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. (Article 24(4))</p>	<p>Requires resident state to permit deduction of payment for services under same conditions as if paid to a resident.</p>
<p>Mode 2 – consumption abroad: in the territory of one Member to the service consumer of any other Member; E.G., a user in Country A travels to Country B to receive services in Country.</p>	<p>Indirect ...for the purpose of determining the taxable profits of such enterprise, amounts must be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. (Article 25(4))</p>	<p>Requires resident state to permit deduction of payment for services under same conditions as if paid to a resident.</p>
<p>Mode 3 – commercial presence: by a service supplier of one Member, through commercial presence, in the territory of any other Member.</p>	<p>Direct... The taxation on a permanent establishment of an enterprise of a Contracting State in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.</p>	<p>Tax shall not be levied less favourably. Does not oblige a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.</p>
<p>Mode 4 – presence of natural persons: by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member.</p>	<p>Direct if service provider is a tax resident ... 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.</p>	<p>There is no OECD non-discrimination obligation in respect of a non-resident service supplier without a permanent establishment in the source country.</p>
<p>Direct taxes-exception to national treatment indirect taxes?</p>	<p>Taxes of every kind and description. (Article 25(6))</p>	<p>Issue: Does Article XXII(3) of GATS exclude the national treatment obligation with respect to all taxes in favour of tax treaties?</p>

(b) The GATS-Non-Discrimination Obligations

Article II: Most-Favoured-Nation Treatment

1. With respect to any measure covered by this Agreement, 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.

Article XVII: National Treatment

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

Appendix 2

(a) Article 24 OECD Model Tax Treaty: Non-Discrimination

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. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.
2. Stateless persons who are residents of a Contracting State shall not be subjected in either 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 the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.
3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.
4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.
5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.
6. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

(b) Article 24 of the UN Model Tax Treaty: Non-Discrimination

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. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. Stateless persons who are residents of a Contracting State shall not be subjected in either 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 the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 6 of Article 12 apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of each enterprise, be deductible under the same conditions as if they had been contracted to the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

Chapter 3: Non-Discrimination Obligations in Free Trade Agreements and Bilateral Tax Treaties in Regional Trade Blocks

A. Overview

This chapter examines the non-discrimination obligations in regional trade blocks that apply to the trade in services using the North American Free Trade Agreement (NAFTA) and the bilateral tax treaties entered into by the NAFTA Parties as a primary example. Reference is also made to the ASEAN–Australia New Zealand Trade Agreement (AANZFTA) and the tax treaties entered into by the AANZTA signatories.

The Chapter begins with a discussion of the core non-discrimination obligations that apply to trade in services under the NAFTA, including the most favored nation and national treatment obligations. An examination of the provisions in the NAFTA affecting tax measures follows. These include a general carve out for all tax measures and then the selective inclusion of a small number of provisions to which the national treatment and most favoured nation obligations will apply. Like the General Agreement for Trade in Services (GATS), the NAFTA generally provides for the primacy of tax treaties in tax matters. This means that the specific provisions in the bilateral tax treaties between each of the NAFTA signatories assume considerable importance in determining the tax treatment of a non-resident service provider as well as any applicable non-discrimination obligation.¹²⁴ As will be seen the existence of a tax treaty between the NAFTA Parties also serves to limit the most favoured nation and national treatment obligations with respect to tax measures that would otherwise apply under the NAFTA and the GATS.

There are seven major objectives for this chapter. The first is to underline the trade obligations that operate to protect non-resident service providers in areas other than taxation under these regional trade agreements. The second is to point out that both the NAFTA and the AANZFTA severely limit trade obligations and in particular the most favoured nation and national treatment obligations with respect to tax measures. The third is to draw attention to the differences in tax treatment that a service provider in a small regional trade block like the

¹²⁴ It will also determine host country's right to tax the income or profits of the non-resident service provider.

NAFTA can anticipate when providing services in the NAFTA Block because there are few national treatment or most favoured nation obligation with respect to tax measures. The fourth is to emphasize how differences in the tax treatment of services under each tax treaty may result in differences in the non-discrimination obligations that apply under the tax treaty.¹²⁵ The fifth is to draw attention to the differing non-discrimination obligations that apply to each of the NAFTA Parties in respect of the tax treatment of non-residents based on the interface between the applicable tax treaty and the GATS. The sixth objective is to establish how the ambiguous language employed in the NAFTA in respect of the tax carve out for tax treaties creates potential for conflict in interpreting and applying the NAFTA in a tax dispute. The final objective is to make clear that the interaction of tax and trade agreements in the NAFTA Block and in the AANZFTA Block results in the inconsistent and uncertain application of non-discrimination obligations to tax measures and that for the most part there is no non-discrimination obligation owed to a non-resident service provider.

B. The North American Free Trade Agreement

1. Overview

The NAFTA came into effect on January 1, 1994, with respect to Canada, the US and Mexico. Its objectives, “as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency”, include the elimination of barriers to trade in, and the facilitation of the cross-border movement of, goods and services between the territories of the Parties and the promotion of conditions of fair competition in the free trade area.¹²⁶

As signatories to the WTO Agreement, Canada, the US and Mexico agreed to honor all of their obligations under the GATS, but also assumed additional obligations under the NAFTA to their NAFTA partners.¹²⁷

¹²⁵ This issue is explored more fully in Chapter 6.

¹²⁶ See the NAFTA Article 102.

¹²⁷ See the NAFTA Article 103 (Relation to Other Agreements), where the NAFTA explicitly provides that in case of inconsistency with other agreements, unless otherwise specified in the NAFTA, the NAFTA will override other agreements that existed at the time the NAFTA became effective. The WTO Agreement became effective after the NAFTA. In the final analysis the choice of forum rules determines which of the WTO or NAFTA rules apply.

Chapter 12 (Cross-Border Trade in Services) of the NAFTA establishes basic rules agreed to by Canada, the US and Mexico for regulating the provision of services across their respective borders. The Agreement calls for national treatment and most favoured nation treatment, and prohibits local presence requirements.¹²⁸ The NAFTA exceeds the GATS both in scope and coverage, bringing all existing and future government measures relating to cross-border, non-financial services within the scope of Chapter 12.¹²⁹ Thus unlike the GATS, where specific commitments to national treatment must be negotiated, the NAFTA operates in reverse and requires each party to state explicitly – in various annexes – if it does not intend to conform to the general rules in Chapter 12 with respect to most favoured nation, national treatment and other NAFTA obligations.¹³⁰

The principal provisions relating to the cross-border provision of service are contained in five chapters: cross-border trade in services,¹³¹ telecommunications and financial services,¹³² investment¹³³ and temporary entry for businesspeople.¹³⁴ Three annexes compliment these chapters, specifically land transportation,¹³⁵ professional services¹³⁶ and specific reservations and exceptions.¹³⁷

¹²⁸ The NAFTA prohibition against requiring service providers to establish a presence (such as an office) within the territory of a NAFTA Party as a condition of market access eliminated many of the regulatory measures that cross-border service suppliers were formerly subject to when a local office was required.

¹²⁹ Notwithstanding the limitations on the services protected, the general provisions of the GATS reflect the overall *General Agreement on Tariffs and Trade*, 30 October 1947, 58 UNTS 187, CAN TS 1947 No 27 (entered into force 1 January 1948) [hereinafter the GATT] philosophy, thus the GATS contains a number of measures not found in the services provisions in the NAFTA. For example, the GATS contains a safeguard limitation on services imports under a balance of the payments crisis (GATS Article XII). Government procurement of services is also exempted from the most favored nation, national treatment and market access provisions (GATS Article XII). Finally, the Agreement commits Members to “enter into negotiations with a view to developing the necessary multilateral disciplines” to avoid the trade distortive effects of subsidies on trade in services.

¹³⁰ These exceptions are provided in lieu of grandfather provisions. Annex 1 of the NAFTA contains the three countries reservations schedules for their non-conforming federal measures. See the NAFTA Article 1206(a)(i). Laws and regulations that are grandfathered or listed as a reservation in Annex 1 cannot be challenged as long as they do not become more inconsistent with the Agreement.

¹³¹ The NAFTA Chapter 12.

¹³² The NAFTA Chapters 13 and 14.

¹³³ The NAFTA Chapter 11.

¹³⁴ The NAFTA Chapter 16. To facilitate access to other signatory countries, the NAFTA establishes the principle that business persons of one country who fall in any one of four categories – business visitors, traders and investors, intra-company transferees, and professionals – will be granted temporary entry into the territory of the other countries. See The NAFTA Annex 1603.

¹³⁵ The NAFTA Annex 1212.

¹³⁶ The NAFTA Annex 1210.5.

¹³⁷ The NAFTA Annex 2106 (exempting Canadian Cultural Industries).

Under the NAFTA the cross-border provision of a service is defined as providing a service: from the territory of one Party into the territory of another Party (e.g., cross-border), in the territory of one Party by a person of that Party to a person of another Party (e.g., tourism) and by a national of a Party in the territory of another Party (e.g., an on site visit to the service recipient by a non resident service provider.¹³⁸ Unlike the GATS, which includes in the definition of the supply of a service, services provided by a service supplier of one Member through a commercial presence in the other, the NAFTA addresses this mode of supply through the investment provisions in Chapter 11 (Investment). A number of obligations from the Trade in Services Chapter are cross-referenced to the Investment Chapter.

The NAFTA requires that Parties accord to service providers of other Parties the better of national treatment and most favoured nation treatment.¹³⁹ Under the national treatment obligation, each Party is obligated to treat service providers no less favorably than it treats its own service providers.¹⁴⁰ States and provinces are also obligated to provide no less favorable treatment than the most favorable treatment that the sub-national accords to the service providers of the country which it forms a part.¹⁴¹ The most favoured nation obligation ensures that service providers of other NAFTA Parties in its territory may be treated no less favorably than service providers of any other country in similar circumstances.

Overall, the NAFTA is designed to significantly liberalize the trade in services by providing for common licensing rules,¹⁴² transparency provisions,¹⁴³ dispute resolution procedures¹⁴⁴ and an ongoing commitment to automatically include new services. The Agreement however, does not generally affect the respective income tax laws of each country or affect a country's sovereign right to tax profits earned by non-residents within its borders. Thus, although many non-tariff barriers may be reduced or eliminated under the NAFTA, the basic NAFTA principles of national treatment and most favoured nation treatment do not, for the most part,

¹³⁸ See the definition of “cross-border provision of a service” in NAFTA Article 1213.

¹³⁹ The NAFTA Article 1204.

¹⁴⁰ The NAFTA Article 1202.

¹⁴¹ The NAFTA Article 1202(2).

¹⁴² The NAFTA Parties are also committed to encourage professional bodies to develop mutually acceptable standards for licensing professionals and reciprocal recognition of each other's professional accreditations. This was an important step in eliminating a significant non-tariff barrier to free trade in services. Unfortunately there is no time limit on this process under the NAFTA, although some progress has been made with respect to the engineering profession and foreign legal consultants. See The NAFTA Annex 1210.5(1). The NAFTA also require the Parties to fairly review and answer applications by the NAFTA party nationals for professional licensing.

¹⁴³ The NAFTA Articles 1207 and 1209.

¹⁴⁴ The NAFTA Article 2003.

apply to the domestic tax measures of the NAFTA Parties. As will be discussed, the prima facie exclusion of national tax rules from the NAFTA has important implications in the tax treatment of cross-border service providers in the NAFTA Block and in particular for the non-discrimination obligations that apply.

2. Taxation Measures

(i) *Overview*

Although it may not generally discipline direct tax matters, the NAFTA specifically addresses signatory obligations in respect of both direct and indirect taxation measures.¹⁴⁵ The principal provisions that relate to taxation are contained in Article 2103 (Taxation), which begins by announcing that nothing in the NAFTA will apply to any tax measure except as specifically provided for in Article 2103(1).

The first matter to be clarified in the NAFTA is the status of tax treaties entered into by the NAFTA signatories. In general, these are to have priority in all cases including any inconsistencies with the NAFTA.¹⁴⁶ This is made clear in the very specific language in the NAFTA which provides “Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.” As a result, the NAFTA, like the GATS, anticipates that disputes about tax matters covered by a tax treaty will be resolved exclusively under the applicable tax treaty provisions.¹⁴⁷

There are two exceptions to the primacy of tax treaties in tax matters specifically listed in the NAFTA. The first is with respect to the national treatment obligation as it relates to the trade in goods. The national treatment obligation, as proscribed in Article III of the General Agreement on Tariffs and Trade (GATT), will have primacy over lesser obligations assumed

¹⁴⁵ Taxation measure is a term that is given a broad interpretation under the NAFTA. Article 2017 defines it by exclusion and indicates that it does not include customs duties and related measures.

¹⁴⁶ The NAFTA Article 2103(2).

¹⁴⁷ It has been suggested that in the case of parallel rights and obligations under a Canada-US Tax Treaty and the NAFTA, only the Canada-US Tax Treaty’s procedural provisions with respect to such rights and obligations shall be used. See Canada Gazette Part 1, January 1, 1994 at 214.

under a tax treaty.¹⁴⁸ The second is with respect to export taxes; specifically the provisions of Article 314 (National Treatment and Market Access for Goods), which allows Mexico to impose an export tax on basic foodstuffs, and Article 604 (Export Taxes), which addresses the imposition of export taxes on energy in defined circumstances. These exceptions may be of little practical effect, as such matters are not normally addressed in a tax treaty. In addition, Article 2103(6) provides that Article 1110 (Expropriation) shall apply to taxation measures subject to certain procedural rules.¹⁴⁹

Article 2103 of NAFTA includes three other areas where the NAFTA may apply to tax measures: income and capital tax measures that relate to the purchase or consumption of cross-border services or financial services, other taxes affecting services and investments, and tax measures linked to performance requirements. These provisions are discussed below.

(ii) Services

Discrimination against the use direct tax measures including taxes on income and capital that may impact trade in cross-border in services or financial services, is provided to a limited extent by the national treatment obligation. Article 2103(4)(a) provides that, subject to any applicable tax treaty, the national treatment clause “shall apply to all taxation measures on income, capital gains, or the taxable capital of corporations, and to ...[the asset tax under the Asset Tax Law of Mexico], to the extent that those taxes relate to the purchase or consumption of particular services from a service provider.”¹⁵⁰ Note that this national treatment obligation does not apply to the tax treatment of the service provider, but rather to

¹⁴⁸ See e.g., the GATT at subparagraph 3(a) provides that Article 301 applies to taxation measures to the same extent that Article III of the GATT would apply and therefore allows access to the NAFTA dispute settlement procedures in alleging discrimination with respect to imported goods.

¹⁴⁹ The NAFTA Article 2103(6) states that the expropriation provisions of Article 1110 apply to taxation measures. A taxation measure alleged to be expropriatory must be referred by the investor to the appropriate competent authorities under the relevant tax convention at the same time that it gives notice under Article 1119. If such competent authorities determine that the measure is not an expropriation, the Article 1110 cannot be invoked by the investor as the basis for a claim under Articles 1116 or 1117. However, the investor may submit its claim to arbitration if the component authorities do not agree to consider the issue or cannot agree that the measure is not an expropriation within a six-month period commencing at the time of referral to the competent authorities.

¹⁵⁰ Specifically, in relation to direct taxes, the NAFTA Article 2103(4)(a) provides that certain direct tax measures listed therein (taxes on income, capital gains or the taxable capital of corporations and the Mexican asset tax) are but for listed limitations, subject to the national treatment obligation with respect to the cross-border provision of services, including financial services. However, with regard to financial services subparagraph 4(a) applies only to the cross-border provision of a financial service under the NAFTA Article 1405(3).

tax measures that relate to the purchase or consumption of services. This provision would presumably prevent, for example, a NAFTA country's income tax law from allowing for the deduction of consulting services purchased from a domestic consulting firm but not from firms in other NAFTA countries.¹⁵¹

In contrast, and subject to a tax treaty, a non-resident service provider must be accorded national treatment and most favoured nation treatment with respect to indirect taxation measures. Specifically, Article 2103(4)(b) clarifies that the national treatment and most favoured nation treatment provisions in the investment, cross-border trade in services and financial services chapters apply to all taxation measures other than those on income, capital gains, capital, estates, gifts, inheritances and generation-skipping transfers. This means that the national treatment and most favoured nation obligations apply to excise tax, sales tax and, in Canada's case, the Goods & Services Tax¹⁵² (GST) to the extent that such taxes apply to a non-resident service provider.

Although Article 2103(4) of the NAFTA may initially appear broad in scope, any direct or indirect tax measures that are subject to non-discrimination obligations under the NAFTA are limited by a number of important exceptions.¹⁵³

The first relates to tax treaty partners. As stated, any applicable tax treaty would appear to override the national treatment obligation under the NAFTA.¹⁵⁴ Further, obligations assumed under the most favoured nation provisions in the NAFTA do not prevent the government of a NAFTA Party from providing an exclusive bilateral advantage under a tax treaty to a specific treaty partner.¹⁵⁵

¹⁵¹ See the *North American Free Trade Agreement Implementation Act American Statement of Administrative Action* (US) Final Draft September 1993 c 21.3. A non-discrimination obligation is also provided under Article 24(4) of the OECD Model Tax Treaty in respect to the deductibility of expenses paid to a non-resident.

¹⁵² See the *Convention between Canada and the United States of America with respect to Taxes on Income and on Capital*, 26 September 1980 Can TS 1984 No 15 (entered into force 16 August 1984) [hereinafter the Canada-US Tax Treaty]. Article XXV(5) of Canada-US Tax Treaty extends the non-discrimination provisions to federal sales and excise tax, including in the case of Canada, the GST. This would give the Canada-US Tax Treaty priority in a dispute related to the imposition of such federal taxes.

¹⁵³ The NAFTA Article 2103(4)(c-h).

¹⁵⁴ The NAFTA Article 2103(2) and Article 2103(4)(a). This issue is discussed further below.

¹⁵⁵ See The NAFTA Article 2103(4)(c). But see the Canada-US Tax Treaty which negates this in part by providing for most favored nation treatment for corporations under Canada-US Tax Treaty Article XXV(5).

Second, the NAFTA provisions do not apply to any taxation measures in existence at the time that NAFTA went into effect (January 1, 1994),¹⁵⁶ or to the renewal or any amendment of a tax measure that does not decrease its conformity. This will allow existing tax measures to remain in place indefinitely even if they are inconsistent with the national treatment or most favoured nation obligations in the NAFTA with respect to cross-border services and investments.

Third, similar to the GATS, a widely drafted exclusion clause has been added for “any new tax measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the parties or arbitrarily nullify or impair benefits accorded under those articles.”¹⁵⁷ Thus, withholding taxes and measures that may be adopted by a Party that are directed at tax avoidance or abuse and levied by that Party will be considered to be taxation measures imposed in accordance with the exception described above.¹⁵⁸ The application of this exception is discussed further in Chapter 8 in the context of the United States new Foreign Account Tax Compliance Act (FACTA) regime.¹⁵⁹

(a) Performance Requirements

The two remaining NAFTA tax measures described in Article 2103 of the NAFTA are found in Chapter 11 – the investment chapter – and relate to performance requirements that are linked to taxation measures. These provisions will apply if the non-resident service supplier establishes a commercial presence in a NAFTA partner country. Chapter 11 contains prohibitions that prevent NAFTA Party governments from imposing certain conditions on the “establishment, acquisition, expansion, management, conduct, operation or sale” of an investment of an investor of a Party or of a non-Party in its territory. Article 1106(1) prohibits seven different types of practices¹⁶⁰ as a requirement of operating in the particular market

¹⁵⁶ The NAFTA Article 2103(4)(c).

¹⁵⁷ The NAFTA Article 2103(4)(g).

¹⁵⁸ Such measures would include, for example, provisions relating to the proper characterization of payments between related parties and provisions for the determination of income and expenses in transactions between related parties.

¹⁵⁹ *Foreign Account Tax Compliance Act*, 26 USC (2010) Pub L No 111-147.

¹⁶⁰ See the NAFTA Article 2103(5). The prohibited performance requirements are summarized in the NAFTA Implementation Act *supra* note 151, at 141 which states “Under Article 1106 [of the NAFTA], a government may not, as a condition for the establishment or operation of an investment, require a firm to: limit its sales in the domestic market by conditioning such sales on exports or foreign exchange earnings; buy or use components from a local supplier or accord a preference to domestic goods or

including: achieving a given level or percentage of domestic content, purchasing, using or according a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory. Article 1106(1) also establishes a general prohibition on all requirements, commitments or undertakings upon an investor to use goods or services provided in its territory.¹⁶¹ Thus government actions that commit an investor to use local goods or services constitute a clear violation of the NAFTA.

In addition to the general prohibition on performance requirements established in Article 1106(1), the NAFTA contains a special reference to prohibitions on performance requirements made in connection with the conferral of benefits by a government. Such benefits would include subsidies, financing assistance and tax concessions. Specifically, NAFTA Article 1106(3) provides that “No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:

- (a) to achieve a given level or percentage of domestic content;
- (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
- (c) to relate in any way the volume or value of imports to the volume or value of exports, or goods and services while Article 1106(3) only applies to goods; or
- (d) to restrict sales of goods or services in its territory by relating such sales to the volume or value of its exports or foreign exchange earnings.”

Article 2103(5) has incorporated these performance prohibitions into the NAFTA tax provisions. It provides that subject to an applicable tax treaty, the prohibitions shall also apply to tax measures. As a result a government is prohibited from tying a tax advantage, such as a tax holiday or exemption, “to the purchase of locally produced goods or the manufacture of goods with a certain level of domestic content.”

services; achieve a minimum level of “domestic content”; limit its imports to a certain percentage of exports or foreign exchange inflows associated with the investment; transfer technology to any domestic entity, except to remedy an alleged violation of competition law; export a specified level of goods or services; or supply designated regional or world markets solely from its local production.”

¹⁶¹ The NAFTA Article 1106(1)(c).

Notwithstanding, Article 1106(4) provides that a Party is not prohibited from “conditioning an advantage, in connection with an investment in its territory of an investor, or compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities or carry out research and development in its territory.” Thus a Party may condition the receipt of a tax advantage on the performance of services in its territory. It follows that a NAFTA Party may also condition the receipt or continued receipt of a tax benefit in connection with the purchase of services on the requirement that the service be provided in its territory.¹⁶²

These may prove important exceptions in the obligation to provide national treatment to non-resident service providers. In particular, these exceptions may be significant when one considers, for example, the tax advantages currently available in Canada and no doubt many other countries with respect to investment tax credits, including scientific research and experimental development tax credits.¹⁶³ These tax credits are generally much more generous when the services are provided within the country.

In summary, tax treaties have primacy under the NAFTA including, based on very specific wording in the NAFTA, in the case of any inconsistency with the NAFTA. However the limited national treatment obligations under the NAFTA with respect to direct tax measures and the national treatment and most favoured nation obligations with respect to indirect tax measures will apply if the tax treaty does not apply. For example, none of the provisions of tax treaties between Canada and the other NAFTA Parties include taxes imposed by states, provinces, or local authorities.¹⁶⁴ Thus despite a tax treaty between Canada and another NAFTA Party, an income tax imposed by a province of Canada (or a state of the US or of Mexico) that affects the purchase or consumption of services would be subject to the national treatment obligation under NAFTA, assuming the tax was not permitted under an exception such as a “grandfather clause”¹⁶⁵ or allowed as a new measure to ensure the “equitable and effective imposition or collection of taxes.”¹⁶⁶

¹⁶² For a discussion of this issue, see NAFTA Article 1103(6) and Barry Appleton, *Navigating NAFTA: A Concise User's Guide to the North American Free Trade Agreement* (Scarborough: Carswell, 1994) at p 83-85.

¹⁶³ *Income Tax Act*, RSC 1985, c 1 (5th Supp) as amended (“ITA”) ss 127(5)-(35) [hereinafter the ITA].

¹⁶⁴ In contrast, taxes imposed by political subdivisions or local authorities under the US-Mexico Tax Treaty are subject to the non-discrimination Article in the tax Treaty. See Article 25.

¹⁶⁵ The NAFTA Article 2103(4)(c).

¹⁶⁶ The NAFTA Article 2103(4)(g), or otherwise exempted under the other exclusions in subparagraphs 2104(3)(3)-(f).

A more difficult question is whether the non-discrimination obligations in the NAFTA apply if the matter relates to a federal tax measure but there is no non-discrimination obligation in the applicable tax treaty. As will be discussed, the non-discrimination article in a typical tax treaty does not address many aspects of potential discrimination against non-resident service providers. Consider a Party's grant of additional tax relief or a tax credit to consumers of domestic but not foreign (non-resident) services contrary to NAFTA Article 2103(4). To the extent that this difference in tax treatment is not addressed by a non-discrimination provision in a tax treaty, is it subject to scrutiny under the national treatment obligation in the NAFTA? It would appear the answer to that question may be yes.¹⁶⁷

C. The NAFTA and the Tax Treaties between the NAFTA Parties

1. Overview

Like the GATS, discipline over the taxation of non-resident service providers has, for the most part, been carved out of the most favoured nation and national treatment protections provided under the NAFTA, and is regulated by bilateral tax treaties. It follows that the three tax treaties entered into between Canada and the US, the US and Mexico and Canada and Mexico respectively assume considerable importance both in the tax treatment of non-resident service providers by the NAFTA partners in the NAFTA Block and in the applicable non-discrimination obligations.

The discussion below provides a brief overview and comparison of three of the specific tax treaty articles that potentially impact the tax treatment of a non-resident service provider, details of the tax treaty non-discrimination obligations, and the limits that each tax treaty imposes on dispute resolution alternatives.

The discussion is meant to be illustrative of the potential impact of regional trade agreements and tax treaties on the non-discrimination obligations that impact a non-resident service

¹⁶⁷ At issue will be whether the absence of a non-discrimination obligation under the applicable Tax Treaty provides the complete answer to the question of whether national treatment is required under the NAFTA. See Example 2 in part B and the discussion *infra* note 243. Recall that Article 2103(2) of the NAFTA provides that nothing in the NAFTA “shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency...the convention shall prevail.” Can this be interpreted to mean that additional non-discrimination obligations cannot be presumed for the parties other than those contained in a tax convention if a tax convention is in place.

provider from within a trade block when providing services in the trade block. The NAFTA provides an excellent example, as it is a small trade block consisting of three countries. Notwithstanding extensive commitments made by each country to provide most favoured nation treatment and national treatment and to each other's service providers, these obligations do not extend to tax matters. The following material describes the potential results.

First, as a consequence of the exclusion of the most favoured nation obligation from direct tax measures, a non-resident service provider may receive very different tax treatment than a NAFTA counterpart when providing services to another NAFTA Party. This difference in tax treatment is generally the result of a tax treaty, but need not be.¹⁶⁸ The discussion is intended to point out the differences in tax treatment that result from bilateral tax treaties. It is included as part of the broader question of whether the most favoured nation obligation should apply to tax measures. As will be discussed, there are good reasons for excluding the most favoured nation obligation from direct tax measures in trade agreements given that tax treaties are negotiated bilaterally. There may also be good reasons to include the most favoured nation obligation in the tax treaties in a small regional trade block like the NAFTA, in particular with respect to the imposition of indirect tax measures.¹⁶⁹

Second, as a consequence of the general exclusion of the national treatment obligation for tax measures from the NAFTA, the tax treaties between the NAFTA Parties will play a critical role in determining what non-discrimination obligations apply to a non-resident service provider from another NAFTA Party. As will be seen, these tax treaty obligations are very limited and, as a result of the ambiguous language used in Article 2106(2) of the NAFTA may negate the national treatment obligations under the NAFTA.

Because each of the NAFTA Parties are also signatories to the WTO agreement, non-discrimination obligations may also arise under the GATS. Of particular note is the potential for derogation from the national treatment obligation for direct tax measures under the GATS

¹⁶⁸ The difference in tax treatment of a NAFTA Party may also result under the domestic law of a NAFTA Party, although this does not appear to be a frequent occurrence.

¹⁶⁹ Indirect taxes are subject to the most favoured nation obligation under the NAFTA. The inclusion of this obligation in the tax treaties in the NAFTA Block would clarify the primacy of the tax treaty in resolving any dispute about an indirect tax measure.

as a result of language used in the non-discrimination article in the applicable tax treaty. This may result in differences in the applicable non-discrimination obligation.

2. The NAFTA Tax Treaties

Each of the NAFTA Parties has entered into bilateral treaties with its NAFTA partners. The timing of the negotiation or, in the case of Canada and the US, the renegotiation of these tax treaties was doubtless not coincidental. Mexico entered a bilateral tax treaty with both Canada (Canada-Mexico Tax Treaty)¹⁷⁰ and the US (US-Mexico Tax Treaty)¹⁷¹ almost concurrently with the signing of NAFTA. Changes were also made to the Canada-US Tax Treaty¹⁷² to accommodate the NAFTA in the form of a third protocol.¹⁷³ Subsequently a fourth and fifth protocol were signed between Canada and the US.¹⁷⁴ The Canada-Mexico Tax Treaty was replaced by a new treaty in 2006¹⁷⁵ and a second protocol was entered into in the US-Mexico Treaty in 2002. These tax treaties, like the majority of tax treaties entered globally, are based on the Model Tax Treaty prepared by the OECD. Both the Canada and

¹⁷⁰ The *Convention between the Government of Canada and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 8 April 1991, Can TS 1992 No 15 (entered into force 11 May 1992) [hereafter the Canada-Mexico Tax Treaty]. Like the Canada-US Treaty, it is generally patterned on the OECD Model Tax Treaty; however, in recognition of Mexico's status as a developing country, it also borrows from the UN Model Tax Treaty. The UN Model Tax Treaty was designed to recognize and counter the fundamental imbalance in investment flow between itself and its more developed treaty partner. This treaty is currently under renegotiation.

¹⁷¹ *Convention Between the Government of The United States Of America And the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 18 September 1992, Treaty Doc. No. 103-7, 103d Cong., 1st Sess, (entered into force 1 January 1994) [hereinafter the US-Mexico Tax Treaty]. A second protocol was signed on November 26, 2002. The US-Mexico Tax Treaty also draws from the OECD Model Treaty and the UN Model Treaty. Thus although it follows the same general pattern as the Canada-US Tax Treaty, like the Canada-Mexico Tax Treaty, there are some significant differences in recognition of Mexico's developing country status.

¹⁷² The current version of the Canada-US Tax Treaty was negotiated on the basis of the OECD Model Tax Treaty. The Treaty was signed in 1980 and has been the subject of four subsequent protocols, the latest being signed in July of 1997. The third protocol, signed in March of 1995 includes a number of changes that appear to be in direct response to the NAFTA Agreement. The Convention deviates from both the OECD and UN Model Treaty in a number of respects in order to take into account, and to allow for the interaction with, the particular features of Canadian law, the unique economic relationship of Canada and the United States, and the existing Convention.

¹⁷³ *Ibid. Protocol Amending the 1980 Tax Convention with the United States*, SC 1995, c 34. (Royal Assent: 8 November 1995).

¹⁷⁴ 1997 Protocol enacted in Canada by SC 1997, c 38 (Royal Assent: 10 December 1997); 2007 Protocol enacted in Canada by SC 2007, c 32, (Royal Assent: 14 December 2007).

¹⁷⁵ Enacted in Canada by SC 2006, c 8, Part 2 (Royal Assent: 12 December 2006), (Entered into force April 12, 2007).

US tax treaties with Mexico also borrow from the UN Model Tax Treaty.¹⁷⁶ Notwithstanding these commonalities, all three NAFTA tax treaties vary to some extent to reflect the differences in tax systems and policy objectives of the two countries concerned and their relative strengths and weaknesses.

3. Applicable Treaty Provisions

As discussed in Chapter 2, tax treaties are designed to avoid double taxation by allocating the right to tax income or gains between the Contracting States.

Assuming the income generated in the other Contracting State is from the provision of services, the business profits article and the independent and dependent personal services articles in the NAFTA tax treaties are the main treaty articles that govern the tax treatment of services performed by non-residents. If payment is with respect to specific services, such as those provided by directors or senior managers, government service,¹⁷⁷ artists and athletes¹⁷⁸ or affects students or apprentices,¹⁷⁹ reference must be made to those treaty articles if they form part of the applicable treaty.

(i) *Articles 7 and 14: Business Income and Independent Personal Services*

Article 14 of the OECD Model Tax Treaty governed the taxation of independent personal service until it was removed from the Model in 2000 and the provision for services subsumed under the business profits article.¹⁸⁰ Article 14 provided that a resident of a Contracting State

¹⁷⁶ UN, *Convention Between (State A) and (State B) for Avoidance of Double Taxation with Respect to Taxes on Income [and on Capital]* (1980). A revised draft was adopted on May 7, 1999 and was finalized on January 11, 2001: UN DESA, *Model Double Taxation Convention between Developed and Developing Countries*, (New York: 2011) [hereinafter the UN Model Treaty]. Generally, Mexico preferred to follow the OECD Model Treaty, a model designed to establish a bilateral relationship between two developed or highly industrialized countries, in negotiations.

¹⁷⁷ See e.g., The Mexico-Canada Tax Treaty Article 19.

¹⁷⁸ The Mexico-Canada Treaty Article 17.

¹⁷⁹ The Mexico-Canada Treaty Article 20.

¹⁸⁰ Under the OECD Model Tax Treaty Article 14 (Independent Personal Services) was deleted from the Convention on April 29, 2000, on the basis of the report OECD, *Issues Related to Article 14 of the OECD Model Tax Convention*, Issues in International Taxation, No 7 (2000) which was adopted by the Committee on Fiscal Affairs on January 27, 2000. According to the Commentary there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. It was also thought it was unclear which activities fell within Article 14 as opposed to Article 7. The result of the deletion of Article 14 is that income derived from

who received payment for independent personal services performed in the other Contracting state would not be taxable in that other state unless the income was earned through a fixed base located in that state.

Article 14 was also removed from the Canada-Mexico Tax Treaty when the second Treaty was signed in 2006, and from the Canada-US Tax Treaty in the Fifth Protocol effective 2010.¹⁸¹ A version of Article 14 remains in the US-Mexico Tax Treaty. Its application, as well as the new provisions in the business profits article is outlined below.

Article 14(1) remains in the US-Mexico Treaty and expands the circumstances under which the source country may tax the income earned by an independent service provider in the other Contracting State to include a time test in addition to the fixed base test.¹⁸² Specifically, an individual who is a resident of one Contracting State who derives income from the performance of independent personal services in the other State will avoid host country taxation only if the resident does not have a fixed place of business in the other Contracting State which is regularly made use of¹⁸³ in the course of performing activities, or is not present in the other Contracting State for a period or periods aggregating 183 days or more in any twelve month period. If the non-resident service provider is liable to taxation in the source state under Article 14, the source state may tax ‘income’ attributable to the fixed base or to the activities performed.¹⁸⁴ Note that ‘profits’, rather than income is used in Article 7 if the payment is considered to be in respect of business activities.

professional services on other activities of an independent character is now governed by Article 7 as business profits under the OECD Model Tax Treaty. See discussion in Chapter 2 at 2.1.

¹⁸¹ The *Protocol Amending the Convention Between Canada and the United States of America With Respect to Taxes on Income and on Capital Done at Washington on 26 September 1980, as Amended by the Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997*, 21 September 2007 (hereinafter the Fifth Protocol). The United States ratified the Fifth Protocol on September 23, 2008. Notwithstanding the Treaty exemption, an American individual may be subject to Canadian withholding tax. Regulation 105(1) of the ITA, *supra* note 163, requires a withholding of 15 percent from payments made to non-resident persons in respect of services rendered in Canada other than in the course of regular and continuous employment. See generally Kristen A Parillo, “U.S., Canadian Officials Sign Treaty Protocol,” *Worldwide Tax Daily*, (24 September 2007); *Long-Awaited Protocol to Canada-U.S. Canada-U.S. Treaty Provides Significant Benefits*, 4 December, 2007, reprinted in 1 *Tax Treaties (CCH) 1947*; James P Fuller, “Canada-U.S. Protocol” (2007) 48 *Tax Notes International* 491.

¹⁸² This was in response to the decision in *The Queen v. Dudney*, 2000 DTC 6169 (FCA) 253. In that case an American spent extensive periods in Canada providing services but was not taxable as there was no time test in the Canada-US Tax Treaty that would create liability in the absence of a fixed base.

¹⁸³ In contrast, the Mexico-Canada Tax Treaty language is “unless he has a fixed base regularly available to him in the other Contracting State.”

¹⁸⁴ In accordance with the principles of Article 7 (Business Profits), the tax base is net of expenses incurred in earning the income. In the *Treasury Department Technical Explanation of the Convention*

The Canada-Mexico Tax Treaty

In contrast to the US-Mexico Treaty independent personal services are subject to the business profits article and permanent establishment rules under the Canada-Mexico Tax Treaty.

Generally, the business profits article provides that income is taxable by the country in which the non-resident is providing services only if the non-resident service provider is carrying on a business in the host country through a permanent establishment.¹⁸⁵ If so, the non-resident service provider may be taxed by the host country, but only to the extent the profits are attributable to the permanent establishment.¹⁸⁶

The Canada-Mexico Tax Treaty generally follows the OECD Model Tax Treaty and defines a “permanent establishment” as “a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on.” The term specifically includes a place of management, a branch, an office, a factory, a workshop, a mine, oil or gas well, a quarry, or any other place of extraction of natural resources. A building site or construction or installation project that continues for a period of more than six months is also considered a permanent establishment.¹⁸⁷ Like the OECD Model Tax Treaty, a permanent establishment

And Protocol Between The Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 18 September 1992 (general effective date under Article 29: 1 January 1994) [hereinafter the US- Mexico Treaty Treasury Technical Explanation] explains that the Protocol extends Article 14 of the US-Mexico Tax Treaty to income derived by a resident US company furnishing personal services through a fixed base in Mexico. In such a case, the company may compute the tax on the income from such services on a net basis as if that income were attributable to a permanent establishment in Mexico. In the converse case, the United States will apply Article 7 (Business Profits) directly. As, under Mexican tax law, a personal service company is not considered to earn business profits, such income must be taxed under Article 14. In Mexican law, there is a rebuttable presumption that when services are paid for by a resident of Mexico and were partly performed in Mexico, the entire payment is for services performed in Mexico. The taxpayer has the burden of proving that part of the services were performed outside of Mexico.

¹⁸⁵ See the Canada-US Tax Treaty Article VII(1).

¹⁸⁶ The Canada-Mexico Tax Treaty Article VII(1). In determining the business profits of a permanent establishment, the article allows deductions for expenses incurred for purposes of the permanent establishment, including executive and general administrative expenses incurred within or without the host country in which the permanent establishment is located. However, neither Canada nor the United States is required to allow a deduction for any expenditure that is not generally allowed as a deduction under the tax laws of that country.

¹⁸⁷ See the Canada-Mexico Tax Treaty Article V(3). This is a temporal threshold found in the UN Model Tax Treaty. The use of a drilling rig or ship in the other Contracting State for a period of more than three months in any twelve-month period to explore for or exploit natural resources falls within the definition of a permanent establishment. The Canada-Mexico Tax Treaty Article V(4). The term “permanent establishment” does not include a fixed place of business used solely for, or a person engaged in, one or more of the following specified activities: the use of facilities for the purpose of storage, display or delivery of goods belonging to the resident whose business is carried on; the

may also exist if a non-resident has a person acting in the host country on its behalf, if such person has, and habitually exercises, the authority to conclude contracts in the name of the non-resident. A non-resident will not be deemed to have a permanent establishment merely because the non-resident carries on business in the host country “through a broker, general commission agent or any other agent of an independent status, provided that such person [is] acting in the ordinary course of business.”¹⁸⁸

The permanent establishment article in the Canada-Mexico Tax Treaty also includes the optional wording contained in the OECD Model Tax Treaty for service permanent establishment. Thus a permanent establishment is also created through the furnishing of professional services or other activities of an independent nature by an individual service provider within a Contracting State if the service provider is present in the territory of such Contracting State for a period or periods exceeding in the aggregate 183 days within any twelve month period.¹⁸⁹ In addition, the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, will create a permanent establishment if the activities continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve month period.¹⁹⁰

The Canada-US Tax Treaty

The Fifth Protocol to the Canada-US Tax Treaty also eliminated the independent personal services article from the Treaty and introduced a similar provision to the permanent establishment article with respect to non-resident service providers.¹⁹¹ Under the new provision, an enterprise providing services in the host country is deemed to have a permanent

maintenance of a stock of goods belonging to the resident for the purpose of storage, display or delivery; the maintenance of a stock of goods belonging to the resident for the purpose of processing by another person; the purchase of goods, or the collection of information, for the resident; or advertising, the supply of information, scientific research or similar activities which have a preparatory or auxiliary character The Canada-Mexico Tax Treaty Article V(6).

¹⁸⁸ The Canada-Mexico Tax Treaty at Article V (7). The mere fact that a non-resident controls or is controlled by a company which is a resident of the host country, or carries on business in the host country, whether or not through a permanent establishment, will not, in and of itself, result in either company being a permanent establishment. The Canada-Mexico Treaty at Article V(8).

¹⁸⁹ The Canada-Mexico Treaty Article 7 (c).

¹⁹⁰ Canada-Mexico Tax Treaty at Article 7(b). For the purposes of computing the time limits the activities carried on by an enterprise associated with another enterprise within the meaning of Article 9 shall be aggregated with the period during which the activities are carried on by the associated enterprise, if the activities of both enterprises are identical or substantially similar. Canada-Mexico Treaty Article 7 (c).

¹⁹¹ The Canada-US Tax Treaty Article V(9), amended by Article 3(2) of the Fifth Protocol.

establishment in that country if it meets one of two thresholds. First, a permanent establishment is deemed to exist if services are performed in the host country by an individual who is present there for a period aggregating 183 days or more in any twelve month period and, during that period, more than fifty percent of the gross active business revenues of the enterprise consists of income derived from the services performed in the host country.¹⁹² Second, a permanent establishment is deemed to exist if the services are provided in the host country for a period aggregating 183 days or more in any twelve month period and are provided with respect to the same or a connected project for customers who are either residents of the other country or maintain a permanent establishment in the other country and the services are provided in respect of that permanent establishment.¹⁹³ Thus, a non-resident service provider in the host country providing independent personal services who satisfies one of the thresholds is deemed to have a permanent establishment in the host country and is therefore subject to tax by the host country on the business profits attributable to the permanent establishment. The permanent establishment is deemed to exist even though the non-resident service provider does not have a fixed place of business or a dependent agent with authority to contract in the host country.¹⁹⁴

What is the practical effect of these differences under the Canada-US Tax Treaty as compared to the other tax treaties in the NAFTA Block? Under the national laws of all three countries in the NAFTA Block, income generated by a non-resident service provider within that countries borders is potentially subject to host country taxation. As will be discussed in Example 1 later in this Chapter, non-resident service providers in the NAFTA Block will find themselves liable for host country taxation under very different circumstances than their non-resident NAFTA counterparts as a result of the operation of the specific tax treaty. For example, under the Canada-Mexico Tax Treaty, assuming the service provider has no

¹⁹² *Ibid.*

¹⁹³ In judicial proceedings, the Canadian tax authorities were unsuccessful in taxing a US consultant and US engineer providing services in Canada for extended periods of time on the basis that the non-residents did not have a permanent establishment in Canada. See, e.g., *The Queen v Dudney supra* note 182, and *Wolf v The Queen*, [2002] 3CTC 3 (FCA). Also see Brian J Arnold, “The New Services Permanent Establishment Rule in the Canada-U.S. Treaty Protocol” (2008) 51:2 Tax Notes International 189 for an analysis of the amended definition of permanent establishment by the Firth Protocol.

¹⁹⁴ Canada-US Tax Treaty, Article V(9), amended by Article 3(2) of the Fifth Protocol. The Fifth Protocol deletes Article XIV (Independent Personal Services) of the Canada-US Tax Treaty. Under the Independent Personal Services Article, generally, compensation for personal services performed by a self-employed, non-resident alien in the host country was taxed by that country, if the individual has or had a fixed base in the host country, but only to the extent the compensation is attributable to the fixed base. Thus, income from independent personal services was treated similarly to business profits under Article VII (Business Profits).

permanent establishment in the host country, host country liability is based a simple time test: 183 days. If the non-resident service provider is present in the other Contracting State for more than 183 days the tax treaty exemption no longer applies. In contrast, under the Canada-US Tax Treaty both a time test and a gross profits test must be met before a host county may exercise its domestic right to tax.

Non-resident service providers may also find themselves subject to tax on a very different basis. As discussed, a US service provider, if liable to tax in Mexico, the tax liability is based on income under the independent personal services article and not profits as would be the case under the other tax treaties in the NAFTA Block that treat income from independent personal services as business profits.

One feature that each of the tax treaties do share in common is the lack of a non-discrimination principle assuming the non-resident service provider does not have a permanent establishment in the source State. The tax treatment of a non-resident service provider will be based entirely on domestic law and administrative practice in the source State or any applicable trade agreement.

(ii) Article 15: Dependent Personal Services¹⁹⁵ (Income from Employment)

Employees may also provide services cross-border. Assuming the services fall within the dependent personal service article (in contrast to, for example, Article 16 (Directors) or Article 17 (Artist and Sportsmen), the following treaty provisions apply.

The Canada –US Tax Treaty

Generally, the income of an employee will remain taxable in their country of residence unless the services are performed in the other country.¹⁹⁶ Even when the employment is exercised in

¹⁹⁵ Before 2000, the title of Article 15 of the OECD Model Tax Treaty referred to “Dependent Personal Services” in contrast to Article 14, “Independent Personal Services”. As a result of the elimination of Article 14 in the OECD Model Tax Treaty, Article 15 was changed to “employment” – a term thought to more commonly describe the activities to which the Article applies.

¹⁹⁶ The Canada-US Tax Treaty Article 15. These exemptions do not apply to public entertainers (such as theatre, motion picture, radio or television artists, musicians or athletes) who derive more than US \$15,000 in gross receipts for activities in the US in a calendar year (Article 16).

the other country,¹⁹⁷ the right to tax remains with the country of residence provided that: (1) the employee earns less than \$10,000 or (2) the employee is present in the other country less than, in the aggregate, 183 days in that year,¹⁹⁸ and the remuneration is paid by or on behalf of an employer who is not a resident of the other country, and is not borne by a permanent establishment or a fixed base that the employer has in the other country.¹⁹⁹

If one hires a Canadian employee, Article 15 will result in US taxation only when the employee is present in the US for periods exceeding 183 days out of the year, or where the employment is exercised in the US and the remuneration is “borne by”²⁰⁰ an employer who is a resident of the US, or by a permanent establishment or fixed base which the employer has in the US and payment exceeds US \$10,000.

A complete exemption from taxation in the other Contracting State is also provided in respect of an employment regularly exercised in more than one state on a ship, aircraft, motor vehicle or train operated by a resident of the other Contracting State.²⁰¹

¹⁹⁷ According to the OECD Commentary, “employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid.” OECD Commentary on Article 15 paragraph 1 (added 23 October, 1997). This is so regardless of whether the results of the work are exploited in the other State.

¹⁹⁸ The wording of The Canada-US Tax Treaty Article 15 closely complies with the OECD Model Tax Treaty. Article 15 used to refer to a presence in the other contracting state “for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned.” The change, to add the words “in the year,” is intended to eliminate differences in tax treatment that were based solely on the carefully planned timing of the employee’s arrival. For example, under the former wording an employee could straddle two fiscal terms and remain for periods in excess of 183 days, and still avoid host country taxation. Under the new wording, this form of planning according to the OECD Commentaries will no longer be possible. The commentaries also assist in calculation of the 183-day period. It is the OECD’s position that any day of physical presence in the host country, including days of departure and arrival, sick days, and holidays should be included in the computation. The changes to the Article were the result of a 1984 report entitled Organization for Economic Co-operation and Development, “Taxation Issues Relating to the International Hiring Out of Labour.” Adopted by the OECD Council 24 August 1984, published in *Trends In International Taxation* (Paris: OECD, 1985).

¹⁹⁹ The Canada-US Tax Treaty Article 15.

²⁰⁰ The US view is that “borne by” in this context means the wages or salary are deductible by the US entity. Thus if a Canadian employed at the Canadian permanent establishment of a US based company performs services in the US and receives more than US \$10,000, that income is not exempt from US tax. If a foreign employer pays the salary of an employee, but the host country or a permanent establishment reimburses the foreign employer and deducts the expense, the conditions of (b) or (c), as the case may be, will not have been met. See the US Treasury Department, *Technical Explanation of the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital* (signed 26 September 1980, Washington D.C) as amended [hereinafter the Canada-US Tax Treaty Technical Explanation]. The Canadian view, although similar, extends the notion of “borne by” an employer to include a determination of who directs the employee on a day-to-day basis rather than simply who pays the employee’s salary.

²⁰¹ Canada-US Tax Treaty Article 15(3).

The US-Mexico Tax Treaty and the Canada-Mexico Tax Treaty

Both the US-Mexico and Canada-Mexico Tax Treaties follow the basic provisions of the OECD Model Tax Treaty. Pursuant to Article 15(1), salaries, wages, and other similar remuneration are generally taxable only in the State of residence. However, as is the case with the Canada-US Tax Treaty, if the employment is exercised in the other Contracting State, such remuneration may be taxed in that other State if certain conditions are met. Specifically, under the US-Mexico Tax Treaty, if a taxpayer seeks to remain taxable solely in the country of residence (1) the recipient cannot be present in the other State for a period or periods exceeding 183 days in a twelve month period; (2) the remuneration cannot be paid by, or on behalf of, an employer who is a resident of the other State; and (3) the remuneration cannot be borne by a permanent establishment or fixed base which the employer has in the other State.

Thus a US resident who works in Mexico but is paid by a US company with no permanent establishment in Mexico will not be taxable in Mexico unless the time limit of 183 days is exceeded. A Mexican employee working in Canada for less than 183 days, in contrast, will be taxable in Canada under the Canada-Mexico Tax Treaty once the remuneration earned exceeds \$16,000 Canadian dollars (or its equivalent in Mexican pesos).²⁰² Mexican employees will also be taxable in Canada if their stay exceeds 183 days in any twelve-month period commencing or ending in the calendar year concerned or if the wages or salaries are borne by an employer in Canada, or by a permanent establishment that the employer has in Canada.

If one examines the potential mobility of employees under the three treaties it becomes apparent that the most restrictive provisions apply to Americans or Mexicans working in the other's country. Host country taxation begins at 0 dollars earned and sourced (paid or borne by) in the host country. In the case of the Canada-Mexico Tax Treaty host country taxation begins at \$16,000 Canadian dollars or the equivalent in pesos if the income is sourced in Mexico. The Canada-US Tax Treaty is slightly less generous, in exempting income at source, imposing host country tax on employment income earned and sourced in the other country

²⁰² The Canada-US Tax Treaty Article 15 goes on to add “or such amount as may be specified and agreed in letters exchanged between the competent authorities of the Contracting States.”

beginning at \$10,000 Canadian dollars assuming the income is earned in Canada, or \$10,000 US if the income is sourced in the US.

(iii) Article 24: Non-Discrimination

Each of the tax treaties currently in force in the NAFTA Block also impose non-discrimination obligations on the source State.²⁰³ These vary widely both with respect to what obligations have been assumed and who they have been assumed by. The non-discrimination obligations found in the tax treaties are also much narrower than the non-discrimination obligations in trade agreements in the case of a non-resident.

The Canada-US Tax Treaty

The non-discrimination obligations in the Canada-US Treaty generally follow the OECD. Article 25(1) establishes a prohibition against discrimination against nationals of the US or Canada who are resident in the other's country.²⁰⁴ Specifically, nationals of one Contracting State cannot be subjected to taxation in the other Contracting State or any requirement connected therewith that is "more burdensome than the taxation and connected requirements to which citizens of that other State in the same circumstances²⁰⁵ are or may be subjected."²⁰⁶ As well, individual citizens cannot be subjected to taxation requirements that are more burdensome than those imposed on similarly situated citizens of any third State. Any benefit available to a citizen in a third State that has a tax treaty with Canada would also be available to a citizen living in that Contracting State.²⁰⁷ Thus, a Canadian citizen residing in Mexico, but earning income in the US, could avail themselves of any tax treaty benefits available to a Mexican citizen living in Mexico and earning income in the US. Special provisions are also included to deal with married individuals and with dependent deductions.²⁰⁸

²⁰³ Canada-US Tax Treaty; See the Article 25 Canada-Mexico Tax Treaty Article 22 and the US-Mexico Tax Treaty Article 25.

²⁰⁴ Note that the provision does not prohibit discrimination against non-residents. The prohibited discrimination is discrimination based on nationality.

²⁰⁵ Article 25(1) deviates in two ways from the OECD Model Tax Treaty. First it eliminates the words "other or" from the article. The prohibited behaviour is thus taxation that is simply more burdensome. Second, instead of referring to in the same circumstances, particularly with respect to residence, this treaty states refers to being in the same circumstances "particularly with respect to world-wide income." This reflects the fact that the US also taxes on the basis of citizenship.

²⁰⁶ Canada-US Tax Treaty Article 25(1).

²⁰⁷ Canada-US Tax Treaty Article 25(2).

²⁰⁸ Canada-US Tax Treaty Articles 25(3) and (4).

In the case of business enterprises, limited protection against tax discrimination is provided. Specifically, tax on a permanent establishment located in the other Contracting State cannot be less favorably levied than the taxation levied on residents of the other State carrying on the same activities.²⁰⁹ There is also an obligation to provide a deduction for interest, royalties and other disbursements paid by an enterprise of one State to a resident of the other; such amounts should be deductible in calculating taxable profits under the same conditions as those paid to a resident of the same State.²¹⁰

In the case of a resident but foreign controlled corporation, Article 25(4) of the Canada-US Tax Treaty provides only most favoured nation treatment with respect to taxation and related requirements.²¹¹

A somewhat unusual provision in Article 25(8) of the Canada-US Tax Treaty also allows for the deduction of convention or meeting expenses if the function is to be held in the other Contracting State. This provision was apparently considered necessary due to a prohibition in US domestic law to the deduction of convention expenses where the event is held outside the country.²¹²

Despite Article II of the Canada-US Tax Treaty, which limits the taxes covered in the case of Canada to taxes imposed under the *Income Tax Act*, Article 25(9) of the tax treaty extends the obligation of non-discrimination to “all taxes imposed by a Contracting State.” This would include, in the case of Canada, the GST, but not provincial or local taxes. To the extent that such provincial or local taxes are considered contrary to trade obligations, including national treatment or most favoured nation obligations, resort to the NAFTA or the WTO procedures would presumably be available.

²⁰⁹ See the Canada-US Tax Treaty Article 25(5). Notwithstanding this general obligation, there is no obligation to provide national treatment with respect to personal allowances or reliefs on account of civil or family matters on dividend treatment.

²¹⁰ Canada-US Tax Treaty Articles 25(7).

²¹¹ See the Canada-US Tax Treaty Article 25(4). This non-discrimination provision is not as broad as that normally sought by the US, or as contained in the OECD Model Tax Treaty as it provides most favored nation treatment, but not national treatment to foreign controlled corporations. The most obvious example of the limitations of the article is the small business tax credit that is available under the Canadian ITA exclusively to Canadian controlled private corporations, and is therefore unavailable to US subsidiaries. A number of other important tax concessions are also available only to Canadian taxpayers. The Canada-US Tax Treaty also provides only most favored nation treatment to citizens of one State that are not resident in the other. As previously discussed, all discrimination matters falling within the scope of the Canada-US Tax Treaty must be resolved under the Treaty.

²¹² See the Canada-US Tax Treaty Technical Explanation at Article 25 (8). This prohibition has since been relaxed in favour of conventions held in North America.

The US-Mexico and the Canada-Mexico Tax Treaties

Both the Canadian and US tax treaties with Mexico provide that nationals of a Contracting State may not be subjected in the other Contracting State to any taxation or connected requirements that are other or more burdensome than the taxation or connected requirements to which the nationals in the other State in the same circumstances are subjected.²¹³ The income of business enterprises is also subject to a non-discrimination obligation. Under both tax treaties, taxation cannot be less favorably levied by the source State on a permanent establishment of a resident of the other Contracting State, than the taxation levied on residents of the other State carrying on the same activities:

Despite the commonalities among the three NAFTA Tax Treaties there are also significant differences. For example, unlike the non-discrimination obligation in the Canada-US Tax and Canada-Mexico Tax Treaties that apply only to the Contracting States, the non-discrimination obligation in the US-Mexico Tax Treaty extends to all taxes imposed by a Contracting State, political subdivision or local authority. As will be discussed, a 2003 Protocol to the US-Mexico Tax Treaty also further limits any non-discrimination obligation with respect to tax measures with an express proviso in the treaty that “the provisions of any other agreement shall not apply to a taxation measure unless the competent authorities agree that the measure is not within the scope of Article 25 (Non-Discrimination) of this Convention.”²¹⁴

Other differences in the non-discrimination provisions in the tax treaties in force between the signatories in the NAFTA Block include the tax treatment of a corporation resident in one Contracting State but controlled by nationals of another. For example, unlike the Canada-US Tax Treaty, Article 25(5) of the US-Mexico Tax Treaty requires that a Contracting State not impose other or more burdensome taxation or connected requirements on a company that is a resident of that State but that is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State. Thus, in contrast to the Canada-US or Canada-Mexico Tax Treaties, a form of national treatment rather than most favoured nation treatment is provided to foreign corporations resident in the other Contracting State.

²¹³ Neither Contracting State is required to provide to a resident of the other Contracting State the same personal exemptions and deductions that it provides to its own residents to take account of marital status or family responsibilities.

²¹⁴ Article 1(3)(b) of the Second Additional Protocol that modifies the US-Mexico Tax Treaty, *supra* note 171.

In summary, the non-discrimination article in the US-Mexico Tax Treaty is much broader in scope than the non-discrimination Article in the Canada-US Tax Treaty and the Mexico-Canada Tax Treaty with respect to the persons who impose the tax. The US-Mexico Tax Treaty will therefore have primacy in a broader range of circumstances. One result of this will be that recourse to both the NAFTA and the WTO dispute resolution procedures will be more limited under the US-Mexico Treaty than under either of the other treaties.

The following provides a summary of the taxes covered in the non-discrimination articles in each of the NAFTA tax treaties.

	<i>Canada-US</i>	<i>Canada-Mexico</i>	<i>US-Mexico</i>
<i>Taxes Covered</i>	Taxes on income and capital – Gov’t of Canada the <i>Income Tax Act</i> – US federal income taxes under Internal Revenue Code (1986)	Taxes on income – Gov’t of Canada: the <i>Income Tax Act</i> – Mexico income tax under income tax law	Taxes on income – Mexico-Income tax under Income Tax Law – US taxes under the Internal Revenue Code
<i>Non-Discrimination</i>	Covers all taxes imposed by a Contracting State. Although GST covered by tax treaty NAFTA, Article 2103 (3) overrides (2) and NAFTA applies to goods.	Applies to all taxes imposed by a Contracting State Until 2006: Covered taxes that are “subject” to the Treaty	Applies to all taxes imposed by a Contracting State, political subdivision or local authority. Second Protocol, Nov. 2002 states that interpretation issues are to be decided under the competent authority procedure in the tax treaty.

4. Non-Discrimination, Taxation Measures and Treaty Interpretation

As discussed, discipline over taxation measures was for the most part carved out of both the NAFTA and the GATS. This was largely at the insistence of the United States, whose negotiators wanted such matters dealt with under the more 'diplomatic,' competent authority

procedure under its bilateral tax treaties.²¹⁵ This preference is clearly reflected in the language of the US tax treaties in the NAFTA Block.

For example, in the case of the Canada-US Tax Treaty, the tax treaty itself addresses the potential role of the WTO in resolving tax matters. Specifically, the Third Protocol amended Article 29 of the tax treaty to include new provisions for purposes of the application of Article XXII (3) of the GATS. The amendment provides that for the purposes of GATS, Canada and the US agree that a tax measure will fall under the tax treaty if it relates to Article 25 (Non-Discrimination) or, if it does not relate to non-discrimination, it falls within another tax treaty provision, but only to the extent that the measure relates to a matter dealt with in that tax treaty provision.²¹⁶ The tax treaty also clarifies that notwithstanding Article XXII of the GATS, any doubt as to the interpretation of the scope of a treaty provision, and specifically whether the tax treaty applies, will be resolved under the mutual agreement procedure of the tax treaty.²¹⁷

In the case of the US-Mexico Tax Treaty, a Second Protocol was signed on November 26, 2002²¹⁸ to further clarify the primacy of the tax treaty; this Protocol is very explicit and far-reaching. The Protocol provides that no other agreement to which the US and Mexico are parties shall apply with respect to taxation measures unless the competent authorities agree that the measure is not within the scope of the non-discrimination provisions of Article 25 of

²¹⁵ All of the tax treaties signed among the NAFTA countries contain a provision establishing a Mutual Agreement Procedure for resolving treaty disputes. This procedure is the umbrella for a number of important aspects of taxpayer relief. For example, under the Mutual Agreement Procedure, if a taxpayer believes the actions of one or both of the Contracting States will result in taxation not in accordance with the provisions of the treaty, the taxpayer may present the case in writing to the Competent Authority of the State in which the taxpayer is a resident or national. If relief appears to be justified and the contracting state of residency cannot arrive at a satisfactory solution, the Competent Authorities of both contracting states will attempt to resolve the case by mutual agreement. In addition to attempting to resolve disputes arising as to the interpretation or application of a provision in a Canada-US Tax Treaty, the Competent Authorities of the contracting states may consult together regarding disputes not provided in the various Conventions. The Mutual Agreement Procedures of the Canada-US Tax Treaty and the US-Mexico Tax Treaty also contain binding arbitration provisions if a dispute cannot be resolved.

²¹⁶ See the Canada-US Tax Treaty Article 29 at para 6. This clarification of the role of the tax treaty was considered necessary, notwithstanding that the Protocol was grandfathered under the GATS provisions, as the Third Protocol also extends the non-discrimination article of the Treaty to “all taxes imposed by either contracting state.” Apparently, the negotiators wanted to ensure that these new taxes (including the GST) would be subject to the Tax Treaty dispute resolution mechanism. The amendment to Article XXIX of the Canada-US Tax Treaty to limit the role of the WTO was of no surprise given the very strong position taken by the US during the Uruguay Round.

²¹⁷ Canada-US Tax Treaty Article 29.

²¹⁸ *Supra* note 171. Article 1, para 3(b).

the US-Mexico Treaty.²¹⁹ Accordingly, absent agreement by both the competent authority of Mexico and the United States, no national treatment obligation undertaken by the Contracting States in any other agreement shall apply to that taxation measure.²²⁰

The first Canada-Mexico Tax Treaty was in existence prior to the entry into force of the GATS. In consequence, although the Canada-Mexico Tax Treaty was silent about the role of the GATS, according to the GATS understanding, the non-discrimination article in that tax treaty would have primacy over the GATS national treatment obligations. As well, the Parties would be subject to the GATS requirement that both parties must consent to have the issue of the treaties scope settled by the Council for Trade in Services.²²¹ The second Canada-Mexico Treaty, which entered into force in 2007, now specifically includes this latter requirement in Article 23(4).

None of the tax treaties between the signatories of the NAFTA Block expressly refer to the role of the NAFTA. However, a fairly comprehensive interpretation of Article 2103 of the NAFTA which addresses tax measures was provided by the House Ways & Means Committee and the Senate Finance Committee in their report to Congress. This report was incorporated into the Congressional Record in November of 1993.²²² The Committee interprets the provisions as follows:

Related to Article 2103(2),

- 1) “The Committee understands that, in the case of parallel rights and obligations under a tax convention and NAFTA, only the tax convention’s procedural provisions with

²¹⁹ A “measure” is defined broadly to include a law, regulation, rule, procedure, decision, administrative action, or any other form of governmental action or guidance. *Ibid.*

²²⁰ Read literally, this would provide paramountcy to the Canada-US Tax Treaty over the NAFTA obligations in Article 2103(3) with respect to taxation measures affecting the national treatment obligation and goods, as well as certain excise taxes. The NAFTA is clear that it has paramountcy over any tax convention in these circumstances. Notwithstanding, the treaty protocol purports the converse. One explanation for this apparent inconsistency is that the obligations under NAFTA Article 2103(3) relate primarily to goods while the obligations under the Canada-US Tax Treaty relate to citizens, nationals and business enterprises. It does not necessarily follow, however, that a tax measure will not fall under both sets of obligations. According to the Canada-US Tax Treaty Technical Explanation *supra* note 77, any question arising as to the interpretation or application of the tax treaty, and in particular whether a taxation measure is within the scope of the treaty, shall be resolved exclusively in accordance with the provisions of the Mutual Agreement Procedure in the treaty.

²²¹ The GATS, Article XXII(3).

²²² See Congressional Record 139 Cong. Rec S16092-01, 1993 WL 478653.

respect to such rights and obligations shall be used and, thus, the tax convention, subject to certain provisions and understandings [...] shall prevail.

- 2) “The Committee understands that rights or obligations in respect of a tax must be addressed by the terms of the tax convention if the tax convention is to prevail over NAFTA in accordance with paragraph 2.”
- 3) “Under the terms of tax conventions between NAFTA countries, the competent authorities of the Parties are to resolve by mutual agreement any difficulties or uncertainty with respect to the interpretation or application of the tax conventions. Therefore, the Committee understands that the competent authorities designated by the terms of the tax conventions shall determine whether the tax convention is to prevail over NAFTA in accordance with paragraph 2.”

Further,

- 4) “The Committee understands that, with respect to rights and obligations not subject to a tax convention, those rights and obligations may be subject to the NAFTA to the extent provided for in Article 2103. For example, the provisions of a tax convention requiring non-discriminatory treatment may not address certain aspects of discrimination against foreign service providers resulting from a Party’s grant of tax relief or reduction in income tax to consumers of that service. To the extent that such discrimination is not addressed in a tax convention, such discrimination may be subject to the provisions of NAFTA to the extent provided for in paragraph 4, which imposes certain national treatment and most-favoured nation requirements on taxation measures in certain cases.” [Emphasis added.]

It would appear that the US Senate Finance Committee is of the view that the NAFTA could be interpreted to allow for the challenge of a taxation measure that violates a NAFTA obligation if the alleged discriminatory measure is not specifically dealt with by a provision of a tax treaty. Put differently the US Senate Finance Committee did not interpret Article 2103(2) as precluding a challenge under the NAFTA merely because a tax treaty was in place.

If a dispute occurs with respect to a taxation measure in circumstances in which both the WTO Agreement and the NAFTA may apply, the NAFTA sets out the choice of forum rules for resolving the dispute.²²³ In general the choice is up to the complaining party.²²⁴

5. Potential Tax Discrimination: Some Examples

The following provides examples of differences in the tax treatment of service providers who provide services within the NAFTA Block. In particular it considers permitted differences in tax treatment based on the carve out for tax measures from the most favoured nation and national treatment obligation under the NAFTA and the rights and obligations assumed in each of the tax treaties.

(i) *Most Favoured Nation Treatment*

Example 1: Independent Personal Services

George Simpson is a Canadian telecommunications engineer specializing in train radio systems. He currently has a number of clients (both Canadian and American) but his major clients' remains B&B Railroad and O&Y Railroad. Both are putting out a bid for a new radio system for their trains. The successful bidder will be required to remain in the US for approximately 6-8 months to complete the jobs, primarily completing installations on railroad trains. Manuel Perez is also a telecommunications engineer, trained at MIT but now living in his hometown of Guadalajara, Mexico. Both George and Manuel are interested in the job. At issue is whether they will be liable for US tax. If so, the applicable US tax rate will be fatal to

²²³ The NAFTA Article 2005.

²²⁴ However, dispute settlement proceedings initiated under the NAFTA or the WTO Agreement precludes the initiation of proceedings under the other forum. The ability to choose the forum for dispute resolution clearly provides an advantage to the complaining party, who will obviously choose a forum with rules most favorable to the success of its case. The United States, for example, pursued its case against Canadian policies in respect of periodicals (the "Sports Illustrated" dispute) through the WTO rather than NAFTA because, unlike NAFTA, the WTO Agreement does not contain an exception for cultural matters. Conversely, Canada, which had little success in avoiding the imposition of countervailing and dumping duties for softwood lumber under the NAFTA, chose to argue its case before the WTO where it could rely on the GATT Subsidies Code rather than US domestic law for a finding of whether there was in fact a subsidy. Given that the parties in the NAFTA block have assumed more extensive obligations with respect to the cross-border trade in services under NAFTA, it is likely that it will more often be the preferred forum for dispute resolution. If the dispute relates to a tax matter, reference must be made to the applicable Canada-US Tax Treaty, as both the GATS and the NAFTA specify that bilateral tax treaties take precedence in all but very limited exceptions with respect to matters covered in the applicable Canada-US Tax Treaty.

the competitiveness of their bid. George should be able to avoid US tax liability. Manuel will not. The reasons are as follows.

George will be subject to US tax if he has a permanent establishment in the US and then to the extent of the profits attributable to that permanent establishment. George will be deemed to have a permanent establishment in the US if he performs services in the US, is present there for a period aggregating 183 days or more in any 12-month period and, during that period, more than fifty percent of his gross active business revenues consists of income derived from the services performed in the US.²²⁵ George will also be deemed to have a permanent establishment in the United States if the services are provided in the US for a period aggregating 183 days or more in any twelve-month period and are provided with respect to the same or a connected project for customers who are either residents of the other country or maintain a permanent establishment in the other country and the services are provided in respect of that permanent establishment.

However, even if George remains in the US for more than 183 days to complete the work, he will not be subject to US tax unless more than fifty percent of his gross active business revenue consists of income derived from the US. George also has a Canadian client base. To the extent that he is able to generate sufficient revenue from this Canadian base he will avoid US tax liability. George will also avoid being caught under the second deeming rule notwithstanding his stay in the US of more than 183 days because the services are not being provided with respect to the same or a connected project; they are being supplied to different customers.

Manuel will not fare as well. Under the independent personal services Article in the US-Mexico Treaty, Manuel will become subject to US tax liability once he remains in the US for 183 days. Has the US violated its most favoured nation obligation to Manuel under the GATS or the NAFTA? The answer is no. There is no most favoured nation obligation under the NAFTA and such differences in tax treatment are considered totally acceptable under the GATS provided they are the result of a tax treaty.

²²⁵ Canada-US Tax Treaty Article 7.

The above example provides a factual and obvious illustration of how differences in tax treatment are permitted in the NAFTA Block, despite most favoured nation obligations assumed under a trade agreement. There is no cause for complaint under any of the tax treaties or trade agreements that currently operate in the NAFTA block.

Sometimes the answer to the questions “Has tax discrimination occurred?” and if so, “Does the tax treaty apply?” are not as obvious. Consider the following two examples, which are purely hypothetical and relate to the national treatment obligation.

(ii) National Treatment

Example 2: Goods and Services Tax (GST)

An additional GST surcharge of 1% is introduced by the Government of Canada that will apply to any services provided by a non-resident if their gross income from the provision of services in Canada exceeded CDN \$70,000 in the prior year. Dianna, a US resident providing consulting services in Canada is advised that she is obliged to collect and remit this additional tax. Has the national treatment obligation under the NAFTA been violated? Although the GST surcharge prima facie violates the national treatment obligation found in NAFTA Article 2103(4)(b), the answer is unclear.

The national treatment obligation under the NAFTA²²⁶ (and the GATS if applicable)²²⁷ prohibits governments from using sales taxes, excise taxes and value added taxes (VAT) to discriminate against cross-border service providers or, in the case of the NAFTA, their investments. In the ordinary case this would include a tax like the GST. However, a literal interpretation of the NAFTA carve-out for tax measures results in the Canada-US Tax Treaty selectively overriding in the national treatment obligation. Article 2103(2) of the NAFTA provides that nothing in the NAFTA “shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency...the convention shall prevail.” The non-discrimination article in that tax treaty applies to all taxes imposed by a Contracting State. Dianna, is a non-resident and in these circumstances has no rights under the tax treaty.

²²⁶ The NAFTA Article 2102.

²²⁷ The GATS Article XVII. Assuming a commitment has been by the country in that sector in their Schedule of Commitments.

Further, Canada owes no obligation of non-discrimination to her. To find a right or an obligation under the NAFTA would thus be inconsistent with the tax treaty.

On the other hand, one might adopt the logic of the US Finance Committee, who opined that “with respect to rights and obligations not subject to a tax convention, those rights and obligations may be subject to the NAFTA to the extent provided for in Article 2103.”²²⁸ If one accepts this view, this GST measure, in addition to being offensive in tax policy terms, would be contrary to the national treatment obligation under the NAFTA.

Is there a remedy for Dianna’s plight under the GATS? Likely not. At issue will be the meaning of the words in the Third Protocol to the Canada-US Tax Treaty, which provides that for the purposes of the GATS, Canada and the US agree that a measure will fall under the tax treaty if it relates to Article 25 (Non-Discrimination). This matter relates to Article 25 which applies to all taxes imposed by the Government of Canada. The obligation to provide national treatment and thus the protection against discrimination is simply not provided. The argument against a successful claim under the GATS is further reinforced by the wording of Article XXII (3) of the GATS. It provides that a Member may not invoke the national treatment article with respect to “a measure of another Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation.” As the matter of non-discrimination and indirect taxation is addressed in Article 25 of the tax treaty, the wording of Article XXII(3) of the GATS would appear to preclude a complaint. At issue will be how Article XXII(3) is interpreted, and in particular, what is considered to fall within the scope of a tax treaty.

In summary, notwithstanding that Article 2 of the Canada-US Tax Treaty restricts the application of the tax treaty provisions to taxes covered under the *Income Tax Act* in the case of Canada, and the *Internal Revenue Code* of 1986 in the case of the US, (and certain other identified taxes), the scope of the non-discrimination article in the tax treaty is crafted to be considerably broader. If read literally, and in conjunction with Article XXII(3) of GATS, it would appear that any dispute about any direct or indirect tax measures affecting trade in services that are imposed by the US or Canada must be resolved under the tax treaty.

²²⁸ See discussion in Chapter 2.A.

A careful examination of each of the bilateral tax treaties signed by the NAFTA signatories is required to determine precisely what obligations are assumed under the tax treaty and how these relate to the obligations assumed by the particular country under the NAFTA and the GATS. The answer to both questions is preliminary to a determination of whether discrimination has occurred and, if so, what potential remedy is available. Consider the following two examples.

Example 3: Provincial / State Tax Measures

The Province of Alberta will not permit a deduction in calculating taxable income for Alberta tax purposes for amounts paid to non-residents (but not residents) of Canada that exceeds \$100,000 per annum. An Alberta client denies a US engineer, earning income of excess of \$100,000 in Calgary, Alberta further work. The US government seeks to challenge the Alberta tax measure tax as being in violation of the national treatment obligation under Article 2104(4)(b) of the NAFTA. Is the dispute resolution procedure under the NAFTA the appropriate dispute resolution forum? The answer is yes.

The non-discrimination article in the Canada-US Tax Treaty applies only to tax levied by the Government of Canada. Provincial tax measures are not covered by the tax treaty, except for the limited purpose of defining the scope of the obligation of the other Contracting State to provide relief from double taxation.²²⁹ Thus, a dispute about a discriminatory provincial income tax measure can be brought under the NAFTA. Whether or not a claim can be made under the WTO dispute resolution procedures will depend on the specific commitments and exemptions claimed by Canada in its schedule to the GATS.²³⁰

The same is true if the engineer were from Mexico. The Canada-Mexico Tax Treaty applies only to taxes imposed by the Government of Canada and not to taxes imposed by the provinces. Thus the Mexican government can also challenge the tax as being in violation of the national treatment obligation under the NAFTA.

However, it would appear that the measure could not be challenged under the NAFTA if the deduction was denied to a Mexican service provider and the non-discrimination article of the

²²⁹ Canada-US Tax Treaty Article 27(7).

²³⁰ See discussion in Chapter 2.A.1.

US-Mexico Tax Treaty applied. This conclusion follows from the wording of the US-Mexico Tax Treaty, which states that it applies to all taxes, imposed by a Contracting State, political subdivision or local authority. As a result, it would appear that any dispute about a California measure that affects non-resident fees earned in California must be resolved through the competent authority procedure under the US-Mexico Tax Treaty.²³¹

6. Non-Discrimination Obligations: The NAFTA and the GATS Compared

Because the Parties to the NAFTA are also signatories to the WTO Agreement, the non-discrimination obligations included in the NAFTA are of relevance only if they operate to expand the non-discrimination obligations that apply to non-residents under the GATS. If not, the NAFTA Parties may continue to rely on the non-discrimination obligations in the GATS.²³²

(i) Most Favoured Nation Treatment

Recall that under the GATS, the non-resident service providers of other Members must be accorded most favoured nation with respect to all tax measures, subject to a tax treaty, but that the measure must not be arbitrary or a disguised restriction on trade ('the chapeau'). Members may therefore challenge a direct or indirect tax measure that violates the most favoured nation obligation under the GATS either because the difference in tax treatment is not the result of a tax treaty or does not meet the requirements of the chapeau.

Parties to the NAFTA may only challenge the most favoured nation obligation under the NAFTA with respect to indirect tax measures. However, due to the NAFTA exception for

²³¹ Article 25(4) of the US-Mexico Tax Treaty requires that the amounts paid to a non-resident be Deductible in determining the taxable profits of a resident under the same conditions as if it had been paid to a resident. Assuming the non-discrimination obligation also applies to the State of California under this Treaty Article the Mexican engineer would have a personal and direct remedy under the tax treaty. In contrast, he would have no remedy under the tax treaty or any of the trade agreements in the NAFTA Block if the State of California offered an additional tax credit in respect of services performed by a resident but not a non-resident without the consent of both competent authorities.

²³² If a dispute occurs with respect to a taxation measure in circumstances in which both the WTO Agreement and the NAFTA may apply, the NAFTA sets out the choice of forum rules for resolving the dispute in Article 2005. In general the choice is up to the complaining party.

existing non-conforming tax measures, the GATS most favoured nation obligation remains broader.²³³

The following provides a summary of the most favoured nation obligations in the NAFTA and the GATS.

	NAFTA	GATS
Direct Tax Measures	None	Differences in treatment permitted if the result of a tax agreement and subject to the chapeau requirement that the measure not constitute arbitrary or unjustifiable discrimination or a disguised restriction on trade.
Indirect Tax Measures	Most favoured nation required, subject to a tax treaty or grandfather clause	Differences in treatment permitted if the result of a tax agreement and subject to the chapeau requirement that the measure not constitute arbitrary or unjustifiable discrimination or a disguised restriction on trade.

(ii) National Treatment

The GATS also provides for a limited national treatment obligation in respect of direct measures, although the ability to challenge whether a direct tax measures violates that obligation has been effectively carved out of the GATS if the measure falls within the scope of a tax treaty. If there is no tax treaty, the measure remains subject to the chapeau requirement that the measure must not be arbitrary, unjustifiable discrimination between countries where like conditions prevail or a disguised restriction on trade in services.

The NAFTA national treatment obligation in respect of direct measures is limited to measures that they relate to the purchase or consumption of services. The language in the NAFTA is ambiguous about whether this obligation survives if it is inconsistent with the non-discrimination obligations in a tax treaty. What if the tax treaty is simply silent on the

²³³ With respect to future indirect tax measures, the NAFTA requirements that “to any new taxation measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the Parties or arbitrarily nullify or impair benefits.” This requirement in principle applies to both direct and indirect tax measures. It thus parallels the chapeau found in the GATS.

issue? Is there an argument that if the tax treaty does not include an equivalent right or obligation it would be inconsistent with the tax treaty to impose one under the NAFTA? Assuming the NAFTA obligation does survive, notwithstanding a silent tax treaty, the non-discrimination obligation is indirect and would apply to measures impacting the purchaser of the services and not the service provider. As a result the non-discrimination obligation in the GATS with respect to direct tax measures remains the broader protection for the non-resident service provider, although the ability to challenge whether the national treatment obligation has been violated under the GATS is restricted if the matter falls within the scope of a tax treaty.

In the case of indirect tax measures the GATS national treatment obligation *prima facie* applies. However as is the case with direct tax measures, a Member may not challenge whether a tax measure, including an indirect tax measure, is in violation of the national treatment obligation if it falls within the scope of a tax treaty. At issue in the NAFTA Block is whether indirect taxes fall within the scope of a tax treaty because the non-discrimination Article in each of the tax treaties in the NAFTA Block includes all taxes, not just direct taxes. If indirect tax measures are excluded from any challenge under the national treatment obligation because they fall within the scope of a tax treaty, the non-discrimination obligation in the NAFTA with respect to indirect tax measures may be broader.

The NAFTA requires that the non-resident service provider be accorded national treatment, subject to a tax treaty and the listed exceptions for existing non-conforming measures. At issue under the NAFTA is whether Article 2103(2) operates to exclude the non-discrimination obligation if it is not included in a tax treaty. If so the national treatment obligation under both agreements with respect to indirect tax measures are neutral if there is a tax treaty in place. It follows that if indirect tax measures are not included in the non-discrimination article in a tax treaty that the national treatment obligation in the GATS would apply.

The following summarizes the national treatment obligations under the NAFTA and the GATS.

	NAFTA	GATS
Direct Tax measures	None-Other than Measures that related to the purchase or consumption of services	Carved out of the GATS if aimed at ensuring the equitable or efficient imposition or collection of direct taxes. No challenge to the national treatment obligation if the matter falls within the scope of a tax treaty.
Indirect Tax measures	Subject to the national treatment obligation but subject to a tax treaty and existing non-conforming measures.	Subject to the national treatment obligation. Can be challenged under the GATS if the measure does not fall within the scope of a tax treaty.

D. The ASEAN–Australia–New Zealand Free Trade Agreement (AANZFTA)

1. Overview

The following provides a brief overview of the AANZFTA²³⁴ and the potential impact of tax and trade agreements on taxpayers in the countries that are signatories to it. As will be demonstrated, the interaction of tax and trade agreements in this trade block also results in the negation of the most favoured nation obligation and very different tax treatment contrary to the national treatment obligation otherwise required under trade agreements.

As previously discussed, the GATS led the way in addressing the potential impact of discrimination on service providers and created a new paradigm for international trade in services. It applies to all measures by Members “affecting” all trade in services²³⁵ and every possible mode of supply, including the cross-border supply (Mode 1), the consumption of

²³⁴ The ASEAN–Australia New Zealand Trade Agreement between The Governments of Brunei Darussalam, the Kingdom of Cambodia (Cambodia), the Republic of Indonesia (Indonesia), the Lao People’s Democratic Republic (Lao PDR), Malaysia, the Union of Myanmar (Myanmar), the Republic of the Philippines (Philippines), the Republic of Singapore (Singapore), the Kingdom of Thailand (Thailand) and the Socialist Republic of Viet Nam (Viet Nam), 27 February 2009, (entered into force on 1 January 2010 for eight Parties: Australia, New Zealand, Brunei, Burma, Malaysia, the Philippines, Singapore and Vietnam. Thailand implemented the FTA from 12 March 2010, Cambodia, Indonesia and Laos have yet to ratify) [hereinafter the ASEAN–Australia New Zealand Trade Agreement]

²³⁵ The GATS Article I(1).

services abroad (Mode 2), and the cross-border movement of service suppliers through the establishment of a commercial presence (Mode 3) or in person (Mode 4).²³⁶

The GATS approach, including the definition of “trade in services” with its four modes of services supply, is followed in the AANZFTA with one exception. The exception is that a Party’s commitments in relation to the movement of natural persons are set out in a separate schedule to the Movement of Natural Persons Chapter (Mode 4).²³⁷

The AANZFTA is advertised as making commercially meaningful improvements to existing WTO commitments across a range of services sectors, including professional services, construction and mining-related services, education, financial services and telecommunications.²³⁸ It includes the general GATS non-discrimination obligations (most favoured nation and national treatment) and specifically incorporates the GATS exceptions into the agreement.²³⁹

2. Most Favoured Nation Treatment

The most favoured nation obligation under the GATS requires that Member countries “accord immediately and unconditionally to services and service suppliers of any other Party, treatment no less favorable than that it accords to like services and service suppliers of any other country.” Deviation from this standard is permitted only if the Member lists such measures in the Annex on Article II Exemptions and provided the conditions for such exemptions are met.

Member countries are also exempt from the most favoured nation obligation with respect to direct tax matters²⁴⁰ if the obligation was assumed under an international agreement such as a

²³⁶ See the GATS Article 1(2) where the four modes for trade in services are defined in Article 1(2)(a –d).

²³⁷ See the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA): Australian Guide to Key Obligations, online: Australian Government Department of Foreign Affairs and Trade <http://www.dfat.gov.au/fta/aanzfta/guide/australian_guide.html> Chapter 8.

²³⁸ *Ibid.*

²³⁹ See the AANZFTA Chapter 15 Articles 2 and 6 and the GATS Article XIV including the footnotes is incorporated into the AANTZFTA in Chapter 15 Article 2(1).

²⁴⁰ See the GATS Article XXVIII (9) defining the meaning of direct taxes within the GATS as: “... all taxes on income, on total capital or on elements of income or of capital, including taxes on gains from

tax treaty.²⁴¹ However, Members may not adopt and enforce treaty-based measures inconsistent with the most favoured nation obligation if such measures are “applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or are a disguised restriction on trade.”²⁴²

The result of this exception is that a source State may provide and preferential treatment to the non-resident service provider of a tax treaty partner, than to non-residents in general, notwithstanding the most favoured nation obligation assumed under the WTO Agreement. As well, service providers within smaller trade blocks like the AANZFTA Block may be subject to different tax treatment within their trade block as the result of the carve out from those agreements for obligations assumed under a tax treaty.

Consider the following examples. Example 1 compares the treatment of an Australian and Canadian service provider by the US under the provisions of the GATS and applicable tax treaties. Example 2 demonstrates permitted differences in tax treatment in the AANZTA Block.

Example 1: The GATS

Australiacorps Conventions Inc. (Australiacorp) organizes conventions, meetings and other such events at its facility in Sydney. Australiacorp’s bid to host the next annual meeting of US Corp., a large US corporation was rejected by US Corp., who states a clear preference for holding its meeting in Canada. According to US Corp. the costs of the meeting, if held in Canada, are fully deductible, but will not be deductible if the meeting is held in Australia.

Can it be argued that the US has violated its most favoured nation obligation under the GATS by refusing to permit the deduction of meeting expenses if the convention is held in

the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.”

²⁴¹ See the GATS Article XIV (e) which states “or any other international agreement or arrangement by which the Member is bound.”

²⁴² The GATS Article XI. The determination of whether the most favored nation obligation has been violated under this exception or under the domestic law of a Member State, or whether the requirements for a specific claimed exemption under Article II have been met, is through the WTO dispute resolution process. See Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes to the WTO Agreement.

Australia? The answer is no. The matter is covered by the terms of a tax treaty. Specifically, Article 24(9) of the Canada-US Tax Treaty provides for the deduction of convention expenses to the same extent that such expenses would be deductible if the convention were held in the US. Because the WTO Agreement expressly permits the violation of the most favoured nation obligation if the matter is addressed in a tax treaty, there is no basis for complaint by Australia. Australiacorp will have to adjust its pricing if it wants to win the contract.

Example 2: AANZFTA

Roberta, a management consultant from Sydney, has identified Vietnam as an important emerging market. Under the Australia-Vietnam Tax Treaty²⁴³ any income she earns in Vietnam from management and accounting services is exempt from tax in Vietnam so long as Roberta does not have a fixed base in Vietnam. In contrast her friend Helen from Malaysia is subject to tax in Malaysia under the Malaysia-Vietnam Tax Treaty if she remains in Malaysia for more than 183 days in a fiscal year or her remuneration exceeds \$10,000 US, regardless of her stay.²⁴⁴ If the fees are considered technical fees, “defined as management or consulting fees” they will alternatively be subject to a 10% gross tax.²⁴⁵

As seen, non-resident service providers may be subject to different tax treatment notwithstanding a trade commitment to most favoured nation in trade agreements.

3. National Treatment

The national treatment obligation in the GATS serves to level the playing field for resident and non-resident service providers. It applies to the extent of a Member’s listed commitments

²⁴³ *Agreement Between the Government of Australia and the Government of The Socialist Republic of Vietnam for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 13 April 1992, [1992] ATS 44, (entered into force 30 December 1992), Article 14.

²⁴⁴ See the *Agreement Between the Government Of Malaysia and the Government of the Socialist Republic of Vietnam for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 7 September 1995, P.U. (A) 60/1996, (entered into force 1 January 1997) [hereinafter the Malaysia-Vietnam Treaty] at Article 15. This assumes payment is derived by residents of Malaysia or a permanent establishment in Malaysia.

²⁴⁵ *Ibid*, Article 13.

and is subject to the specified conditions and qualifications.²⁴⁶ It requires that in the sectors listed in a Member's schedule of commitments, "like" service providers of other Members are to be treated no less favorably than domestic ones.²⁴⁷ Treatment can be formally identical or formally different, but it will be considered less favorable "if it modifies the conditions of competition"²⁴⁸ in favor of services or service suppliers of the Member compared to like services or service suppliers of any other Member. There are a number of exceptions to this rule, including an exception for certain direct tax measures.²⁴⁹

Specifically, different and potentially discriminatory tax treatment is permitted provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers in other Member countries,²⁵⁰ and as long as the measure does not constitute "arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services." As discussed, this exception to the national treatment obligation was critical to the successful negotiation of the GATS.

The AANZFTA generally follows the GATS with respect to the national treatment obligation and specifically incorporates the GATS exceptions into the chapters on trade in services,

²⁴⁶ The GATS Article XVII.1.

²⁴⁷ *Ibid.*

²⁴⁸ The GATS Article XVII.3.

²⁴⁹ The GATS Article XXVII(o) provides that "direct taxes" comprise all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

²⁵⁰ See the GATS Article XIV(d). A footnote to Article XIV(d) clarifies that "equitable or effective imposition of taxes" includes measures taken by a Member under its taxation system that:

- apply to non-resident service suppliers in recognition of the fact that tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory (for example, withholding taxes);
- apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
- apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
- distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
- determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches or between related persons or branches of the same person, in order to safeguard the member's tax base.

movement of natural persons and investments.²⁵¹ With respect to taxation measures it goes on to further clarify and narrow the application of the agreement with respect to taxation matters.²⁵²

The Agreement begins by announcing that nothing in the AANZFTA will apply to any tax measure except as specifically provided for in Chapter 15.²⁵³ Chapter 15 (General Provisions and Exceptions) clarifies that the Agreement shall only grant rights or impose obligations with respect to taxation measures where corresponding rights and obligations are also granted or imposed under the WTO Agreement. Like the NAFTA, the AANZFTA is clear about the status of tax treaties entered into by its signatories. In general, these are to have priority in all cases including any inconsistencies with the Agreement.²⁵⁴ As a result, the AANZFTA, like the GATS (and the NAFTA) requires that disputes about tax matters covered by a tax treaty be resolved exclusively under the applicable tax treaty provisions.²⁵⁵ The practical result of this is that whether a remedy is sought under the GATS, or pursued under the NAFTA or the AANZFTA, the competent authorities of both the source and resident countries must agree.

As is no doubt apparent, tax treaties will play a critical role in providing any protection from tax discrimination. Do the bilateral tax treaties entered into by the AANZFTA provide protection from tax discrimination to the non-resident service provider in any of the circumstances outlined in Chapter and summarized below? The answer is, no they do not.

- | |
|---|
| <ol style="list-style-type: none">1. The host country imposes an excessive and arbitrary gross withholding tax.2. The requirements of the source country to obtain a refund of withholding tax on amounts that are exempt under the tax treaty may be arbitrary or unduly onerous.3. The host state provides an additional tax credit to a tax resident that purchases services |
|---|

²⁵¹ The AANZFTA Chapter 15: General Provisions and Exceptions.

²⁵² *Ibid*, Article 3.

²⁵³ The AANZFTA Chapter 15 at Article 3 paragraph 1.

²⁵⁴ The AANZFTA Chapter 15 at Article 3 subparagraph 2(a).

²⁵⁵ The NAFTA Article 2103(2). The AANZFTA Chapter 15 Article 6 provides as follows “Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention relating to the avoidance of double taxation in force between any of the Parties. In the event of any inconsistency relating to a taxation measure between this Agreement and any such tax convention, the latter shall prevail. Any consultations between the relevant Parties about whether an inconsistency relates to a taxation measure shall be done by the competent tax authorities, as stipulated under the domestic laws and regulations of the relevant Parties. The request for such consultations shall be addressed through the contact points designated in accordance with Article 2 (Communications) of Chapter 16 (Institutional Provisions).”

from a resident but not from a non-resident service provider.

4. The measure is a disguised tax measure in the form of a penalty, fee or charge. For example, there may be additional fees associated with non-resident filings or claims for refunds.

5. The measure is in respect of indirect taxes. For example, the source country may impose different and discriminatory indirect taxes such as sales taxes, excise taxes, value added taxes-and tariffs or other similar charges on the services provided by a non-resident service provider.

Each of these measures may fall within the scope of a tax treaty.

4. Differing Levels of Protection

The current interaction of tax and trade agreement also results in different levels of protection from tax discrimination for non-resident service providers within the AANZTA Block, in particular with respect to direct tax measures.

The highest level of protection is reserved for non-resident service providers from countries where there is no tax treaty with the source State. Such service providers may rely on the GATS national treatment obligation, exception and the chapeau that requires that the measure must not be arbitrary, unjustified or a disguised restriction on trade in services. There is also a potential remedy under the WTO dispute resolution process in the five categories described above. For example, Brunei, Burma and Laos do not have a tax treaty with Australia.

The next level of protection applies to non-resident service providers from countries with a tax treaty with the source State. At issue will be whether the matter falls within the scope of a tax treaty, an important issue in the context of the Canada-Australia Tax Treaty.²⁵⁶ If not, the GATS national treatment obligation exception and the chapeau will apply.²⁵⁷

²⁵⁶ The *Convention Between Canada and Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income*, 21 May 1980, Can TS 1981 No 12 (entered into force 29 April 1981) amended by Protocol of January 23, 2002 [hereinafter the Canada-Australia Tax Treaty]. Article 24(6) provides the “For the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this

The least protection against tax discrimination is provided to non-resident service providers from countries that have a tax treaty with the source State in which the signatories have totally insulated themselves in the tax treaty from any obligation with respect to discrimination in both direct and indirect tax matters.²⁵⁸ This is achieved in the tax treaty by specifying that for purposes of the national treatment obligation in the GATS that all matters relating to direct or indirect taxes fall within the scope of the tax treaty.²⁵⁹ Under such tax treaties there would be no ability to challenge a violation of the national treatment obligation and no remedy against tax discrimination in the five categories described above.

E. Conclusions

Trade agreements ensure national treatment, most favoured nation trade status and a host of other negotiated trade benefits to non-resident service providers who provide services to a regional trade partner. Similar guarantees do not extend to the tax treatment of these service providers. Instead the taxation of non-resident service providers is determined bilaterally under tax treaties. A number of consequences follow.

First, as we have seen, the tax treaties signed by the NAFTA and ANNZTA signatories contain critical differences with respect to the taxation of trade partners, particularly with respect to the tax treatment of service related payments. These differences reverse the benefits of most favoured nation treatment. As a result Canadian tax liability for an US

paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.”

²⁵⁷ See e.g., the *Agreement Between the Government of Australia and the Government of the Kingdom of Thailand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 31 August 1989, [1989] ATS 36 (entered into force 27 December 1989), which does not include a non-discrimination clause.

²⁵⁸ See e.g., Article 25 of the Canada-US Tax Treaty. The *Convention Between the Government of the United States of America and the Government of --- for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 15 November 2006 online: <<http://www.irs.gov/pub/irs-trty/model006.pdf>> [hereinafter the 2006 US Model Tax Treaty] further limits the applicability of the GATS. It provides that notwithstanding the provisions of subparagraph (b) of paragraph 2 of Article 25 of the Canada-US Tax Treaty “for purposes of paragraph 3 of Article XXII (Consultation) of the [GATS, which allows signatories to refer unresolved questions to arbitration], the Contracting States agree that any question arising as to the interpretation or application of this Convention and, in particular, whether a taxation measure is within the scope of this Convention, shall be determined exclusively in accordance with the provisions of Article 25 (Mutual Agreement Procedure) of this Convention; and ii) the provisions of Article XVII of the [GATS, providing for national treatment] shall not apply to a taxation measure unless the competent authorities agree that the measure is not within the scope of Article 24 (Non-Discrimination) of this Convention.”

taxpayer, for example, who earns income from the provision of services in Canada, may be very different than that of a Mexican taxpayer in identical circumstances.²⁶⁰ Similarly, the Convention organizer from Sydney will be at a disadvantage when compared to a Canadian organizing a Convention in Toronto as the result of the special provisions for deductibility of convention costs under the Canada-US Tax Treaty.²⁶¹

Second, there are significant differences in the taxes covered and the obligations assumed under the non-discrimination articles in the tax treaties. This will impact what rights a cross border service provider will have both with respect to an assertion of discriminatory tax treatment and to dispute resolution alternatives. As we have seen there are considerable variations with respect to non-discrimination obligations among the AANZTA and NAFTA signatories.

Third, tax measures, as currently disciplined under tax treaties, can be used by regional trade partners to both raise impediments to the cross-border trade in services and to provide trade-distorting subsidies far more egregious than practices prohibited in trade agreements.²⁶² Such practices would clearly negate the benefits negotiated under trade agreements.

Are these acceptable outcomes? Should the non-discrimination obligation in tax treaties in regional trade agreements be broader? Do the objectives of regional trade agreements dictate a higher level of protection against discriminatory tax treatment?

Some might argue for example, that regional trade agreements should not include a carve out from the most favoured nation obligation if the difference in treatment is based on the provisions a tax treaty. If the view is that regional trade partners should receive the same tax treatment this is achievable. The obligation to provide most-favoured nation treatment is

²⁶⁰ See Example 1 (Independent Personal Services) at Chapter 3.5(a)(i).

²⁶¹ See Example 1 (the GATS) *supra*.

²⁶² Although it would appear that little discipline with respect to most favored nation and national treatment obligations is imposed in income tax matters, this is not entirely true. See the *United States - Tax Treatment for "Foreign Sales Corporations" (Complaint by the European Communities)* (2007), WTO Doc WT/DS108/AB/R (Appellate Body Report), online: WTO <<http://docsonline.wto.org>>. The WTO Appellate Body stated "that [a] Member of the WTO may choose any kind of tax system that it wishes-so long as, in so choosing, that Member applies that system in a way that is consistent with its WTO obligations." This quote came in the context of the dispute about the US foreign sales corporation program. At issue was whether the US was providing export subsidies through its foreign sales corporation provisions.

being increasingly incorporated into international tax treaties that complement regional trading blocs.²⁶³

The carve out from the national treatment obligation for tax measures presents very different issues and requires a different solution. There may be good reasons to treat non-residents service providers differently than residents for tax purposes. There is always an element of discrimination in the imposition of differing measures. Gross withholding tax may exceed taxes on net income; lengthy administrative requirements or delays may affect refunds; withholding tax may be required by a source State despite a treaty exemption. These are all realities in cross border trade. The question is: Does the absence of a non-discrimination obligation in tax agreements result in significant differences in tax treatment for non-resident service providers contrary to what may have been anticipated in trade agreements?

The effect of the mismatch between tax and trade agreements was recognized in the GATS and a minimum standard against which national tax legislation and its administration could be measured was included. The standard under the GATS is that tax measures cannot result in “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.”²⁶⁴ There is no similar obligation under a tax treaty.

In summary, although the NAFTA and the AANZFTA fundamentally change the non-discrimination obligations that apply to the trade in services throughout these free trade blocks, the agreements do not establish new rules or mechanisms for taxing these cross-border activities nor do the tax treaties between the parties to the free trade agreements add any parallel non-discrimination obligations.

²⁶³ See e.g., the South Asian Association for Regional Cooperation (SAARC), Multilateral Tax Agreement between Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka (2005), and the Nordic Multilateral Tax Agreement between Denmark, Finland, Iceland, Norway and Sweden (1996).

²⁶⁴ The GATS Article XXII.

Chapter 4: Non-Discrimination Obligations in Bilateral Free Trade Agreements and the Role of Tax Treaties

A. Overview

In total more than 250²⁶⁵ bilateral free trade agreements have been negotiated globally since 1995. The purpose of the Chapter is to examine the role of these bilateral free trade agreements and the applicable tax treaties between the bilateral free trade partners in establishing non-discrimination obligations in respect of non-resident service providers. The interaction of bilateral free trade agreements and tax treaties between the same parties is examined by means of the treaty networks adopted by two illustrative jurisdictions, Canada and Australia.²⁶⁶ As will be seen, the carve out strategy for tax measures adopted in the bilateral free trade agreements entered into by these jurisdictions substantially duplicates the approach adopted in regional trade agreements like the AANZTA and the NAFTA. Tax treaties also serve a similar role in potentially limiting trade obligation with respect to tax measures.

B. Canada's Bilateral Free Trade Agreements

Beginning in 1997, Canada has entered into seven bilateral free trade agreements,²⁶⁷ including the Canada-Colombia Free Trade Agreement (CCFTA)²⁶⁸ and the Canada-Panama

²⁶⁵ The World Bank, *Agreements Library*, online: The World Bank <<http://wits.worldbank.org/gptad/library.aspx>>.

²⁶⁶ The departure from the undertaken multilateral obligations is envisaged in some cases under the GATS. The GATS Article V is an illustration of one of such exemptions as it seeks to promote wider economic integration by allowing WTO Members to enter into economic integration agreements, such as regional trade agreements, provided such agreements do not result in raising the overall level of barriers to trade in services. Regional liberalization of trade on a bilateral or plurilateral basis is thus seen as preferable to limited or no liberalization at all. Whether creation and proliferation of such agreements is the best way of dealing with this issue is debatable.

²⁶⁷ The *Canada-Chile Free Trade Agreement* entered into effect 5 July 1997 as amended November 15, 2006, and in 2013 with the addition of a new financial services chapter, the *Canada-Costa Rica Free Trade Agreement* came into effect on 1 November 2002, the *Canada-European Free Trade Association* came into effect on 1 July 2009, the *Canada-Peru Free Trade Agreement* came into effect on 1 August 2009. In addition, the *Canada-Israel Free Trade Agreement* came into effect on 1 January 1997 and the *Canada-Jordan Free Trade Agreement* was signed on 28 June 2009. The free trade agreements with Israel and Jordan do not include services. A further twelve free trade agreements are under negotiation, including treaties with the European Union, Turkey, Ukraine, Morocco, Korea and Singapore. See Foreign Affairs and International Trade Canada, *Negotiations and Agreements*, online: Government of Canada: <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/index.aspx>>.

Free Trade Agreement (CPFTA),²⁶⁹ discussed in more detail below. These agreements have been selected because at the time of writing they are the two most recent free trade agreements entered into by Canada. Canada’s other bilateral free trade agreements substantially duplicate the provisions discussed below and can be found in Appendix A.

1. Trade Obligations

Both the CCFTA and the CPFTA seek, among other things, to create an expanded and secure market for the trade in services.²⁷⁰ The following provides an overview of how these accords deal with the issue of non-discrimination and the tax treatment of non-resident service provider (cross-border service provider) of the other Party. The discussion begins with the definition of “cross-border trade in services,” a review of the two core non-discrimination principles established in both free trade agreements and a look at the tax carve out and its potential impact on cross-border trade in services. As stated, these provisions are typical in most free trade agreements and definitions are similar to those found in the NAFTA.²⁷¹

Table 1: What is cross-border trade in services?

Canada – Colombia FTA	Canada – Panama FTA
<p>Cross-border trade in services or cross-border supply of services means the supply of a service:</p> <p>(a) from the territory of one Party into the territory of the other Party;</p> <p>(b) in the territory of one Party by a person of that Party to a person of the other Party; or</p>	<p>Cross-border trade in services means providing a service:</p> <p>(a) from the territory of one Party into the territory of the other Party;</p> <p>(b) in the territory of one Party by a person of that Party to a person of the other Party; or</p>

²⁶⁸ *Free Trade Agreement Between Canada and the Republic of Colombia*, 21 November 2008, Can TS 2011 No 11 (entered into force 15 August 2011) [hereinafter the Canada-Columbia Free Trade Agreement].

²⁶⁹ *Free Trade Agreement Between Canada and the Republic of Panama*, 14 May, 2010, Can TS 2013 No 9 (entered into force 1 April 2013) [hereinafter the Canada-Panama Free Trade Agreement].

²⁷⁰ Whether the Canada-Columbia Free Trade Agreement and Canada-Panama Free Trade Agreement can be regarded as increasing opportunities in trade in services largely depends on whether the regulatory environment provided for in these regional trade agreements is more conducive to the cross-border trade in a services.

²⁷¹ See the discussion in Chapter 3.A.

<p>(c) by a national of a Party in the territory of the other Party,</p> <p>but does not include the supply of a service in the territory of a Party by a covered investment, as defined in Article 838 (Investment – Definitions);</p> <p style="text-align: right;">Article 913</p> <p>The term “service” is not defined.</p>	<p>(c) by a national of a Party in the territory of the other Party,</p> <p>but does not include providing a service in the territory of a Party by a covered investment as defined in Article 9.01 (Investment – Definitions);</p> <p style="text-align: right;">Article 10.01</p> <p>The term “service” is not defined.</p>
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Under both the CCFTA and CPFTA “cross-border trade in services” or “cross-border supply of services” is defined by reference to the location of activities and service suppliers. Because the basis for direct taxation generally depends on factors such as residence or location of activities, it follows that a service provider who provides services across borders may be liable to income tax in more than one jurisdiction.

Like the GATS and the NAFTA, the CCFTA and CPFTA contain broad obligations to provide national treatment and most favoured nation treatment to the service providers of the other Party.

Table 2: Core non-discrimination principles

Canada – Colombia FTA	Canada – Panama FTA
<p>National treatment</p> <p>1. Each Party shall accord to service suppliers of the other Party treatment no less favorable than that it accords, in like circumstances, to its own service suppliers.</p> <p style="text-align: right;">Article 902(1)</p>	<p>National treatment</p> <p>1. Each Party shall accord to a service provider of the other Party treatment no less favorable than that it accords in like circumstances to its own service providers.</p> <p style="text-align: right;">Article 10.03(1)</p> <p>3. The treatment accorded by a Party under paragraph 1 extends to a relevant service provided by that service provider.</p> <p style="text-align: right;">Article 10.03(3)</p>

<p>Most-favoured-nation treatment</p> <p>Each Party shall accord to service suppliers of the other Party treatment no less favorable than that it accords, in like circumstances, to service suppliers of a non-Party.</p> <p style="text-align: right;">Article 903</p>	<p>Most-favoured-nation treatment</p> <p>1. Each Party shall accord to a service provider of the other Party treatment no less favorable than that it accords in like circumstances to service providers of a non-Party.</p> <p>2. The treatment accorded by a Party under paragraph 1 extends to a relevant service provided by that service provider.</p> <p style="text-align: right;">Article 10.04</p>
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2. Taxation Measures

Service providers cannot, however, rely on the national treatment obligation or benefit from the most favoured nation obligation in these trade agreements in respect of direct and in some cases indirect tax measures.²⁷² Like the NAFTA, these trade agreements specifically exclude all tax measures²⁷³ and then selectively include specific tax provisions in the trade agreement. Table 3 below demonstrates both the very limited protection in tax matters provided under the CCFTA and CPFTA and that the non-discrimination provisions in both trade agreements must yield to tax treaty provisions.

Table 3: Carve out for taxation measure

Canada – Colombia FTA	Canada – Panama FTA
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²⁷² In the Canada-Panama Free Trade Agreement Article 23.01, what is considered a Tax and a Taxation measure is defined by exclusion. Specifically it does not include a customs duty or certain measures related to anti-dumping or countervailing duties, customer user fees related to imported goods or certain premiums related to imported goods. There is a similar definition in the Canada-Columbia Free Trade Agreement Article 2208.

²⁷³ Taxation measures are defined only by exclusion. They do not include customs or related duties.

<p>1. Except as set out in this Article and paragraph 2 of Annex 1101.5 [Understanding Regarding Financial Services Measures], nothing in this Agreement shall apply to taxation measures.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.</p> <p>3. Where similar provisions with respect to a taxation measure exist under this Agreement and under a tax convention, the procedural provisions of the tax convention alone shall be used, by the competent authorities identified in the tax convention, to resolve any issue related to such provisions arising under this Agreement.</p> <p style="text-align: right;">Article 2204</p> <p>No most favoured nation obligation is imposed with respect to an advantage accorded by a Party pursuant to any tax convention.</p> <p style="text-align: right;">Article 2204(5)(c)(i)</p>	<p>1. Except as set out in this Article, this Agreement does not apply to a taxation measure.</p> <p>2. This Agreement does not affect the rights and obligations of a Party under a tax convention. In the event of inconsistency between this Agreement and a tax convention, that convention prevails.</p> <p>3. Where a provision with respect to a taxation measure under this Agreement is similar to a provision under a tax convention, the competent authorities identified in the tax convention shall use the procedural provisions of that tax convention to resolve an issue that may arise under this Agreement.</p> <p style="text-align: right;">Article 23.04</p> <p>No most favoured nation obligation is imposed with respect to an advantage accorded by a Party pursuant to a tax convention.</p> <p style="text-align: right;">Article 23.04(6)(a)</p>
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In general the approach to the carve out for tax measures out from these free trade agreements is very similar to that found in the NAFTA.²⁷⁴ Thus, as the case with the NAFTA, tax treaties generally have primacy in all cases including any inconsistencies with the trade agreements.

²⁷⁴ See generally the discussion at Chapter 3.B.1.

The trade agreements then impose non-discrimination obligations with respect to select tax measures including income and capital tax measures that relate to the purchase or consumption of cross-border services or financial services, other taxes affecting services and investments, and tax measures linked to performance requirements. For purposes of the immediate discussion the most relevant of these obligations is with respect to the purchase or consumption of services. Both trade agreements provide that, subject to any applicable tax treaty, the national treatment obligation applies to all taxation measures on income, capital gains, or the taxable capital of corporations to the extent that those taxes relate to the purchase or consumption of particular services from a service provider. These agreements also clarify that this obligation does not prevent a Party from conditioning the receipt or continued receipt of an advantage relating to the purchase or consumption of particular services on requirements to provide the service in its territory. Subject to a tax treaty, a non-resident service provider must also be accorded national treatment and most favoured nation treatment with respect to indirect taxation measures such as, in the case of Canada, the Goods and Services Tax (GST).

As is the case with the NAFTA, these obligations are limited by three important exceptions. First, obligations assumed under the most favoured nation provisions in the NAFTA do not prevent the government of a NAFTA Party from providing an exclusive bilateral advantage under a tax treaty to a specific treaty partner. Second, provisions do not apply to any taxation measures in existence at the time that the trade agreement went into effect. Third, similar to the GATS, a widely drafted exclusion clause is included for any new tax measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the parties or arbitrarily nullify or impair benefits accorded under those articles.

The free trade agreements with Columbia and Panama also address the issue of which agreement prevails if a similar provision with respect to a taxation measure exists under the free trade agreement and under a tax convention (“tax treaty”). Such an overlap could occur, for example, in respect of the non-discrimination obligation found in the OECD and UN Model Tax Treaties as it applies to the deduction of amounts in determining taxable profits with the trade obligation with respect to tax measures affecting the purchase or consumption of services. Both Model Tax Treaties provide that “disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of

determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.”²⁷⁵ Both free trade agreements include a non-discrimination obligation that would fall within this general wording. Specifically, Article 2204(5)(a) of the CCFTA imposes the national treatment obligation in respect of services for “taxation measures on income, capital gains, or on the taxable capital of corporations that relate to the purchase or consumption of particular services.”²⁷⁶ The free trade agreements make clear that the procedural provisions of the tax convention alone shall be used, by the competent authorities identified in the tax convention, to resolve any issue related to the provision that arises under the trade agreement.²⁷⁷ This provides the competent authority under a tax treaty with the authority to restrict the applicable non-discrimination obligation to the non-discrimination obligations under the tax treaty. It also resolves the dispute resolution issue that was discussed in Chapter 3 if there are similar provisions under a tax treaty and the NAFTA

3. The Impact of Tax Treaties

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

A tax treaty between Canada and Colombia was signed in 2008 and came into force in 2012.²⁷⁸ The Canada–Columbia Tax Treaty follows the OECD Model Tax Treaty. It applies to all taxes subject to the Convention levied by the Government of Canada under the *Income Tax Act*. There is no direct non-discrimination principle in the Canada-Columbia Tax Treaty that applies to a non-resident service provider, absent a permanent establishment in Columbia. The indirect national treatment obligation under the CCFTA related to the

²⁷⁵ See Article 24(4) of the OECD and UN Model Tax Treaties.

²⁷⁶ Article 2204(5)(a) provides that the national treatment obligation shall apply in respect of Article 902 (Cross-Border Trade in Services - National Treatment) and Article 1102 (Financial Services).

²⁷⁷ There is no non-discrimination obligation in the Canada-Columbia Tax Treaty, *infra*, similar to that found in the OECD and UN Model Tax Treaties.

²⁷⁸ The *Convention Between Canada and the Republic of Colombia For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and on Capital* entered into force 12 June 2012, after Canada and Colombia had exchanged the last notification of completion of the required procedures. In the case of withholding tax, the Treaty applies as of 1 January 2013. In the case of other taxes, the Treaty applies for taxation years beginning on or after 1 January 2013.

deductibility of amounts in respect of the purchase or consumption of services may also be negated if it is considered to be inconsistent with the rights and obligations of the parties under the tax agreement. The argument in favour of inconsistency is that the tax treaty does not include a non-discrimination obligation that relates to the purchase or consumption of services.²⁷⁹

For the purposes of paragraph 3 of Article XXII (Consultation) of GATS, the tax treaty includes the standard wording that any dispute between the Contracting States as to whether a measure falls within the scope of the Convention may be brought before the Council for Trade in Services, as provided by that paragraph, can be brought only with the consent of both Contracting States. The tax treaty article goes on to provide that any doubt as to the interpretation of this paragraph (in the tax treaty) shall be resolved through the Mutual Agreement procedure in the tax treaty and failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting State.²⁸⁰

There is no tax treaty between Canada and Panama. A remedy, if at all, for a Canadian service provider from tax discrimination in Panama must be found under the GATS. Canada and Panama are both Members of the WTO, and as signatories are required to observe their multilateral commitments, including the scheduled national treatment and most favoured nation obligations under the GATS. Because there is no tax treaty with Panama, a Canadian service provider may rely on the GATS national treatment obligation and is not restricted from accessing the GATS dispute resolution procedures. As discussed, the national treatment obligation under the GATS is not violated if the tax measure is aimed at ensuring the

²⁷⁹ This conclusion depends on how the trade agreement is interpreted. Read literally the Canada-Columbia Free Trade Agreement Article 2204(2) is clear that “Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.” The imposition of a non-obligation under the trade agreement when there is none under the tax treaty is arguably inconsistent. In order to resolve the issue Article 2204(8)(c) sets out the following procedure: “Where in a dispute between Parties, an issue arises as to whether a tax convention prevails over this Agreement, a Party to the dispute may refer the issue to the designated authorities of the Parties. The designated authorities shall consider the issue and decide whether the tax convention prevails. If within six months of the referral of the issue to the designated authorities, they decide with respect to the measure that gives rise to the issue that the tax convention prevails, no procedures concerning that measure may be initiated under Article 2106 (Dispute Settlement - Establishment of a Panel). No procedures concerning the measure may be initiated during the period that the issue is under consideration by the designated authorities. Where the designated authorities have been referred the issue and have not decided the issue within six months of the referral, the panel shall decide the issue.”

²⁸⁰ Canada-Columbia Tax Treaty, *supra* note 268, Article 28(3).

equitable or efficient collection of taxes.²⁸¹ However under the GATS the measure must not be considered arbitrary or a disguised restriction on trade in services.

4. Dispute Resolution

The free trade agreements with Columbia and Panama also specifically address access to dispute resolution mechanisms. If the dispute relates to whether a measure of a Party is a taxation measure, either Party may refer the issue to the designated authorities of the Parties. The designated authorities then have six months to determine the issue and if they fail to do so a panel may decide. There is a similar process for determining whether a measure falls within the scope of a tax treaty; that is the matter is to be referred to the designated authorities and failing agreement by them to a panel.²⁸²

C. Australia's Bilateral Free Trade Agreements

1. Overview

Australia has bilateral free trade agreements currently in force with Singapore, Thailand, the United States, Chile, Malaysia,²⁸³ and has entered an agreement with New Zealand for Closer Economic Relations that includes the trade in services.²⁸⁴

Australia's free trade agreements generally follow the pattern discussed above with respect to Canada's free trade agreements and include similar definitions about what constitutes trade in services as well as parallel national treatment and most favoured nation treatment obligations.

²⁸¹ The GATS Article XIV. See discussion in Chapter 2 .1 (iii).

²⁸² Canada-Columbia Free Trade Agreement Article 2204(8) (a) and (c).

²⁸³ See Australia's free trade agreements in force, Department of Foreign Affairs and Trade, *Australia's Free Trade Agreements*, online: Australian Government <<http://www.dfat.gov.au/fta/>>. Australia is currently engaged in three bilateral free trade agreement negotiations: China, India and Indonesia. Negotiations with Korea was concluded recently but has not yet entered into force and an agreement has been signed with Japan. See also Razeen Sappideen & Ling Ling He, "Dispute Settlement under Free Trade Agreements: The Proposed Australia-China Free Trade Agreement" (2011) 12 J World Investment and Trade 581.

²⁸⁴ The 1989 protocol to this agreement in respect of services specifically excludes all taxation measures.

Each of Australia's Free Trade Agreements also generally carve out taxation measures²⁸⁵ from trade obligations, although the extent of the tax carve out varies.

Australia's first bilateral free trade agreement following commencement of the GATS agreement, a treaty with Singapore, generally follows the drafting approach used in the GATS.²⁸⁶ Pursuant to Article 18(d) of the agreement with Singapore, measures aimed at the equitable or effective collection of direct taxes are excepted from the national treatment obligation, subject to the chapeau requirement that such measures do not constitute a means of arbitrary or unjustifiable discrimination between the Parties where like conditions prevail, or a disguised restriction on trade in services. A footnote to Article 18(d) largely duplicates the list of national treatment measures found in the GATS. The free trade agreement with Singapore does not define a tax measure or explicitly exclude all tax measures. The leaves open the possibility that other direct or indirect tax measures may be subject to the national treatment or most favoured nation obligation in this free trade agreement. Unlike the GATS, the free trade agreement does not deny access to the consultation and dispute resolution mechanisms under the trade agreement if the dispute is with respect to whether a tax measure violates the national treatment obligation under the trade agreement. This makes this free trade agreement somewhat unique in that a Party may challenge whether a direct tax measure is in violation of the national treatment obligation under the free trade agreement.

In the free trade agreement with Malaysia, which entered into force in 2013, taxation measures are generally carved out by the explicit wording: "nothing in this agreement shall apply to taxation measures except as provided in this Article," however a number of rights and obligations are selectively incorporated, including "any corresponding rights and obligations that are granted or imposed under the WTO Agreement."²⁸⁷ This means that any obligations imposed under the GATS will apply under this free trade agreement, including the national treatment obligation and the exception for direct tax measures from that obligation.²⁸⁸ Thus any tax measure imposed to ensure the equitable or efficient collection of

²⁸⁵ What is considered to be a taxation measures is not generally specified in the free trade agreements however the definition in the agreement specifically excludes customs duties. See for example Article 18.3(8) of the *Malaysia-Australia Free Trade Agreement*, 22 May 2012, [2013] ATS 4 (entered into force 1 January 2013).

²⁸⁶ *Ibid.*

²⁸⁷ See Article 18.3 (4) of the *Malaysia -Australia Free Trade Agreement* and Article 1607(2) of the *Australia-Thailand Free Trade Agreement*, 5 July 2004, [2005] ATS 2 (entered into force 1 January 2005).

²⁸⁸ See generally the discussion in Chapter 2.B.1.

direct taxes under these agreements will be subject to the GATS ‘chapeau’ requirement that the measure not be arbitrary or a disguised restriction on trade. A similar result occurs under the free trade agreement with Thailand, which also includes any rights and obligations that are granted or imposed under the GATS, as well as certain measures relating to expropriation.

The free trade agreement between Australia and the United States adopts a somewhat different tack. The non-discrimination obligation with respect to direct tax measures is much more limited and, subject to a tax treaty, provides only indirect protection in tax matters under the national treatment obligation. More specifically Article 22.3(4)(a) applies to certain taxation measures (including direct tax measures) that relate to the purchase or consumption of particular services.²⁸⁹ It reads as follows:

4. Subject to paragraph 2:

(a) Article 10.2 (National Treatment), Article 13.2 (National Treatment), and Article 13.5.1 (Cross-Border Trade) shall apply to taxation measures on income, capital gains, or on the taxable capital of corporations that relate to the purchase or consumption of particular services...

As is generally the case with Australia’s other free trade agreements, this free trade agreement also provides for the primacy of tax treaties, including in the resolution of any dispute about whether the matter affects the rights or obligations of any party under a tax agreement. This can be seen in the following language in Article 22.3:

2. (a) Nothing in this Agreement shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.

(b) In the case of a tax convention between the Parties the competent authorities under that convention shall have sole responsibility for determining whether any inconsistency exists between this Agreement and that convention....

²⁸⁹ *Australia-US Free Trade Agreement*, 18 June 2004, [2005] ATS 1 (entered into force 1 January 2005), Article 22.3.

The free trade agreement between Australia and Chile generally follows the free trade agreement with the United States.

2. The Impact of Tax Treaties

Of particular interest when one examines the provisions in Australia's free trade agreements and the bilateral tax treaties that Australia has entered into with each of the free trade partners, is the role that the tax treaties appear to play in limiting the non-discrimination obligations that apply to a non-resident service provider. With the exception of Singapore, Australia's free trade agreements with each of its partners include language similar to that found above in the discussion above of the free trade agreement with the United States, in establishing the primacy of tax treaties. In general, each of the free trade agreements provide inter alia that nothing in the free trade agreement shall affect the rights and obligations of either Party under any tax convention, and that in the event of any inconsistency relating to a taxation measure between the Agreement and any tax convention, the latter shall prevail to the extent of the inconsistency. This is a clear statement about the supremacy of tax treaties in respect of non-discrimination obligations and tax measures. The question is how will this provision in the trade agreement be interpreted and applied?

Australia rarely includes a non-discrimination article in its tax treaties²⁹⁰ and did not include a non-discrimination article in the majority of its tax treaties with the Parties with whom it currently has free trade agreements.²⁹¹ Does this mean that based on the language in the trade agreement that no non-discrimination obligation will apply with respect to direct tax

²⁹⁰ Until 2008 Australia reserved its position on Article 24 in para. 85 of the Commentary on Article 24 of the OECD Model. This reservation was replaced in 2008 as follows: Australia reserves the right to propose amendments to ensure that Australia can continue to apply certain provisions of its domestic law relating to deductions for R & D and withholding tax collection." Para 86 OECD Model Commentary on Article 24.

²⁹¹ The exceptions are the tax treaties with the United States and Chile. A non-discrimination obligation is also included in the *Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 31 January 2008, [2008] ATS 21 (entered into force 3 December 2008) [hereinafter the Australian-Japan Tax Treaty]. See the Explanatory Memorandum of Article 26 of the Australia-Japan Tax Treaty, Chapter 1 2008 Australia-Japan Convention, International Tax Agreements Amendment Bill (No. 1) 2008 circulated by the authority of the Treasurer, the Hon Wayne Swan MP, online: <<http://law.ato.gov.au/atolaw/view.htm?DocID=NEM%2FEM200827%2FNAT%2FATO%2F00003>>.

measures under Australia’s free agreements?²⁹² The imposition of a non-discrimination obligation with respect to any tax or tax measure that falls under a tax treaty is clearly inconsistent with the rights and obligations assumed by each of the free trade partners under the tax treaty. If this view is correct, which it appears to be, the existence of a tax treaty that does not include a non-discrimination article would operate to negate any non-discrimination obligation under the free trade agreement.²⁹³ If this conclusion is correct then with the possible exception of Singapore, no non-discrimination obligation currently applies to any tax measure under the majority of Australia’s free trade agreements as the result of the interaction of these bilateral tax and trade agreements.²⁹⁴

Table 4 below provides a summary of the non-discrimination obligations in each of Australia’s bilateral free trade agreements and the non-discrimination obligations if any in the corresponding tax treaty. A tax measure for this purpose is generally considered to be any tax measure other than a customs duty or fee.

Table 4: Non-Discrimination Obligations in Australia’s Bilateral Free Trade Agreements and Tax Treaties

Country	Taxation Measures as Exception in FTA?	Non-Discrimination Clause in Income tax Treaty?	Other Notes
Thailand	Yes (But includes WTO rights and rights on expropriation)	No	
Singapore	Yes (Follows GATS language with respect to direct tax measures)	No	
Malaysia	Yes (But includes WTO rights and rights on expropriation)	No	Includes protection for investments
USA	Yes (Limited national treatment for goods, measures related to purchase or consumption of services and rights on expropriation)	Yes, modified from OECD version excludes tax measures under domestic law relating to tax avoidance,	Tracks The NAFTA

²⁹² A potential exception is an indirect obligation that results from the non-discrimination clause in the tax treaties with the United States and Chile as it applies to the deductibility of amounts paid to a non-resident.

²⁹³ See generally J. Pauwelyn, *Conflict of Norms in Public International Law*, (Cambridge: Cambridge University Press, 2003) at 184-188.

²⁹⁴ There is a non-discrimination Article in the Australia-Japan Tax Treaty. See Article 26. The Free Trade Agreement with Japan has been signed but is not in force.

Chile (2009)	Yes (Limited national treatment for goods, measures related to purchase or consumption of services and rights on expropriation)	YES, modified from OECD version to list certain excluded tax measures under domestic law relating to R&D, tax avoidance, withholding tax etc	Tracks the NAFTA
South Korea (signed in April 2014)	Yes (Limited national treatment for goods, expropriation)	No	Clause 6 in the 1982 protocol of the Tax Treaty states that if Australia ever includes a non-discrimination clause in a future tax treaty it must inform Korea and enter into negotiations for a similar clause in their treaty.

D. Conclusions

The free trade agreements that Canada and Australia have entered into include broad non-discrimination obligations in respect of trade in services and service providers but limited protection against potentially discriminatory tax measures that may have an impact on non-resident service providers. This is typical of bilateral free trade agreements. Also typical of free trade agreements is a provision that establishes the primacy of tax treaties in determining any applicable non-discrimination obligation. Tax treaties include, at best, very limited non-discrimination obligations and provide no direct non-discrimination obligation unless the non-resident service provider takes up tax residence or has a permanent establishment in the other Contracting State. To the extent that Australia does not include a non-discrimination article in a tax treaty with a free trade partner, any non-discrimination obligation in the free trade agreement may be effectively negated with respect to a tax measure. In contrast, because there is no tax treaty between Canada and Panama, either country may rely on the non-discrimination obligation in the free trade agreement with respect to tax measures or to any non-discrimination obligation under the GATS including the national treatment obligation.²⁹⁵

²⁹⁵ See discussion in Chapter 2.A.

Chapter 5: The WTO, NAFTA and the TFEU: Regional Perspectives by WTO Members on Non-Discrimination Obligations

A. Overview

In the last three chapters we have seen that taxation measures, and in particular direct taxation measures, are largely carved out from the non-discrimination obligations assumed under trade agreements and left to the jurisdiction of bilateral tax treaties. For many countries this places the non-discrimination article in a tax treaty between the Contracting States where the non-resident service provider and the recipient of the services reside at the forefront of tax discrimination matters. This is not universally the case, however. The European Union (EU), for example, appears to have largely ignored the non-discrimination article in tax treaties in favour of the non-discrimination obligations in the Treaty on the Functioning of the European Union²⁹⁶ (TFEU) and its predecessors. In interpreting the TFEU, the European Court of Justice (ECJ), now the Court of Justice of the European Union (CJEU) has taken a very broad view of the non-discrimination provisions contained therein with respect to direct tax matters, which results in substantial protection for a non-resident service provider.

The differing approaches to prioritizing tax treaties and other treaties may result in very different non-discrimination obligations and very different tax treatment for World Trade Organization (WTO) Members based on what combination of trade agreement and tax treaties are engaged based on the State where the non-resident resides and the State of the service recipient. These differences are demonstrated using as examples two WTO Members, Canada and the United Kingdom (UK), both of which have assumed non-discrimination obligations in respect of non-resident service providers under regional trade agreements.

The purpose of this chapter is fivefold.²⁹⁷ The first is to compare the non-discrimination obligations in direct tax matters affecting trade in services under the WTO, the North

²⁹⁶ EU, *Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union*, [2012] OJ C 326/01.

²⁹⁷ Portions of this chapter rely on a presentation by the author with M. O'Brien, "Tax Discrimination and the Cross-Border Provision of Services - Canada/UK Perspectives" (Paper delivered at the British Association for Canadian Studies Annual Conference, London, England, June 2005). The paper was

American Free Trade Agreement²⁹⁸ (NAFTA) and in the TFEU. The second is to compare the relationship of the non-discrimination provisions in tax treaties with the non-discrimination obligations in these three trade agreements. The third is to demonstrate the significant differences in treatment accorded to service providers under these three leading trade agreements. The fourth is to demonstrate that a much higher level of protection from non-discrimination that can be found under the TFEU for Members of the EU. The fifth is to draw attention to the piecemeal approach to discrimination obligations that appears to be developing globally under the current regimes in place.

B. Background

As discussed in Chapters 2, 3 and 4, the importance of cross-border trade in services on a global scale has been recognized both in the agreement governing the largest international trade group, the WTO Agreement²⁹⁹, and in trade agreements entered into in smaller trade blocks such as the NAFTA and the TFEU. These trade agreements demand significant commitments of their signatories with respect to market access and non-discrimination in the cross-border supply of services. However, trade discipline over direct taxation³⁰⁰ including the taxation of non-resident service providers, was either largely carved out of these trade agreements (WTO and NAFTA), or at least not expressly included (TFEU).³⁰¹ In the WTO Agreement and the NAFTA, bilateral tax treaties³⁰², were identified as the appropriate primary mechanism to regulate non-discrimination discrimination in direct taxation. Tax treaties generally provide much more limited protection from discriminatory tax practices

later published as a book chapter “Tax Discrimination and the Cross – Border Provision of Services – Canada/UK Perspectives” with M. O’Brien in C. Waters, *British and Canadian Perspectives on International Law* (Leiden/ Boston: Martinus Nijhof Publishers, 2006).

²⁹⁸ *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico, and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289 (entered into force January 1, 1994) [hereinafter NAFTA].

²⁹⁹ WTO, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, 15 April 1994 [hereinafter WTO Agreement].

³⁰⁰ For the purposes of this paper, direct taxation refers to corporate and personal income tax.

³⁰¹ Matters of direct taxation are left to the Member States and unanimity in the Council is required before tax measures can be adopted. Such tax measures must contribute to the functioning of the internal market, and satisfy the requirements of subsidiarity and proportionality.

³⁰² See the OECD, Committee on Fiscal Affairs, *Model Tax Convention on Income and Capital* (Paris: 22 July 2010) [hereinafter OECD Model Tax Treaty]. See also the UN, *Model Double Taxation Convention between Developed and Developing Countries*, (New York: 2011) [hereinafter UN Model Tax Treaty].

than trade agreements. Canada, the United States (US) and Mexico³⁰³ have entered into tax treaties with each other, and with many of their other WTO trade partners.³⁰⁴

The UK has entered into a similar series of bilateral tax treaties with its trading partners, including fellow EU Members.³⁰⁵ However, despite the fact that direct taxation as a restriction on trade is not directly addressed in the TFEU, both the UK's national direct taxation laws and the provisions of its bilateral tax treaties may be "inapplicable" if they are contrary to the TFEU or EU national (secondary) law. The result is that, notwithstanding the commonality of the obligations assumed under bilateral tax treaties and the WTO Agreement, both the approach to tax discrimination and the remedies available to Canadian recipients and providers of services may be very different from those available to their UK counterparts. The tax measures employed by Member States that are challenged before the ECJ also provide clear examples of how a country's national laws can be used to the detriment of a non-resident.

The following section discusses these issues beginning with a short overview of the Canadian perspective on non-discrimination obligations in tax and trade agreements as for purposes of the comparison. A more fulsome discussion is provided in Chapter 3.

C. International Trade Agreements Affecting Trade in Services in the NAFTA Block

³⁰³ See *Convention between Canada and the United States of America with respect to Taxes on Income and on Capital*, 26 September 1980 Can TS 1984 No 15 (entered into force 16 August 1984) [hereinafter the Canada-US Treaty]; *Convention between the Government of Canada and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 8 April 1991, Can TS 1992 No 15 (entered into force 11 May 1992), replaced by a new treaty signed on September 12, 2006 (entered into force on April 12, 2007 [hereafter the Mexico-Canada Treaty]; *Convention Between the Government of The United States Of America And the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 18 September 1992, Treaty Doc No. 103-7, 103d Cong., 1st Sess, (entered into force 1 January 1994) [herein the US-Mexico Tax Treaty].

³⁰⁴ See discussion in Chapter 3.

³⁰⁵ The UK has bilateral tax treaties with over 100 other countries, including all 27 of the other EC Member States and the members of the NAFTA block. See HM Revenue & Customs: Tax Treaties in Force, online: Gov.UK <<http://www.hmrc.gov.uk/taxtreaties/in-force/index.htm>>.

1. A Canadian Perspective

(i) *Overview*

Canada's primary obligations with respect to the regulation of trade in services can be found in the NAFTA, which came into effect on January 1, 1994, with respect to Canada, the US and Mexico, and in the GATS, which came into force on January 1, 1995, as part of the Agreement Establishing the WTO. As a signatory to the WTO Agreement, Canada agreed to honour all of her obligations under the General Agreement on Trade in Services (GATS), but has assumed additional obligations to her NAFTA Partners.³⁰⁶ The immediate discussion focuses on the NAFTA and the GATS. A brief examination of the tax treaties between the NAFTA signatories and the specific provisions that impact the cross-border trade in services follows.

(ii) *The General Agreement on Trade in Services (GATS)*

The GATS, a multilateral agreement covering trade in the service sectors, applies to all WTO Members and thus applies to both Canada and the UK. Its scope and coverage is reliant on the basic definitions of who is a service supplier, and what is considered a measure "affecting trade in services."³⁰⁷ The commitments by Members with respect to such measures may be categorized into two broad groups: first, general obligations, which apply directly and automatically to all WTO Members and services sectors, and second, specific commitments concerning market access and national treatment in designated sectors. These specific commitments are set out in individual country schedules³⁰⁸, the terms of which vary widely.

³⁰⁶ The NAFTA explicitly provides that in case of inconsistency with other agreements, unless otherwise specified in the NAFTA, the NAFTA will override other agreements that existed at the time the NAFTA became effective (Article 103). The WTO Agreement (1994) became effective after the NAFTA. In the final analysis, the choice of forum rules determines which of the WTO or NAFTA rules apply.

³⁰⁷ Specifically, GATS applies to measures by Members "affecting" trade in services. A measure is broadly defined as "any measure by a Member, whether in the form of a law, regulation, procedure, decision, administrative action, or any other form." Trade in services is defined as the "supply of a service."

³⁰⁸ The GATS Article XX.

General obligations assumed under the GATS include a commitment to most favoured nation treatment to the service suppliers of other Members (non-resident service providers). This obligation requires that each party “accord immediately and unconditionally to services and service suppliers of any other Party, treatment no less favourable than that it accords to like services and service suppliers of any other country.”³⁰⁹ In addition to the claimed exemptions for tax measures, the GATS further limits the most favoured nation obligation with respect to direct tax matters if the obligation is assumed under a tax treaty.³¹⁰

Unlike the most favoured nation obligation, each Member’s commitment to provide national treatment to non-resident service suppliers is negotiated under the GATS.³¹¹ A Member may not impose discriminatory measures benefiting domestic services or service suppliers over non-resident services or service suppliers that are contrary to the specific commitments it has made in its country schedule.

As discussed in Chapter 2, the national treatment obligation is subject to a number of general exceptions. In particular Article XIV (d) of the GATS provides that any Member may adopt or enforce direct tax measures that are inconsistent with national treatment, provided that they do not constitute “arbitrary or unjustifiable discrimination” in trade in services and “provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Member countries.” The “equitable or effective” collection of taxes would include, for example, the right to impose a withholding tax.³¹² Like the most favoured nation requirement, the national treatment obligation in respect of direct tax matters has also been largely removed from GATS discipline if a bilateral tax treaty is in effect between the Member countries.³¹³ As a result there may be little room to challenge as discriminatory a direct tax measure under the GATS that relates to the national treatment obligation if a tax treaty is in

³⁰⁹ Some deviation from this standard was permitted provided the Member listed such measures in the “Annex on Article II Exemptions” and the conditions for such exemptions were met. Canada has claimed exemptions for film, video and television co-production, as well as with respect to fishing, banking, trust and insurance services, air and marine transport, and for certain services related to agriculture. See WTO, *Canada Final List of Article II (MFN) Exemptions* (15 April 1994) WTO Doc GATS/EU16, online WTO <<http://docsonline.wto.org>>.

³¹⁰ The GATS Article XIV(e).

³¹¹ The GATS Article XVII.

³¹² The GATS Article XIV (d).

³¹³ The GATS Article XXII (3) provides that the non-discrimination clause in an international agreement relating to the avoidance of double taxation (a tax treaty) has primacy over the GATS national treatment provisions in resolving disputes involving the taxation of services and service suppliers with respect to measures that fall within the scope of the agreement.

place between the two countries.³¹⁴ In contrast, a direct tax measure that violates the most favoured nation obligation may form the subject matter of a potential complaint under the GATS if it is not listed as an exemption by the country complained of or justified under a tax treaty.

In addition to its obligations under the GATS in respect of non-resident service providers, Canada is subject to non-discrimination obligations under the NAFTA.

(iii) The North American Free Trade Agreement (NAFTA)

The NAFTA is designed to significantly liberalize the trade in services by providing for common licensing rules,³¹⁵ transparency provisions,³¹⁶ dispute resolution procedures³¹⁷ and an ongoing commitment to automatically include new services. As discussed in Chapter 3, the NAFTA establishes basic rules agreed to by Canada, Mexico and the US for regulating the provision of services across their respective borders. The Agreement calls for national treatment and most favoured nation treatment,³¹⁸ while prohibiting local presence requirements. The NAFTA exceeds the GATS both in scope and coverage, bringing all existing and future government measures relating to cross-border, non-financial services within the scope of Chapter 12 (Cross-Border Trade in Services). Thus unlike the GATS under which no general national treatment commitments are provided and specific commitments are negotiated separately country by country, the NAFTA operates in reverse and requires each Party to state explicitly – in various annexes – if a Party does not intend to

³¹⁴ Article XXII (3) may preclude one country from challenging the scope of Article XIV(d) (e.g., whether one country's income tax measure applicable to a non-resident is either inequitable or an arbitrary or unjustifiable discrimination), to the extent that the issue falls within the scope of a tax treaty. As a type of national treatment obligation is imposed under most tax treaties with respect to nationals or citizens of a Contracting State who are residents of the other Contracting State, there is arguably little scope to challenge a tax that violates the national treatment obligation, at least under GATS. At issue will be the precise scope of the non-discrimination article in the tax treaty. This issue, according to GATS, is also to be resolved under an established tax treaty unless the Parties consent otherwise.

³¹⁵ NAFTA Parties also committed to encourage professional bodies to develop mutually acceptable standards for licensing professionals and reciprocal recognition of each other's professional accreditations. This was an important step in eliminating a significant non-tariff barrier to free trade in services. Unfortunately there is no time limit on this process under NAFTA, although some progress has been made with respect to the engineering profession and foreign legal consultants (NAFTA, Annex 1210.5(1)). The NAFTA also requires the parties to fairly review and answer applications by the NAFTA party nationals for professional licensing.

³¹⁶ NAFTA Article 1207 and 1209.

³¹⁷ NAFTA Article 2003.

³¹⁸ NAFTA Article 1204 requires that Parties accord to service providers of other Parties the better of national treatment and most favoured nation treatment.

conform to the general rules in Chapter 12 with respect to most favoured nation, national treatment, and other NAFTA obligations.³¹⁹

The NAFTA, like the GATS, specifically addresses the issue of taxation. The principal provisions that relate to taxation are contained in Article 2103 (Taxation). This Article begins by stipulating that nothing in the NAFTA will apply to any tax measure except as specifically provided for in Article 2103(1).

The NAFTA then clarifies the status of tax treaties entered into by NAFTA signatories. In general, tax treaties are to have priority in all cases of inconsistency with the NAFTA.³²⁰ As a result the NAFTA, like the GATS, requires that disputes over tax matters covered by a tax treaty be resolved exclusively under the applicable tax treaty provisions.³²¹

Limited national treatment protection is provided in respect of direct taxes affecting the purchase or consumption of cross-border services and financial services.³²² Article 2103(4)(a) provides that, subject to an applicable tax treaty, national treatment applies to direct taxation measures in respect of the purchase or consumption of particular services.³²³ This provision would presumably prevent, for example, a NAFTA signatory's income tax law from allowing

³¹⁹ Annex 1 of the NAFTA contains the three countries' reservation Schedules for their non-conforming federal measures. See Article 1206(a)(i). Laws and regulations that are listed as a reservation in Annex 1 cannot be challenged as long as they do not become more inconsistent with the agreement.

³²⁰ There are two exceptions to the primacy of tax treaties in tax matters specifically listed in the NAFTA. The first is with respect to the national treatment obligation as it relates to the trade in goods. The national treatment obligation, as proscribed in Article III of the GATT, will have primacy over lesser obligations assumed under a tax treaty. The second is with respect to export taxes, specifically the provisions of Article 314, which allows Mexico to impose an export tax on basic foodstuffs, and Article 604, which addresses the imposition of export taxes on energy in defined circumstances. These exceptions may be of little practical effect as such matters are not normally addressed in a tax treaty. In addition, Article 2103(6) provides that Article 1110 (Expropriation) shall apply to taxation measures subject to certain procedural rules.

³²¹ NAFTA Article 2103(2).

³²² With regard to financial services, subparagraph 4(a) applies only to the cross-border provision of a financial service under paragraph 1405(3).

³²³ Specifically, in relation to direct taxes, subparagraph 4(a) provides that certain direct tax measures listed therein (taxes on income, capital gains or the taxable capital of corporations and the Mexican asset tax) are, but for listed limitations, subject to the national treatment obligation with respect to the cross-border provision of services, including financial services. However, with regard to financial services subparagraph 4(a) applies only to the cross-border provision of a financial service under paragraph 1405(3).

for the deduction of consulting services purchased from a domestic consulting firm but not from firms in other NAFTA countries.³²⁴

The NAFTA obligations with respect to direct (and indirect) taxation measures are limited by a number of important exceptions. Specifically, the non-discrimination provisions do not apply to any most favoured nation obligation with respect to an advantage accorded by a party pursuant to a tax convention, to any taxation measures in existence at the time that the NAFTA came into effect (January 1, 1994) or to the renewal or any amendment of a tax measure that does not decrease its conformity, or to any new tax measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the parties or arbitrarily nullify or impair benefits accorded under those articles.³²⁵

Discipline with respect to measures that affect performance requirements are also covered in Article 2101(General Exceptions). These may apply to service suppliers who establish a commercial presence in country that is a signatory to the NAFTA, opening up arguments under Chapter 11 (Investment) of the NAFTA which contains general prohibitions that prevent one NAFTA signatory from imposing certain conditions on investment by investors of the countries on the other signatory's territory.³²⁶ In addition to these general prohibitions, the NAFTA prohibits certain performance requirements made in connection with the conferral of benefits by a government; such benefits would include subsidies, financing assistance and tax concessions.

In summary, the NAFTA does not generally affect the respective income tax laws of each country or affect a country's sovereign right to tax profits earned by non-resident service providers within its borders. Instead the Agreement generally leaves direct taxation to the domestic law of the three NAFTA signatories and the tax treaties between them. Thus the tax

³²⁴ See the *North American Free Trade Agreement Implementation Act American Statement of Administrative Action* (US) Final Draft September 1993 c. 21.3. Taxation: c) Income & Capital Tax Measures Affecting Cross-Border Services & Financial Services.

³²⁵ NAFTA Article 2103(4) (c-h).

³²⁶ NAFTA Article 1106(1) prohibits seven different types of practices, including achieving a given level or percentage of domestic content, and purchasing, using or according a preference to goods produced or services provided in its territory or to purchase goods or services from persons in its territory.

treaties between the NAFTA signatories assume considerable importance both in the taxation of service suppliers in the NAFTA Block and in preventing tax discrimination.³²⁷

As discussed, Canada has entered into bilateral tax treaties with both its NAFTA partners as well as most of the WTO signatories. Canada's tax treaties, once enacted as Canadian domestic law, take precedence over other domestic law such as the *Income Tax Act*. Because Canada's tax treaties with the NAFTA signatories are bilateral, each tax treaty addresses the matter of non-discrimination differently, including what taxes are covered and how the non-discrimination article is to be interpreted and applied.³²⁸ As a result, in order to determine if a tax is discriminatory from a Canadian perspective, both the questions of whether a tax treaty applies and if not, whether obligations under either the NAFTA or the GATS have been violated must be answered. An additional question is what will be the appropriate forum for dispute resolution—the NAFTA or the WTO?³²⁹

There is very little guidance in this process as there is very little Canadian case law that addresses non-discrimination obligation in Canadian tax treaties. This is not surprising given the very limited scope of the non-discrimination obligations assumed. As stated previously, absent a non-discrimination obligation in the tax treaty it is highly unlikely that a Canadian court would see a claim of tax discrimination. The exception and indeed the only Canadian decision on the meaning and scope of the non-discrimination obligation in Canada's tax treaties is the 2011 *Saipem UK Ltd v R*³³⁰ (*Saipem*) decision. At issue was whether the non-

³²⁷ To understand the Canadian position in the NAFTA block it is important to note that Canada has consistently maintained and negotiated a right to discriminate against non-residents in its tax treaties and has reserved her position under the Non-Discrimination Article in the OECD Model Tax Treaty. As a result, the provisions and the effect of the non-discrimination article in the Canada – Mexico Treaty varies considerably from that of the Canada- US Treaty, where the US rigorously pursued a non-discrimination article that was closer to the OECD Model Tax Treaty.

³²⁸ See discussion in Chapter 3.C.4.

³²⁹ To reach a conclusion about whether a tax is discriminatory, and if so, how it is to be disciplined, a series of questions could be posed. These might include:

1. What is the tax issue being complained about?
2. Does a tax treaty apply?
 - If the answer is yes, the tax treaty prevails.
 - If the answer is maybe, the competent authority will decide if the tax treaty applies to the matter with respect to the national treatment obligation under the GATS. With respect to other issues consider the role of the relevant Mutual Agreement Procedure.
 - If the answer is no, see step 3.
3. If the answer to question 2 is no, which of the GATS or NAFTA applies? If the answer is either, which is the forum from the complainant's perspective for dispute settlement?

³³⁰ *Saipem UK Ltd. v R*, [2011] 2 CTC 2341, 2011 TCC 25, aff'd [2012] 1 CTC 239, 2011 FCA 243.

discrimination provisions in Article 22 of the Canada-UK Tax Treaty³³¹ had been violated because Canadian Revenue Authorities (CRA) refused to allow losses claimed by the Canadian permanent establishment of a UK tax resident against Canadian tax liability.

Although the issue in *Saipem* directly involved the tax treatment of a permanent establishment, Saipem's primary argument for claiming the loss was that residents and non-resident could be "in the same circumstances" for purposes of Article 22(1) of the Canada-UK Tax Treaty, which prohibits discrimination on the basis of nationality. For this reason, the Court's findings have broad application in respect of the non-discrimination obligation in tax matters for any non-resident under Canadian law. The decision is discussed below.

Saipem UK was incorporated and resident in the UK. It carried on business in Canada through a permanent establishment from 2004 to 2008. Saipem's subsidiary, SEI, which was also resident in the UK, carried on business in Canada through a permanent establishment from 2001 to 2003. In 2003 SEI was wound up into Saipem UK.

In computing its taxable income for Canadian tax purposes for the 2004 to 2006 taxation years, Saipem UK claimed deductions relating to certain non-capital losses of SEI under a Canadian domestic provision³³² which allows a parent corporation to deduct the losses of its wound-up subsidiary. A critical requirement in accessing the deduction is that both the parent and the subsidiary be a "Canadian corporation" – that is, resident in Canada and either incorporated in Canada or resident in Canada since at least June 18, 1971. The Minister of National Revenue disallowed Saipem UK's deductions on the basis that neither it nor SEI qualified as a Canadian corporation.

Article 22 of the Canada-UK Tax Treaty prohibits discrimination based on nationality, which in the case of a corporation, means its place of incorporation. Specifically, Article 22(1) provides that the nationals of a Contracting State are not to be subject (in the other State) to taxation or any other requirement "more burdensome than the taxation" to which nationals of the other State in the same circumstances would be subject. Article 22(2) of the Canada-UK

³³¹ *Convention Between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital Gains*, 8 September 1978, Can TS 1980 No 25 (entered into force 17 December 1980) as Amended by the Protocols Signed on April 15, 1980, October 16, 1985 and May 7, 2003, Part X.

³³² Subsection 88(1.1) of the *Income Tax Act*, RSC 1985, c 1 as amended.

Tax Treaty similarly prohibits discrimination for a permanent establishment, requiring that tax must not be levied “less favourably.”

Saipem UK argued that there was discrimination under Article 22(1) of the Canada-UK Tax Treaty and relied on the meaning of the words “in the same circumstances” in that paragraph. According to Saipem UK, the proper comparison was to a Canadian parent corporation having access to the losses of its Canadian subsidiary. On the basis of that comparison, there was, in the view of Saipem UK, discrimination.

Angers J, who heard the matter, disagreed. In his view, the proper approach was to compare Saipem UK “with a Canadian national that was a non-resident of Canada and that had a non-resident wound-up subsidiary.”³³³ That non-resident Canadian national would not have qualified as a Canadian corporation and therefore could not access the losses of its wound-up subsidiary.

In his reasons for judgment, Angers J was also clear that residents and non-residents are not in the same circumstances for purposes of Article 22(1) of the Canada-UK Tax Treaty and that to treat a non-resident differently was not in violation of the treaty non-discrimination obligation.

Angers J also considered Article 22(2) of the Canada-UK Tax Treaty and the required tax treatment of permanent establishments. He noted that Saipem UK was seeking to deduct losses that had resulted from the Canadian activities of its subsidiary, SEI, and not from its own Canadian activities carried on through a permanent establishment. Such a deduction would not have been allowed under Article 7 of the Tax Treaty. Accordingly, Angers J held that non-discriminatory treatment under Article 22 only extended to the taxation of Saipem UK’s – not SEI’s – Canadian permanent establishment activities.

The Federal Court of Appeal affirmed the *Saipem* decision in 2012.³³⁴ According to the Federal Court, the argument by Saipem UK was, in effect, that Canada should not be allowed in the particular circumstances of this case to discriminate against it on the basis of residency.

³³³ *Saipem*, *supra* note 330 at para 58.

³³⁴ *Saipem UK Ltd. v R*, [2012] 1 CTC 239, 2011 FCA 243.

The Court concluded that there was nothing in the Canada-UK Tax Treaty to support that view.

As will be discussed in the context of the EU, the analysis and outcome in *Saipem* would be very different under the TFEU.

D. International Trade Agreements Affecting Trade in Services in the European Union

1. A United Kingdom Perspective

Although the UK, like Canada, is a WTO Member and bound by the GATS, its most significant trade obligations are owed to its 27 fellow EU Member States under EU law. The preceding description of how the GATS applies to direct taxation of trade in services shows that provisions governing direct taxation in bilateral tax treaties generally take precedence over most favoured nation and national treatment obligations in the GATS. As noted, the UK has a very extensive network of bilateral tax treaties with other WTO Members, so that most tax discrimination disputes (except in cases involving the UK's EU partners) will be resolved in accordance with the applicable tax treaty rather than under the GATS. In the case of tax dispute with an EU partner a violation of the non-discrimination obligation would ordinarily be pursued under the TFEU which provides better protection to the non-resident service provider.

The UK's obligations under the TFEU with respect to direct taxation takes priority over its obligations in its tax treaties with other EU Member States. Accordingly, EU law will apply where UK tax laws create restrictions on trade in services with its EU partners.

Although procedure and remedies are generally beyond the scope of this chapter, it is important to note that EU taxpayers have easier access to remedies for tax discrimination. Individuals or corporations can directly enforce, in their national courts, their fundamental EU rights to provide or receive services within the EU without restriction based on nationality or residence. EU taxpayers can thus sue their own and other Member State

governments, and are entitled to a refund of any tax collected contrary to EU law.³³⁵ While UK service providers or recipients can request their national government take action against another WTO Member government if they consider that they are being discriminated against contrary to the GATS, they may not take direct action on their own behalf in any dispute resolution process. This means that when the dispute is between a taxpayer and an EU Member State tax authority, it will normally be resolved under the TFEU.

2. Services and Direct Taxation in the European Union

Free trade in services is one of the fundamental principles of the single market project begun under the Treaty of Rome (now the TFEU) in 1958. The four components of the GATS definition of trade in services³³⁶ are governed by two separate chapters in the TFEU: the Right of Establishment³³⁷ and Services³³⁸. Freedom of services protects the right of a person to provide services to a recipient in another Member State without establishing a commercial presence in the other Member State. Once a service provider has set up an establishment in the other Member State, the right of establishment chapter (Chapter 49) applies in priority to the services chapter (Chapter 56). In this discussion the focus will be on TFEU provisions and cases specifically relating to trade in services, though reference will be made to the right of establishment where necessary.

The TFEU chapter on services applies to services of an industrial, commercial, craft or professional character provided for remuneration. Service providers who are individuals,

³³⁵ The European Commission may also take action directly before the Court of Justice against a Member State for failure to fulfill its Treaty obligations if its laws contravene the Treaty (TFEU Article 258). Until recently, the Commission seemed reluctant to take this action. A Member State of the EU may also commence action in the Court against another Member State (TFEU Article 259), but this is extremely rare.

³³⁶ Article 2 of the GATS defines trade in services as comprising four types of activity: (1) supply of a service from the territory of one Member to the territory of another; (2) in the territory of one Member to the service consumer of any other Member (3) services supplied through commercial presence in the territory of another Member, and (4) through presence of natural persons in the territory of another Member.

³³⁷ TFEU Articles 49-55. The right of establishment requires a Member State to allow a corporation or individual who is a national of another Member State to set up an establishment (for example, an office in the case of an individual offering professional services, or a branch or subsidiary in the case of a corporation) for the purpose of carrying on any type of business (not just providing services) on the host Member State's territory under the same conditions as nationals of the host Member State.

³³⁸ TFEU Articles 56-52, which also incorporate the principles of Articles 51-54 in the chapter on the Right of Establishment.

corporations and firms³³⁹ are all entitled to national treatment (though that phrase is not used) as they may not be subject to restrictions under the law of a Member State which are different than those faced by nationals of that Member State providing the same kind of services. Article 56 of the TFEU (TEC Article 49) expressly protects services providers who are EU nationals, but who are neither nationals of, nor established in, the Member State where the recipient of the services is located. In addition, the obligation imposed by the freedom to provide services guarantee is infringed where a Member State's laws, regulations or administrative policies or practices operate to deter a Member's nationals or residents from seeking to obtain services from suppliers not resident or established in that State.³⁴⁰

With respect to direct taxation, the Council of the European Union has a general power to adopt directives for the harmonization of laws, regulations and administrative positions of the Member States in order to establish and ensure the proper functioning of the internal market.³⁴¹ In the case of tax harmonization measures, the Council must adopt a legislative proposal of the European Commission unanimously.³⁴² The difficulty of obtaining unanimity of all Member States in the Council means that the number of directives in the field of direct taxation is few, though those that have been adopted are significant in their effects. The result is that Member States retain general competence over direct taxation, but with an important caveat: they must exercise that competence in accordance with EU law. This means that they may not enact or maintain in force any tax measure that is contrary to the TFEU or secondary EU law.

As with the other fundamental freedoms³⁴³ contained in the TFEU, the prohibition against discrimination in services is not limited to "overt discrimination," that is, situations where a provision of a Member State's law differentiates specifically between nationals and non-nationals. Discrimination consists of treating those in comparable situations differently, as

³³⁹ TFEU Article 57. Companies and firms formed under the law of a Member State and which have their registered office, central administration or principal place of business in a Member State of the EC are treated as nationals of that Member State. See also TFEU Article 18.

³⁴⁰ EJC, *Safir v Skattemyndigheten*, C-118/96, [1998] ECR I-1897 at para 30, EJC, *Eurowings Luftverkehr*, C-294/97 [1999] ECR I-7447, and AG *v Finanzamt Dortmund-Unna*, C-294/97, [1999] ECR I-7447 at para 37.

³⁴¹ TFEU Articles 114 and 115.

³⁴² TFEU Article 115.

³⁴³ In addition to freedom of establishment and services, the TFEU provides for free movement of goods, workers and capital.

well as in treating persons in different situations the same.³⁴⁴ Applying distinguishing criteria other than nationality is prohibited where in fact it leads to discrimination on the basis of nationality. Thus, a provision of national law which treats non-residents less favourably than residents is prohibited as “covert discrimination” where non-residents can demonstrate that they are in a comparable situation to residents and where, as a practical matter, the impact of the measure is felt primarily by non-nationals.³⁴⁵ This is usually the case, as non-residents of a Member State are much more likely than residents of that State to be non-nationals. If the tax law of a Member State treats the non-resident less favorably, the CJEU (formerly the ECJ), will examine whether the circumstances of the non-resident are comparable to that of a resident in the Member State. If the answer is no the issue becomes one of justification. Can the measure be justified? Finally, the court will ask whether the measure goes beyond what is necessary to achieve the objective being pursued.

The issue of whether residents and non-residents are in a comparable situation with respect to direct taxation will be discussed more fully below.

3. European Union Cases on Direct Taxation and Services

The CJEU / ECJ has heard a number of cases disputing national income tax measures on the grounds of interference with free movement of services. While many of the cases concern the provision of insurance and pension services,³⁴⁶ the types of services addressed in the cases range widely, from aircraft leasing³⁴⁷, lotteries³⁴⁸, research contracting³⁴⁹, providing professional training courses³⁵⁰ to the services of a professional musician³⁵¹ and more recently rock stars³⁵² and football teams.³⁵³ The form of tax discrimination varies, but in each

³⁴⁴ ECJ, *Finanzamt Köln-Altstadt v Schumacker*, C-279/93, [1995] ECR I- 225 at paras 27-30.

³⁴⁵ ECJ, *Giovanni Maria Sotgiu v Deutsche Bundespost*, C-152/73, [1974] ECR 153 at para 11.

³⁴⁶ See among others, ECJ, *Hanns-Martin Bachmann v Belgium*, C-204/90, [1992] ECR I – 249; ECJ, *Commission of the European Communities v Belgium*, C-300/90, [1992] ECR I-305; *Safir*, *supra*, note 45; ECJ, *Danner*, C-136/00, [2002] ECR I-8147; ECJ, *Skandia and Ramstedt*, C-42/02, [2003] ECR I-6817; ECJ, *Commission of the European Communities v France*, C-334/02, [2004] ECR I-2229.

³⁴⁷ *Eurowings*, *supra* note 340.

³⁴⁸ ECJ, *Lindman*, C-42/02, [2003] ECR I-13519.

³⁴⁹ ECJ, *Laboratoires Fournier SA v Direction des vérifications nationales et internationales*, C-39/04, [2005] I-02057.

³⁵⁰ ECJ, *Skatteministeriet v Vestergaard*, C-55/98, [1999] ECR I-7641.

³⁵¹ ECJ, *Arnoud Gerritse v Finanzamt Neukölln-Nord*, C-234/01, [2003] ECR I-05933.

³⁵² ECJ, *FKP Scorpio Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel*, C-290/04 [2006] I–09461.

³⁵³ ECJ, *X NV v Staatssecretaris van Financiën*, C-498/10, [2012] [hereinafter X].

case involves the tax measures of a Member State which result in a heavier tax or administrative burden either on the non-resident service provider or on a recipient who obtains services from a provider who does not have an establishment (either a subsidiary or a branch) in the Member State in which recipient resides or is established. Three representative cases involving non-resident services and service providers are briefly outlined here to illustrate the application of the prohibition of direct tax discrimination in trade in services under EU law in three circumstances: where limits are imposed on the deductibility of expenses related to the provision of cross-border services, where limits are placed on access to tax credits related to the acquisition of cross-border services are purchased; and the requirement to impose withholding tax when cross-border services are provided.

(i) Deductibility of Expenses (Administrative Presumptions)

The first illustrative case, *Skatteministeriet v Vestergaard*³⁵⁴, addressed the deductibility of expenses and the use of administrative presumptions. At issue was the deductibility of professional training expenses. Danish administrative policy, upheld in numerous Danish court rulings, was to impose a presumption that professional training courses held at foreign tourist resorts contained such a significant tourism element that the expenses of attending such courses were deemed not to be deductible.³⁵⁵ Further, in order to rebut the presumption, the practice of the Danish authorities was to require that the taxpayer demonstrate that the foreign location was indispensable to the objective of the training course.³⁵⁶

Mr. Vestergaard was a Danish auditor, employed by a company of which he was the sole shareholder. He attended a tax course specifically for Danish auditors in Crete. The Danish tax authorities allowed the Danish corporation to deduct Mr. Vestergaard's expenses for attendance at the course, but included the amount in Mr. Vestergaard's income as additional

³⁵⁴ *Supra* note 350.

³⁵⁵ Article 24 of the OECD Model Tax Treaty prohibits this discriminatory treatment of business expenses. The tax treaty between Greece and Denmark prohibits (and prohibited at the time) Denmark from disallowing a deduction for a disbursement made to a Greek resident which would be deductible if paid to a Danish resident so that presumably Mr. Vestergaard could have relied on the tax treaty. It may be that Mr. Vestergaard's company paid the amount to a Danish travel agent or other organization, or that the allowance of the deduction to the company meant that the tax treaty did not strictly apply.

³⁵⁶ The rare example of a successful rebuttal of the presumption given in Advocate General Saggio's opinion was of a professor of classical history who was allowed to deduct expenses of a course held in Greece.

salary or bonus. If the same course were held at a Danish tourist resort the cost would not have been subject to the presumption against deductibility of expenses.

The ECJ held that the administrative presumption applied by the Danish revenue authorities was contrary to Article 49 of the TEC (now TFEU Article 56) in that it subjected the service of providing professional courses to different tax rules depending on whether the services were provided in Denmark or in another EU Member State (in this case Greece). There was unequal treatment, making it more difficult to deduct the cost of courses organized abroad than in Denmark, which constituted a restriction on a non-Danish service provider's freedom to offer their services to Danish taxpayers.

(ii) Access to Domestic Tax Credits

A second example of a prohibited and discriminatory tax measure can be found in *Laboratoires Fournier SA v Direction des vérifications nationales et internationales*³⁵⁷ (*Laboratoires Fournier*). In that case, the ECJ held that French tax law, which provided a tax credit equal to 50% of the expenses incurred for research activities carried out in France, but not in other Member States, was contrary to the (TEC) Article 49³⁵⁸ (TFEU Article 56).

The facts in *Laboratoires Fournier* were straightforward. *Laboratoires Fournier* was a pharmaceutical manufacturer that contracted research services to research facilities in various Member States in 1995 and 1996, and claimed the tax credit against its French corporate tax liability in respect of the expenses incurred. Following an audit the French tax authorities denied the credit because the research had not been carried out in France. The ECJ held that the failure to allow the same tax advantage for research expenses incurred in any Member State of the then EC infringed the freedom of service providers involved in research in other Member States to offer their services to French purchasers of services. It also deterred French purchasers of services from obtaining such services from other Member States. The measure

³⁵⁷ *Supra*, note 349.

³⁵⁸ The EC, *Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007*, [2007] OJ, C 306 [hereinafter the Treaty of Lisbon] which came into force December 1, 2009 modified the Treaty on European Union (TEC) and many of the provisions were renumbered.

thus constituted a restriction on the freedom to provide services guaranteed by TEC Article 49 (TFEU Article 56).³⁵⁹

(iii) Cross -Border Services and Withholding Taxes

The trilogy of cases discussed below examines whether the imposition of gross withholding taxes is contrary to Article 49 of the TEC (TFEU Article 56) both from the perspective of the non-resident service provider and of the non-resident recipient of services.

The first of these cases, *Gerritse v Finanzamt Neukölln-Nord*³⁶⁰, involved the imposition of gross withholding taxes by the source state. The taxpayer involved was a Netherlands resident, Mr. Gerritse, who provided services as a professional drummer for a radio station in Berlin in 1996 for which he was paid approximately 6000 Deutsche Marks (DEM). He incurred business expenses of 698 DEM directly related to the services provided in Germany. German law provided for (and the 1959 tax treaty between Germany and the Netherlands allowed) a deduction at source of 25% of the gross income earned by the taxpayer in Germany as his final German tax liability.

Mr. Gerritse argued that he was subject to discrimination contrary to TEC Article 49 because the flat 25% withholding from his gross earnings did not allow him the basic exemption threshold of approximately 12,100 DEM which German residents, and non-residents who earned greater than 50% of their income in Germany, or who had income of less than 12,000 DEM in other countries, were allowed. He also made a second argument that disallowing the deduction of the expenses that he incurred in providing the services in Germany was discriminatory as suppliers of services who were resident or established in Germany were permitted to deduct such expenses in computing their taxable income.

Mr. Gerritse was unsuccessful on the first argument. The ECJ ruled that in relation to direct taxation, residents and non-residents are not generally in comparable situations. A Member State may therefore apply different rules to residents than to non-residents. According to the

³⁵⁹ Note that the Non-Discrimination Article in the OECD Model Tax Treaty would also not have prohibited this measure, as the Model only requires that a Contracting State allow a deduction for an expense where the amount is paid to a resident of the other Contracting Party in any case where the expense would be deductible if paid to a resident of the first State. The OECD Model Tax Treaty provision does not address tax credits.

³⁶⁰ *Supra*, note 351.

Court, it is within the power of State of residence of a taxpayer to make provisions for social objectives such as reduced ability to pay related to personal and family circumstances and to ensure progressiveness in the personal income tax system. In the Court's view, the Netherlands did this by taking into account the German tax in computing Mr. Gerritse's worldwide income subject to Netherlands tax.³⁶¹

Mr. Gerritse was successful with his second argument. The ECJ ruled that the refusal by German revenue authorities to allow the deduction of expenses incurred in order to earn the income was a clear disadvantage to services providers not resident or established in Germany. The ECJ also found that no precise argument had been put forward to justify the discriminatory treatment. A similar argument with respect to the right to deduct expenses was also successful in the *FKP Scorpio Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel*³⁶² (*Scorpio*) case that followed three years later.

The *Scorpio* case involved payment for a performance by a rock star. The particular issue in *Scorpio* with respect to the deductibility of expenses was whether the expenses could be claimed before the basis for withholding tax was established. The case again involved German withholding tax and a non-resident service provider, however the issue of deductibility was more nuanced. The case focused on the question of timing, specifically on precisely when the expenses were deductible when calculating the withholding liability. The question arose because the German Ministry of Finance interpreted the ECJ's decision in *Gerritse* to mean that expenses must be deductible in calculating withholding tax restrictively. The Ministry responded by providing an option for affected non-residents to file a special income tax refund application in which the expenses of the performance could be claimed after the performance.³⁶³ The matter of concern for the German Supreme Court was whether this was sufficient to comply with the promised freedoms in the then EC Treaty. In particular the Court was concerned with the question of whether expenses directly linked to the performance should be deducted when calculating the withholding tax. If so, it followed that German withholding tax could only be levied on net income after the deduction of related expenses. The ECJ agreed with this view and found that withholding taxes could only

³⁶¹ The relationship of EC discrimination law with bilateral tax agreements is discussed in more detail below.

³⁶² *Scorpio*, *supra* note 352. See also ECJ, *Cento Equestre da Lezíria Grande Lda v Bundesamt für Finanzen*, C-345/04, [2007] ECR I-1425.

³⁶³ See D Molenaar & H Grams, "Scorpio and the Netherlands: Major Changes in Artiste and Sportsman Taxation in the European Union" (2007) 2 *European Taxation* 63 at 63.

be levied on the net performance income of the non-resident after the deduction of the expenses directly related to the income earned. It is important that in *Scorpio* the direct expenses incurred in providing the services were reported to the service recipient by the non-resident, a factor that the Court referenced in its opinion.

In summary, in *Scorpio*, the ECJ determined that it was contrary to the freedom to provide services for a Member State to levy a withholding tax on gross income without allowing a deduction for directly linked expenses in circumstances where the gross withholding tax is higher than the tax rates that would otherwise apply to net income. The Court's answer was different with respect to business expenses that were not directly related. The Court held that indirectly related expenses could be taken into account in the refund procedure.³⁶⁴

Although the *Scorpio* decision effectively answered the question of the timing of when directly related expenses must be taken into account when calculating withholding tax, it left open the question of whether the withholding tax itself was contrary to the fundamental freedoms once the mutual agreement in collection directive was in place.³⁶⁵ During the period under review in *Scorpio* the directive on mutual assistance in collection did not exist, leaving many to speculate whether the justification of effective taxation would be accepted if the mutual assistance agreement³⁶⁶ were in place between the Member States. The answer to that question was provided in *X NV v Staatssecretaris van Financiën*³⁶⁷ (X) in 2012.

The X case involved a Dutch football club (Club Feyenoord) that had an agreement with two British clubs to play friendly matches in the Netherlands in August 2002 and August 2004 respectively. The Dutch taxpayer made lump sum payments to the British clubs for the matches at issue. The Dutch Revenue Authorities assessed the Dutch taxpayer an amount equal to 20 percent of the payments made to the British clubs (after the deduction of certain costs³⁶⁸). Under Dutch national laws this equaled the withholding tax that the Dutch taxpayer had failed to collect and remit on those payments.

³⁶⁴ *Scorpio*, *supra* note 352 at para 52.

³⁶⁵ The mutual assistance in collection directive has now been replaced by EU, *Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures*, [2010] OJ L 84/1. The directive was extended to income tax in 2001, since it was originally adopted in 1976.

³⁶⁶ See *infra* note 372.

³⁶⁷ *Supra* note 353.

³⁶⁸ Under Dutch law at that time expenses could be deducted at source, but only after written approval was received from the Dutch tax authorities. The approval could be sought for in advance of the

The taxpayer appealed the assessment on the basis that the relevant Netherlands legislation constituted a restriction on the freedom to provide services within the meaning of TEC Article 56 (now TFEU Article 63) and could not be justified. The Dutch Revenue Authorities argued that the withholding tax was aimed at safeguarding the effective collection of income taxes in respect of non-residents. The Dutch Supreme Court referred the matter to the ECJ in 2010. An additional question posed was whether it was relevant that the non-resident service provider could deduct the tax withheld in the Netherlands from its tax liability in the Member State in which it was established.

One of the reasons that the Dutch Supreme Court decided to refer its questions to the ECJ was the heavy criticism of the *Belgian State - SPF Finances v Truck Center SA*³⁶⁹ (*Truck Centre*) case, a decision that addressed the issue of withholding tax. In *Truck Center*, a Belgian company was required to withhold Belgian tax on interest payments to its Luxembourg shareholder but not in respect of payments to a domestic Belgian shareholder. The ECJ determined that the Luxembourg and Belgian shareholders were not in comparable circumstances and that the tax treaty between the two states allowed for source taxation. The Court also concluded that because the difference in treatment did not necessarily procure an advantage for the resident recipients, it did not constitute a restriction of the freedom of establishment.³⁷⁰ The importance of the decision in the context of this discussion is that the Court ruled that TEC Article 56 (now TFEU Article 63) must also be interpreted as not precluding a Member State from enforcing tax legislation that provides for the retention of tax at source. It is also important because, unlike in *Scorpio*, a specific directive on mutual assistance in the collection of taxes was in existence. However, as the Court did not find discrimination, it did not have to apply the test of proportionality to investigate whether less stringent means could have been used, the question left unanswered in *Scorpio*.

The *X* case differs from the *Truck Center* decision as well as that of *Gerritse* and *Scorpio* in that it addresses the withholding tax obligation from the perspective of the recipient of the services and not the service provider. The argument for discrimination from this perspective is that the obligation to withhold imposes an administrative burden on the service recipient

performance or up to one month after the performance. In the absence of the approval predetermined deemed expenses were deductible.

³⁶⁹ ECJ, *Belgian State - SPF Finances v Truck Center SA*, C-282/07, [2008] ECR I-10767.

³⁷⁰ *Ibid* at para 49 and 50.

and additional tax liability that a recipient would not face if they hired a resident service provider.

The ECJ agreed that the freedom to provide services confers rights not only on the service provider but also on the recipient of the service. The Court also agreed that the obligation to withhold tax entailed an additional administrative burden on the recipient as well as related risks concerning liability. The result, in its view was that cross-border services would be less attractive for the recipient of such services than services provided by resident service providers. The Court also rejected the argument that the disadvantage created by the withholding tax was offset by a reduction of the administrative burden on the non-resident service provider, who was not required to file a tax return in the Netherlands. Consequently, the obligation on the recipient of services to withhold at source tax on the remuneration paid to non-resident service providers, when a similar obligation was not levied on remuneration paid to resident service providers, constituted a restriction on the freedom to provide services.

A restriction on the freedom to provide services was acceptable only if it was justified by overriding reasons in the public interest. The Court concluded “if a service provider provided occasional services in another member state for short periods, a withholding tax at source was an appropriate means of ensuring the effective collection of the tax due.”³⁷¹ It did not go beyond what was necessary to achieve that purpose, even in the light of the opportunities for mutual assistance in the recovery of taxes.³⁷²

The Court’s reasoning with respect to the role of the mutual assistance in collection directive is discussed below. The analysis is significant in the EU context as this is the first time that the Court engaged in a proportionality analysis, a task not required in prior decisions including *Scorpio* and *Truck Centre*.

In the *X* case the court poses the following question. “Does the measure go beyond what is necessary to ensure the effective collection of the tax due, in the light of, inter alia, the

³⁷¹ *X*, *supra* note 354 at para 42.

³⁷² The court references *Council Directive 76/308/EEC of 15 March 1976 as amended by EC, Council Directive 2001/44/EC of 15 June 2001 amending Directive 76/308/EEC on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties and in respect of value added tax and certain excise duties*, [2001] OJ L 175/17.

opportunities presented by Directive 76/308 in the field of mutual assistance for the recovery of taxes?”³⁷³

The Court stated that the purpose of Directive 76/308 was to eliminate obstacles to the establishment and functioning of the common market resulting from the territorial limitation of national provisions relating to tax recovery. In the Court’s view, Directive 76/308 “provides for measures of assistance in the form of the disclosure of information useful for the recovery, notification of instruments to the addressee and the recovery of claims which are the subject of an instrument permitting their enforcement.” The extension of the scope of the Directive to include claims relating to taxes on income was not to replace taxation at source as a method of collecting tax.³⁷⁴

The Court went on to observe that although the renunciation of withholding tax at source and recourse to the arrangements governing mutual assistance would eliminate the restriction to the freedom to provide services complained of, it would not necessarily eliminate all the formalities for which the service recipient was responsible, nor would it eliminate formalities for the non-resident service provider. In particular, in the absence of a withholding tax, the tax authorities concerned would no doubt still impose an obligation on the service recipient to declare the service was being carried out by a non-resident service provider.

Similarly, the renunciation of withholding tax would not eliminate formalities for the non-resident service provider. Instead the tax must be collected directly from the non-resident service provider. This could “lead to a serious burden on the foreign [non-resident] service provider in that he would have to submit a tax return in a foreign language and to familiarize himself with a tax system in a Member State other than that in which he is established.”³⁷⁵ The Court noted that this burden could deter the non-resident service provider from providing a service in another Member State and it ultimately makes it more difficult for the service recipient to obtain a service from another Member State. It “would also give rise to a significant administrative burden for the tax authorities responsible for the service recipient in view of the large number of services provided on an ad hoc basis.”³⁷⁶

³⁷³ The Directive establishes common rules on mutual assistance in order to ensure the recovery of claims relating to certain levies, duties and taxes. It allows a Member State to request assistance from another Member State in the recovery of income tax payable by a taxpayer resident in the other Member State.

³⁷⁴ Directive 2001/44, *supra* note 372.

³⁷⁵ *X* case, *supra* note 354 at para 50.

³⁷⁶ *X* case, *supra* note 354 at para 51.

The Court also concluded that the tax treatment of the service provider in the Member State in which the non-resident service provider was established was not relevant for the purpose of determining whether the obligation on the recipient of services to withhold that tax at source constituted a restriction on the freedom to provide services prohibited by TEC Article 56 (now TFEU Article 63).

One matter of considerable interest in the *X* case was the Court's response to Advocate-General Kokott's comments with respect to proportionality and withholding tax. Advocate General Kokott concluded "the taxation at source here at issue does not go beyond what is necessary, provided that the restriction on the freedom to provide services consists solely in the taxation at source as such and not in a higher tax liability."³⁷⁷

The issue of whether a withholding tax at source that results in a greater tax burden on the service provider than that when services are carried out by a resident constitutes a restriction on the freedom to provide services was not posed by the Dutch Court, nor was it answered by the ECJ. The ECJ noted that if a withholding tax results in the non-resident being subject to a higher tax burden than a resident for the provision of the services it constitutes a restriction on the freedom to provide services if it has repercussions for the cost of the services.³⁷⁸

Based on the rulings in *Scorpio* and the *X* case it is clear that the imposition of withholding tax may be justified under a Member State's national law provided that the withholding tax is calculated after allowing for the deduction of directly applicable and reported expenses. Thus the imposition of gross withholding taxes on non-resident service providers cannot generally be justified in respect of fellow EU Members. The same is not true of gross withholding taxes imposed at source under the national laws of EU Members on non-EU Members, including gross withholding taxes imposed under double taxation agreements. Put differently, the protection against discrimination in respect of withholding taxes provided to EU Members under the TFEU does not extend to non-EU Members under EU law. Thus non-EU Members

³⁷⁷ *X Case, supra* 354 at para 60.

³⁷⁸ The Courts' comments on this point can be found in para 33 "...the answer to the question, which is, moreover, not the subject of the present reference for a preliminary ruling, whether a withholding tax at source such as that at issue in the main proceedings also constitutes a restriction on the freedom to provide services if it results in the provision of services carried out by a non-resident provider being subject to a greater tax burden than that of a provision of services carried out by a resident provider. In so far as such a withholding tax may have repercussions on the cost of provision of the service at issue, it is liable to deter both the non-resident provider from providing that service and the recipient of the service from having recourse to such a provider."

remain subject to the applicable tax treaty and non-discrimination provisions in respect of any withholding taxes imposed by EU Member States.

Service providers who are non-EU Members and who receive income from independent personal services, royalties, interest or ‘other amounts’ in respect of which a tax treaty allocates the right to tax to the source state, will be subject to gross withholding tax and may be without the benefit of deductions for directly applicable and reported expenses that is available to service providers of EU Member States.

In summary, for purposes of EU law, differences in tax treatment based on residence are not discriminatory per se. The situations of residents and non-residents are not comparable. However, in some circumstances, the situations of residents and non-residents may be comparable, for example the branch office of a non-resident service provider may be considered comparable to the office of a resident in the Member State.

Further, the need to ensure the effective collection of income tax from non-resident service providers constitutes an overriding ‘reason in the general interest’ that justifies a restriction on the freedom to provide services.³⁷⁹ Notwithstanding, withholding tax may only be levied after directly related expenses have been taken into account.

Other defenses have been raised by Member States to justify their direct taxation provisions against allegations that they infringe the freedom to provide services (and other fundamental freedoms in the TFEU).³⁸⁰ These have included cohesion of the national tax system³⁸¹,

³⁷⁹ *Scorpio*, *supra* note 353 at para 36.

³⁸⁰ TFEU Article 52 provides for general exceptions to Article 56 where a Member State can demonstrate that its law is necessary to protect public policy, public health or public security, but these defences have not been put forward in direct tax cases.

³⁸¹ In two cases, ECJ, *Hanns-Martin Bachmann v Belgium*, C-204/90, [1992] ECR I-249 and ECJ, *Commission of the European Communities v Belgium*, C-300/90, [1992] ECR I-305, among the earliest to be decided on direct discrimination, this defence was successful. The Belgian tax measure at issue in both cases allowed a deduction to a resident of Belgium in respect of pension contributions paid to an insurance company resident or established in Belgium, but denied the deduction for such payments to an insurance company not established in Belgium. The ECJ found that the measure constituted a restriction on free movement of workers and services, but was justified because there was no less restrictive way for Belgium to ensure that deductions would only be permitted where the insurance and pension benefits which would later be paid would be subject to tax in Belgium. There was a direct link between the deduction of the premiums and the taxation of the benefits in relation to one and the same taxpayer by the same tax authority, so that cohesion could only be maintained by making the deduction contingent on the resulting benefits being taxable. The cohesion argument has now largely been abandoned as it has not been accepted by the court again.

effectiveness of fiscal supervision³⁸², allocation of taxation rights³⁸³ and more recently, ensuring the balanced allocation of jurisdiction to tax.³⁸⁴

4. The Relationship of Bilateral Tax Treaties to European Union Law

The network of bilateral tax treaties among EU Member States is virtually complete, and remains a very important component of direct tax law for the Member States, particularly with respect to individuals.³⁸⁵

(i) *Case Law on Bilateral Tax Treaties and Discrimination*

The relationship of tax treaties to EU law has been considered in several ECJ judgments and opinions of Advocates-General. In the earliest direct tax decision, *Avoir Fiscal*³⁸⁶, the ECJ ruled that the rights conferred by the TFEU (in that case the right of establishment) were unconditional and could not be subordinated to the provisions of a tax treaty concluded with another Member State.³⁸⁷ This is no more than a statement of the principle of supremacy of EU law over national law, which applies whether the national law is enacted before or after accession to the European Union. Since the provisions of tax treaties form part of national law, their provisions are subordinate to EU law in the event of a conflict.

³⁸² However, a discriminatory rule will only be justified if it applies only to purely artificial arrangements intended to evade tax laws and permits a case by case assessment of whether the taxpayer has in fact illegitimately avoided tax. It is not sufficient that the measure have as its purpose the prevention of tax evasion. The ECJ frequently refers to EC, *Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation*, [1997] OJ, L336/15 as ensuring that national tax authorities have the necessary means of obtaining information from other Member States to prevent tax evasion.

³⁸³ The ECJ refuses to allow a tax measure to be justified on the basis that it is necessary to protect government revenues or the tax base, stating that a measure that contravenes a fundamental Treaty freedom cannot be justified on purely economic grounds. Nor may a Member State apply tax rules that seek to equalize the tax burden on a particular form of cross-border income that is lightly taxed in another Member State. See e.g., ECJ, *Anneliese Lenz v Finanzlandesdirektion für Tirol*, C-315/02, [2004] ECR I-07063.

³⁸⁴ *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, C-446/03 [2005] ECR I-10866.

³⁸⁵ The various direct taxation directives adopted at the EC level since 1990 eliminate withholding tax on dividends, royalties and interest between subsidiary and parent corporations in different Member States, facilitate cross-border mergers, and provide for mutual assistance in the exchange of information and recovery of tax claims.

³⁸⁶ ECJ, *Commission of the European Communities v France* C-270/83, [1986], ECR I-00273, commonly referred to as “*Avoir Fiscal*.”

³⁸⁷ *Ibid*, at para 26.

Tax treaties normally only apply specifically to trade in services in the case of individual service suppliers temporarily providing services in a Contracting State of which the individual is not a resident. This engages either the provision based on former OECD Model Tax Treaty Article 14, governing independent personal services or Article 17, governing the activities of artistes and sportsmen.³⁸⁸ Corporate service suppliers are governed by Article 7, which, like former Article 14, allows for taxation of services income derived in the Contracting State of which the supplier is not a resident only where the supplier has a permanent establishment (or “fixed base” in the case of former Article 14) through which the income is earned in that State. As noted earlier, in the EC, once a services supplier has a tax nexus in another Member State in the form of a permanent establishment or fixed base, the discussion moves from free movement of services to the right of establishment under the TFEU. Thus most of the cases that involve a tax treaty are resolved by reference to freedom of establishment under the TFEU. Under that Agreement, the issue is generally the unequal treatment of corporations that have a branch as opposed to a subsidiary in another Member State³⁸⁹ or the unequal tax treatment of permanent establishments of foreign corporations as compared to subsidiaries.

The *Gerritse* and *Scorpio* cases are examples of the way tax treaties are applied in the case of individuals supplying services to a recipient in another Member State. The ECJ has developed a distinct approach to non-discrimination on the basis of residence or nationality in direct taxation, sometimes referred to as the “*Schumacker* principle”³⁹⁰ in the case of individuals. The concept of covert discrimination is conditioned, in direct taxation cases, on the taxpayer demonstrating that non-residents and residents are in a comparable situation as regards their liability to direct taxation in the Member State whose tax measure is challenged. The ECJ has frequently recognized in its rulings that residence is the primary criterion used by the ‘international tax system’ for determining liability to direct taxation, and that in

³⁸⁸ Article 14 was eliminated from the OECD Model Tax Treaty in 2000, so that the distinction previously created by Article 14 between individuals providing “independent personal services” and general business profits in Article 7 no longer exists. In the current OECD Model Tax Treaty, the only provision that treats services providers differently from other businesses is Article 17, which deals with “Artistes and Sportsmen.” However, most tax treaties still contain a provision equivalent to OECD Model Tax Treaty Article 14, even such recent ones as the pending treaty between the UK and France, signed in 2004.

³⁸⁹ See e.g., *Commission v France*, *supra* note 90, ECJ, *Algemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgische Staat*, C-141/99, [2000] ECR I-11619 and ECJ, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt*, C 307/97, [1999] ECR I-6161.

³⁹⁰ *Schumacker*, *supra* note 344 at para 31-35.

general, residents and non-residents are not in comparable circumstances. Thus not every difference in treatment will amount to discrimination, particularly where the issue is access to deductions or credits based on family or personal circumstances.

In the case of artistes (such as Mr. Gerritse) and sportspersons, treaties following the OECD Model Tax Treaty allocate primary taxing jurisdiction to the State where the services are performed. The Netherlands-Germany Tax Treaty followed this Model, so that Germany could impose a 25% final tax on Mr. Gerritse's income derived from services performed in Germany. Even though this imposition of withholding tax resulted in different treatment from the treatment afforded to a resident of Germany, it was not found to be contrary to Article 49 of the TEC (Article 56 of the TFEU). The reasoning was that Mr. Gerritse was not in a comparable situation to a German resident because he was entitled to allowances for his personal and family circumstances in the Netherlands, where he earned most of his income. Further, the Netherlands allowed Mr. Gerritse a tax credit for the German tax paid against his Netherlands tax liability, which fairly compensated him while maintaining progressive taxation, so he could not demonstrate that he was deterred from supplying services in Germany.

On the other hand, the ECJ in *Gerritse* ruled that the refusal by Germany to allow deduction of expenses incurred by the service provider in computing the income subject to the withholding tax was discriminatory, as German service providers were entitled to deduct their expenses so that tax was imposed on net rather than gross income. Neither the Commission nor the Member State governments who intervened in *Gerritse* put forward a convincing argument that residents and non-residents were in objectively different situations regarding deduction of their expenses in computing income subject to tax. The fact that the Netherlands-Germany Tax Treaty permitted Germany to impose the withholding tax on the gross income of the service provider could not justify the measure if it was contrary to Article 49 of the TEC (now TFEU Article 56).

In *Scorpio* there was a tax exemption granted under the Germany-Netherlands Tax Treaty to a non-resident service provider who carried on activity in Germany. As a result, the income derived from the services was not taxable in Germany. One of the questions posed by the German Court was whether the Germany-Netherlands Tax Treaty exemption could be taken into account by the recipient of the services in withholding tax and in proceedings for liability

brought against him. Under German national law the Treaty exemption could only be claimed if a certificate of exemption stating that the conditions of the Treaty were satisfied. The exemption certificate was issued by the German competent tax authority. The question posed was whether the requirement to produce the certificate at various stages constituted a restriction on the freedom to provide services contrary to Article 56 of the TEC (now TFEU Article 63).

The Court agreed that the obligation imposed on a provider of services residing in the Netherlands to request the competent German tax authority to issue a certificate of exemption in order to escape German tax constitutes a restriction on the freedom to provide services because of the administrative steps it requires the service provider to take. It also imposed a restriction on the recipient. The requirement to obtain and produce the certificate thus constituted an obstacle to the freedom to provide services guaranteed by TEC Articles 59 and 60 (TFEU Articles 63 and 64). However, the ECJ concluded that the obstacle was justified in order to ensure the proper functioning of the procedure for taxation at source.³⁹¹ As a result the tax exemption granted under the Treaty could be taken into account by the recipient of the services only if the appropriate certificate of exemption was issued by the competent tax authority.

(ii) *Impact of Tax Treaties on Justifications for Discriminatory Measures*

Somewhat curiously, when a Member State has made the argument that a matter has been regulated under a bilateral tax treaty which should be respected, the ECJ has used the existence of a tax treaty as a double edged sword to eliminate discriminatory tax provisions. On the one hand, because a tax treaty is itself subordinate to EC law if the tax treaty allows a restriction on the exercise of a fundamental freedom, it is inapplicable. On the other hand, the existence of a tax treaty between two Member States has the effect of negating the argument that a measure is necessary to preserve the cohesion of a Member State's tax system.³⁹² The ECJ regards the bilateral agreement allocating tax jurisdiction as moving cohesion to a different level, involving reciprocity between the two Contracting States, rather than as between a taxpayer and a single Member State. Therefore, the direct link between a tax

³⁹¹ *Scorpio*, *supra* note 353 at para 59.

³⁹² ECJ, *GHEJ Wielockx v Inspecteur der Directe Belastingen*, C-80/94, [1995] ECR I-2493.

advantage and a tax obligation with respect to a single taxpayer and a single Member State, necessary to support the cohesion justification, is absent.

(iii) Most Favoured Nation as a Principle of European Union Law

The TFEU contains no provision expressly imposing a most favoured nation principle on Member States. The answer to the question of whether EC law required that a Member State treat nationals and residents of another Member State no less favourably than the Member State treats a third country under a bilateral tax treaty remained unclear. The matter was resolved by the ECJ (now CJEU) in *D v Inspecteur van de Belastingdienst* (“D” case) on July 5, 2005.³⁹³ The *D* case concerned free movement of capital³⁹⁴, but the same principles would be applicable where free movement of services is at issue. D, an individual resident in Germany and subject to Netherlands wealth tax on his real property situated in the Netherlands, claimed the benefit extended by the Netherlands-Belgium Tax Treaty to residents of Belgium who have property subject to wealth tax in the Netherlands. The Netherlands-Belgium Tax Treaty provides the same threshold exemption to Belgian residents as is allowed to residents of the Netherlands under Netherlands’ national law. The Netherlands-Germany Tax Treaty provides no threshold exemption for residents of Germany.

The argument that most favoured nation treatment applies so that a resident of any Member State is entitled to the most favourable treatment available to a resident of any other Member State was an alternative argument in the *D* case.³⁹⁵ The primary argument was that the Netherlands was unjustifiably discriminating against D in denying him the threshold exemption available to Netherlands residents, and was thus imposing a restriction on free movement of capital.

In his Opinion of 26 October 2004, Advocate-General Ruiz-Jarabo Colomer concluded that D should succeed on his primary argument. The Advocate-General considered the most favoured nation argument, and gave the opinion that the right to equal treatment for all EU

³⁹³ EJC, *D v Inspecteur van de Belastingdienst*, C-376/03, [2005] ECR I-05821.

³⁹⁴ TEC Article 56 (now TFEU Article 63).

³⁹⁵ In ECJ, *Metallgesellschaft v Commissioners of Inland Revenue and HM Attorney General*, C-397/98, [2001] ECR I-1727 the question was referred to the ECJ as to whether the UK was obliged to grant the same type of tax credit for UK advance corporation tax to German residents as it granted to residents of the Netherlands under its tax treaty with the Netherlands, but neither the Advocate General nor the court responded to this question.

nationals cannot be subordinated to the principle of reciprocity that governs bilateral tax treaties. Member States must take the utmost care in negotiating their tax treaties with other Member States, to ensure that they do not hinder the establishment of the single market. If obligations undertaken in a bilateral tax treaty run “counter to the fundamental ideas driving the construction of a unified Europe” then, in the Advocate-General’s opinion, the Member States concerned must find other solutions that do not breach EU law or prejudice citizens of other Member States.

The Advocate-General nevertheless concluded that the ECJ should decline to rule on the most favoured nation argument, as an affirmative ruling would “create upheaval in the legal systems of the Member States” and the system of bilateral agreements. The ECJ, sitting in a Grand Chamber of 13 judges, rejected both the advice not to rule, and the principle of most favoured nation where the more favourable treatment is the result of a bilateral tax treaty between two Member States. The Court held that a resident of Belgium, which has a favourable tax treaty with the Netherlands, is not in a comparable position to a person who is resident in Germany, which does not have the same preference in its tax treaty with the Netherlands. Residence in a particular State is a distinguishing criterion which is fundamental to the application of a tax treaty, and the allowance accorded under one treaty to residents of the Contracting States had to be regarded as part of the treaty’s overall balance, rather than as a discriminatory provision which was contrary to the free movement of capital in TEC Articles 56 and 58 (now TFEU Articles 63 and 65).

The result of the *D* case on the most favoured nation principle is quite surprising, given the very strong rulings of the ECJ in the past restricting the scope of Member States to justify different treatment of residents and non-residents by relying on a tax treaty. It is less controversial that the ECJ also found that the Netherlands’ refusal of the wealth tax allowance to Mr. D was not itself an infringement of TEC Articles 56 and 58, because only 10% of Mr. D’s total wealth was situated in the Netherlands. He was not, therefore, in a comparable situation to a Netherlands national or resident who had the greater part of his wealth situated in the Netherlands and subject to Netherlands wealth tax.

The reasoning in the *D* case would seem to allow Member State X to accord more favourable treatment to service providers from Member State Y than to those from Member State Z, if the provisions of a tax treaty between X and Y provide for the more favourable treatment.

However, where the tax treatment by a Member State of non-resident service providers is less favourable than for residents, even though residents and non-residents are in comparable situations with respect to their tax liability, the different treatment may still constitute an infringement of TEC Article 49 (now TFEU Article 56.)

E. Tax Discrimination? Some Comparative Examples

The following are some hypothetical examples of differences in tax treatment that, in principle, violate either the most favoured nation or national treatment obligations under a trade agreement. A discussion of how the matter would be addressed in both Canada and the UK follows to underline the differences in result.

1. Example 1

Assume Canada's income tax law does not permit a deduction in calculating taxable income for amounts paid to non-residents of Canada that exceed \$100,000 per annum. A US engineer, earning income in excess of \$100,000 for services performed in Canada in 2005, is denied further work by a Canadian client. The US government seeks to challenge the refusal of the deduction as a violation of the national obligation under the NAFTA. Will the Canada – US Tax Treaty restrict recourse to the competent authority procedure under the Tax Treaty? The answer is yes. Article 25(7) of the Canada-US Tax Treaty, provides *inter alia* that in determining the taxable profits of a resident of Canada, disbursements paid to a resident of the US shall be deductible under the same conditions as if they had been made to a resident of Canada. As a result, any dispute about a tax measure that impacts the deductibility of fees paid to a non-resident by a Canadian resident must be resolved under the Tax Treaty.

The answer changes if the province of Ontario denied the deduction for purposes of computing provincial income tax liability. The Canada-US Tax Treaty applies only to tax levied by the Government of Canada. Provincial taxes do not fall within the scope of the Tax Treaty, except for the limited purpose of defining the scope of the obligation of the other Contracting State to provide relief from double taxation.³⁹⁶ There is thus no argument that

³⁹⁶ Article 24(7) Canada-US Tax Treaty.

might restrict the US from seeking redress for the discriminatory provincial income tax under the NAFTA on the basis that that the matter is covered by a tax treaty. Further, the NAFTA imposes a national treatment obligation as the tax relates to the purchase or consumption of cross-border services.³⁹⁷ There is therefore a clear argument that the national treatment obligation in the NAFTA has been violated.

Can the US government argue there has been a national treatment violation under the GATS, assuming a commitment by Canada in this sector? The answer appears to be negative, because Article 26(7) of the Canada-US Tax Treaty addresses the issue of the deductibility of disbursements paid to a non-resident, so the matter must be addressed under the Tax Treaty.

If the engineer is from Mexico, can the Mexican government argue there has been a national treatment violation under the GATS? Until the Mexican Treaty with Canada was renegotiated in 2006, the answer was “maybe”. There was no clause in the original 1992 Canada-Mexico Tax Treaty similar to that found in the Canada-US Tax Treaty that addresses the deductibility of disbursements paid to non-residents. Whether or not a claim could be made under the WTO dispute resolution procedures would therefore depend on the specific commitments and exemptions claimed by Canada in its schedule to the GATS³⁹⁸ and the interaction between Article XXII (3) of the GATS and the Canada-Mexico Tax Treaty. Specifically, the issue would be whether the matter falls within the ‘scope’ of a tax treaty, given the non-discrimination article and interpretive rules in the Canada-Mexico Treaty.³⁹⁹

The issue was resolved without being decided in the Canada-Mexico context by the addition of the deductibility provision in the new Canada-Mexico Tax Treaty. The issue and the analysis however, will remain the same for any tax treaty between Canada and a WTO

³⁹⁷ The same is true if the engineer were from Mexico. The Canada-Mexico Tax Treaty applies only to taxes imposed by the Government of Canada under the *Income Tax Act* and not to income taxes imposed by the provinces. Thus the Mexican government can also challenge the tax as being in violation of Canada’s national treatment obligation under the NAFTA.

³⁹⁸ See discussion in Chapter 2.A

³⁹⁹ The OECD commentary to Article 25 at paragraph 44.5 includes the following discussion of the scope of a tax treaty: “... the phrase ‘falls within the scope’ is inherently ambiguous, as indicated by the inclusion in paragraph 3 of Article XXII of the GATS both an arbitration procedure and a clause exempting pre-existing conventions from its application in order to deal with disagreements related to its meaning. While it seems clear that a country could not argue in good faith that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is unclear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.”

Member that does not include the deduction clause in the non-discrimination article. The analysis would proceed along the following lines.

The non-discrimination clause in the Canada-Mexico Tax Treaty specifically addresses the rights of a national who is a resident of a Contracting State. Thus it is arguable that all aspects of the national treatment obligation fall within the scope of the Treaty and there is simply no obligation of non-discrimination under the Tax Treaty in respect of a national who is a non-resident of the Contracting State. Another view is that the national treatment obligation in respect of the treatment of payments to a national who is a non-resident does not fall within the scope of a tax treaty and thus access to the WTO dispute resolution procedures is available. If this latter interpretation were incorrect, there would be no remedy for the tax discrimination under the WTO.

If the engineer were British, the UK would face this issue in disputing the denial by Canada of the deduction of the disbursement in excess of \$100,000 under the GATS. The Canada-UK Tax Treaty contains no non-discrimination provision requiring deduction of disbursements incurred to non-residents on the same basis as deduction of disbursements incurred to Canadian residents.

If it were the French government that denied the deduction of expenses for services over €100,000 if paid to a British engineer (but at the same time would not deny the deduction if it were paid to a French engineer), the discriminatory treatment would infringe Article 26(3) of the UK-France Treaty.⁴⁰⁰ In addition, EC law would require France to treat UK service providers according to the same rules as French service providers, and either the British engineer or the French company could successfully obtain a ruling from the French courts that the French law was contrary to TEC Article 49, (Article 56 of the TFEU) based on the *Laboratoires Fournier* decision.

2. Example 2

UK Conventions Inc. (UK Corp) organizes conventions, meetings and other such events at its facility at Charing Cross. UK Corp's bid to host the next annual meeting of Cancorp, a large

⁴⁰⁰ Article 26(3) of the UK-France Treaty is the equivalent provision to Article 24(7) of the Canada-US Tax Treaty and Article 24(3) of the OECD Model Tax Treaty.

Canadian corporation, has been rejected by Cancorp, on the basis that the costs of the meeting will not be deductible if the meeting is held at Charing Cross. The problem, Cancorp argues, is a restriction in the *Income Tax Act* (Canada) on the deductibility of expenses incurred for foreign conventions held outside the NAFTA block.

Can the UK claim that Canada has violated its most favoured nation obligation under the GATS by refusing to permit the deduction of meeting expenses by Cancorp if the convention is held in Charing Cross? The answer appears to be yes. An exemption from the most favoured nation obligation under the GATS exists only if the difference in treatment is the result of a tax treaty or is specifically listed as an exemption in Canada's country annex.⁴⁰¹ In this case there is no applicable tax treaty exemption or specific listing. In contrast, the most favoured nation obligation would not be violated if the preference with respect to the deduction of convention expenses were given in respect of conventions held by Cancorp in the US because Article XXV (9) of the Canada-US Tax Treaty provides for the deduction of such expenses.

What is the result if the analysis is performed under the NAFTA (assuming there is no tax treaty exemption from most favoured nation)? Can a complaint be made by Mexico that Canada has violated its most favoured nation obligation under the NAFTA, if a deduction is permitted by Canada under her domestic legislation for convention expenses incurred in the US but not Mexico? The answer is no.

The NAFTA does not apply to any taxation measure except as specifically provided in Article 2103. There is no requirement to provide most favoured treatment with respect to taxes on income and capital gains in these circumstances. As a result, it would appear that there is no most favoured nation obligation in respect of the favourable tax treatment for payments to service providers from one country over another. Further, there is no national treatment obligation, assuming the relevant tax provision was in effect at the time the NAFTA entered into force.⁴⁰²

If it were the domestic tax law of the UK that denied the deduction for convention expenses of a UK company's meeting held in France, the result would be the same as in the first

⁴⁰¹ GATS Article II (2).

⁴⁰² NAFTA Article 2103(4)(c).

example: discrimination contrary to Article 49 of the TEC (TFEU Article 56) (*Vestergaard and Laboratoires Fournier*) and violation of the UK-France Tax Treaty Article 26(3).

If the UK tax authorities allow a deduction, in conformity with EC law, for expenses in respect of conventions held on the territory of the EC, must they provide the same treatment for conventions held in Canada under the GATS most favoured nation provision? The answer is no. Article V of the GATS permits Members to enter into economic integration agreements, such as the TFEU, and to offer more favourable treatment to its partners in the economic integration agreement than to other WTO Members.

3. Example 3

Canada's Income Tax Regulations require a person paying a fee, commission or other amount, in respect of services rendered in Canada, to a non-resident, to withhold 15% of the gross amount on account of the non-resident's potential Canadian tax liability. While a waiver of the withholding requirement is sometimes available from the Canada Revenue Agency if the services income is not attributable to a fixed base or permanent establishment of the non-resident in Canada, the process for obtaining a waiver can be complex and time-consuming, and must be initiated at least 30 days before the services are performed. A non-resident corporation that is not subject to Canadian tax on the income from providing services in Canada because it has no permanent establishment in Canada⁴⁰³ must file a non-resident tax return to obtain a refund of the amount withheld at source from the Canadian government. Non-residents providing services in Canada are thus treated unfavourably compared to Canadian resident service providers.

Can either the US or Mexico complain that Canada is not according their service providers national treatment under the GATS or the NAFTA? The answer in both case is no. The GATS provides an exemption from the national treatment obligation "provided the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes."⁴⁰⁴ There is a similar exemption under the NAFTA.⁴⁰⁵

⁴⁰³ See generally Article 7 of Canada's tax treaties, as well as of the OECD Model Tax Treaty.

⁴⁰⁴ The GATS Article XIV(d). A footnote refers specifically to measures by members to ensure the imposition or collection of taxes in their territory.

⁴⁰⁵ NAFTA Article 2103(4).

Assume the UK imposes a withholding obligation identical to Canada's in respect of services performed in the UK by non-residents. Could a Portuguese firm (which has no permanent establishment in the UK), which supplies translation services to a UK newspaper through the intermittent presence of a Portuguese translator in the UK challenge the withholding rules under TFEU Article 56? Note that the Portuguese firm will be able to obtain a full refund (some months later) of the tax withheld by filing a UK tax return and relying on its exemption under the UK-Portugal Tax Treaty. Alternatively, it may obtain a waiver of all or part of the withholding requirement from the UK tax authorities through an administrative process.

The issue is whether the additional administrative burden imposed on either the service recipient (to withhold and remit 15% of the fees paid for the services performed in the UK by the Portuguese firm) or the service provider (to either obtain the waiver or file an income tax return to obtain the refund) is a restriction on the exercise of free movement of services.

A related issue is the requirement imposed on the translation firm to pay an amount on account of UK tax, at the time the newspaper pays for the services, with no refund for several months, a restriction on the ability to offer services in the UK contrary to TFEU Article 56? The answer to both questions is yes. The requirement that service providers from other Member States pay 15% of gross fees as UK tax by requiring the service recipients to withhold this amount is a restriction on the freedom to provide services, discouraging foreign service providers from offering their services in the UK, and creating a disincentive for UK purchasers of services to obtain them from providers in other Member States.⁴⁰⁶ The cash flow disadvantage is real and significant, especially as the withholding applies to gross fees, as was held to be discriminatory in *Gerritse*. Nonetheless the ECJ has ruled that the imposition of withholding taxes can be justified to ensure the effective collection of taxes.

⁴⁰⁶ Indeed, the Commission has commenced an infringement action against Belgium (ECJ, *Commission of the European Communities v Kingdom of Belgium*, C-433/04, [2006] ECR, I-10653) claiming that Belgium's requirement to withholding 15% of gross amounts paid to construction industry subcontractors not established in Belgium infringes Article 49.

F. Conclusions

Some 25 years elapsed between 1958, when the original version of what is now the TFEU came into force, and the filing of the first case alleging that a Member State's direct tax measure infringed a Treaty freedom. However, in the past fifteen years there have been more than a dozen decisions of the ECJ and CJEU on direct tax discrimination in trade in services, and many more cases are pending. Combined with the positive harmonization of Member States' direct tax laws through secondary legislation, the rulings of the ECJ and CJEU imply the formation of the first true international taxation regime based on common rules and enforced by an independent international court. As a Member of the EU, the UK is now finding that its trade relationship with its EU partners, with respect to services as well as in other areas, has a significant and growing impact on its supposed sovereignty over direct taxation. While the *D* case allows different treatment of residents of other Member States if it is the result of a tax treaty and the non-resident is not in a comparable situation to a resident, it remains to be seen how broad an exception to the strict non-discrimination rules this ruling will support.

By contrast, the trade agreements to which Canada is a party expressly exclude application to direct taxation measures in most circumstances, leaving Canada's tax sovereignty legally intact. The NAFTA does not envisage the deeply integrated single market constructed under the TFEU, so it is not surprising that the integration of tax and trade has progressed much farther in the EU as compared to the NAFTA block.

However, the potential difference in treatment of non-resident service providers when viewed from a global perspective is somewhat alarming. For example, from a Canadian perspective there is no non-discrimination obligation with respect to the tax treatment of non-residents in any of Canada's tax treaties or under trade agreements like the WTO if a tax treaty is in place. The same is not true in the EU. From a UK perspective in order to determine whether the tax treatment of a non-resident service provider is discriminatory, one must examine the scope of the freedom at issue, whether the resident and non-resident are incomparable circumstances factually or legally, whether the measure can be justified and finally whether the measure goes beyond what is necessary to achieve the objective being pursued. The outcome of a claim of discriminatory tax treatment will thus be very different for EU

residents depending on whether they are operating within their trade block. A non-resident of the EU can also anticipate the application of differing non-discrimination obligations in respect of the services they provide in the EU on a short-term basis from those applicable to EU Member States. These differing obligations are obviously the result of obligations assumed by Member States under the TFEU. However, the difference could be narrowed by more robust non-discrimination obligations in the tax treaties between the trade partners.

**Part III: Are the Current Non-Discrimination
Obligations in Tax and Trade Agreements
Adequate?**

Chapter 6: Part III Overview

Four central facts underlie this study. The first is that the importance of trade in services has grown significantly in global trade in the last two decades. The second is that the growth in the global trade in services was considered to be of sufficient importance that significant trade commitments have been made at the global level, through the WTO, through smaller multilateral free trade agreements and in bilateral free trade agreements. Tax measures imposed by the state where the services are performed by the non-resident can have a significant impact on the competitive position of the non-resident and discriminatory measures can have pernicious impacts on the benefits of cross-border trade in services. All of these trade agreements include non-discrimination obligations in respect of each other's service providers. Each of these trade agreements also either carve out or limit these non-discrimination obligations with respect to direct tax matters. As a consequence, existing trade agreements are unable to address the problem of discriminatory tax measures applied to trade in services.

In general the exclusions from the most favoured nation obligation may lead to very different taxing rights for the host or source country and very different tax treatment for the non-resident service provider than that provided to other signatories to the trade agreement. Within the framework of this study, those differences are accepted as appropriate⁴⁰⁷ within the current international framework as the differences are negotiated bilaterally between the two Contracting States. Benefits so negotiated are often at a price and it is conceded that it would be inappropriate to provide those same benefits to countries that had not agreed to pay that price. A Contracting State can also protect itself by including a most favoured nation clause in their tax treaties in respect of key provisions, for example those that include a negotiated rate of withholding tax.

A different issue is raised with respect to the carve out from the national treatment obligation. Differences in tax treatment may operate to the disadvantage of the non-resident service provider and may impact his or her ability to effectively compete against resident service providers in the resident's home market. Like the most favoured nation obligation, the national treatment obligation in trade agreements is generally negated if there is a tax treaty

⁴⁰⁷ This assumes the differences are not arbitrary or a disguised restriction on trade.

between the parties.⁴⁰⁸ However, there is no tax treaty non-discrimination applicable to non-residents in the absence of a permanent establishment in the host country. This means that the host country is free to impose tax on non-residents generating income from within its borders using any tax measures it considers appropriate.

Some have suggested that the current non-discrimination principles in the UN and OECD Model Tax Treaties are entirely adequate because there is no evidence of discriminatory treatment of non-residents or evidence that a country may be imposing tax measures on a non-resident for a purpose other than to collect the tax that it is due.⁴⁰⁹

The following three chapters challenge this notion. Chapter 7 examines the potential for discriminatory tax treatment based on structural elements in the OECD and UN Model Tax Treaties. Chapter 8 discusses the withholding tax regime applicable with respect to payments made for services provided by non-residents in Canada and in the Mercosur countries. The purpose of these Chapters is again illustrative. Canadian domestic provisions are used as an example because they are the provisions with which the author is most familiar. The Chapter also draws on numerous examples from the Mercosur countries mainly because the information was made available through a translator. The primary purpose of the discussion is to demonstrate that there are clear differences in the tax treatment of resident vs. non-resident taxpayers, differences that will affect the competitive position of the non-resident. The point being made is not that all tax measures employed by a host country in the taxation of a non-resident service provider are necessarily discriminatory, but rather that there is no applicable non-discrimination obligation against which to judge that fact.⁴¹⁰

⁴⁰⁸ Specifically, under the GATS, the ability to challenge whether the national treatment obligation has been violated is limited if there is a tax treaty in place between the two Contracting States.

⁴⁰⁹ AJ Cockfield & BJ Arnold. "What Can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model" (2010) 2:2 World Tax Journal 139. See also Joel Nitikman & Lincoln Schreiner "Non-discrimination at the Crossroads of International Taxation" in *Studies on International Fiscal Law vol 93a* (Rotterdam: International Fiscal Association, 2008) who comment "As a practical matter, discrimination for tax purposes is not a prominent issue in Canada with foreign nationals, as evidenced by the lack of litigation and because foreign persons simply see (with good advice) the differences before them, and then appropriately measure and weigh the additional cost of adapting" With respect, this seems to be a circular argument. A determination as to whether or not tax discrimination is occurring, if based on an analysis of a law that does not include a non-discrimination obligation, will inevitably lead to a lack of evidence of discriminatory treatment.

⁴¹⁰ Developing countries for example may apply gross withholding taxes because they are administratively the easiest to apply.

Chapter 9 examines the withholding tax provisions of the United States Foreign Account Tax Compliance Act (FATCA) regime. This regime is one in which the US uses the threat of a gross withholding tax on US sourced income to ensure reporting compliance by non-resident entities with US investors.⁴¹¹ It has been described as the ‘carrot and stick approach’⁴¹² aimed at ensuring compliance with US reporting obligations by non-residents that the US would otherwise be unable to enforce. The withholding requirements under FATCA, which are imposed regardless of the tax exempt status of the non-resident under a tax treaty, are examined against the non-discrimination principles in tax and trade agreements. In summary it would appear that this use of withholding tax, as a form of economic coercion, is in violation of neither. It also invites the question: Should there be a non-discrimination principle (in the Model Tax Treaties) to prevent this form of arbitrary tax treatment of non-residents, regardless of how justified one might argue the reason for the measure?⁴¹³

⁴¹¹ The general concept underlying the FATCA is remarkably simple: Foreign financial institutions and foreign corporations must annually disclose US account holders or their US beneficial owners respectively, or the foreign entities carry a 30% gross withholding tax on all investment income sourced in the US. In other words, FATCA forces foreign entities to cooperate with the US tax authorities.

⁴¹² See Luzius Cavelli, “Automatic Information Exchange versus the Withholding Tax Regime Globalization and Increasing Sovereignty Conflicts in International Taxation” (2013) 2 World Tax Journal 172.

⁴¹³ According to the Joint Committee on Taxation, FATCA is expected to prevent US taxpayers from evading taxes in the amount of USD 8.714 billion over the next ten years. See Cavelli *ibid*.

Chapter 7: Tax Treaties: The Potential for Discriminatory Tax Treatment Based on Structural Elements in OECD and UN Based Tax Treaties

A. Overview

Chapter 2 provided a snapshot of how trade obligations in the GATS and the provisions of the OECD and UN Model Tax Treaties potentially impact non-discrimination obligations with respect to tax measures that affect non-resident service providers. This Chapter takes a closer look at the treatment of services in tax treaties based on the OECD and UN Model Tax Treaties. It focuses on the wide discretion that a country has in selecting, interpreting and applying specific tax treaty allocation provisions to the income derived by a non-resident service provider.⁴¹⁴ The purpose of the discussion is not to argue that differences in tax treatment based on differences in the tax treaty allocation provisions are discriminatory. Rather the objective is to point out first, that the tax administrators in a source country may often select among a number of treaty allocation provisions when characterizing the income earned by a non-resident service provider,⁴¹⁵ second, that there are significant differences in the tax treatment of the non-resident service provider under a tax treaty based on the tax treaty allocation rule selected, and third, that there may be wide variance in the discretion available to local revenue authorities in the tax treatment of the non-resident depending on the allocation rule applied. The potential for differences in the tax treatment of a non-resident service provider begins with the threshold for source country taxation which varies depending on the allocation rule applied. Other differences in treatment can range from exemption from source taxation to exclusive source taxation, from unlimited to limited rates

⁴¹⁴ This issue has been the subject of considerable interest in recent years. See Ariane Pickering, "Taxation of Non-Resident Service Providers", Paper No. 6-A, Papers on Selected Topics in Administration of Tax Treaties for Developing Countries (UN May 2013); Tizhong Liao, "Taxation of Cross-Border Trade in Service: A Review of the Current International Tax Landscape and the Possible Future Policy Options" (Written for the Committee of Experts on International Cooperation in Tax Matters, Geneva, 9 October 2013); Ariane Pickering, General Report, in IFA Enterprise Services Cahiers 2012 Volume 97A (IFA: Online Books, 2012). W Wijnen, J de Goede & A Alessi, "United Nations/OECD - The Treatment of Services in Tax Treaties" (2012) 66 Bulletin for International Taxation 1, at 27; B Arnold, "The Taxation of Income from Services Under Tax Treaties: Cleaning Up the Mess" (2011) 65 Bulletin for International Taxation 2, at 59.

⁴¹⁵ These articles include OECD Article 7 (Business Profits), Article 14 (Income from Independent Personal Services), Article 12 (Royalties), and Article 21 (Other Income).

of source taxation and from gross to net taxation.⁴¹⁶ The discretionary issues that may arise in the administration of source country taxation rights include such matters as whether to impose interim or final withholding taxes, how final tax liability is to be determined, applicable refunds and refund procedures and a host of collection and enforcement matters. As will be seen there is wide scope for the introduction of protectionist or discriminatory tax practices through national laws and tax treaty interpretation, beginning with how the income from services is initially characterized under the tax treaty. However, even where the characterization of income from services is obvious under a tax treaty, there remains room for broad discretion both in the national laws and in how they are administered in the State of the recipient of the services (payer).

The Chapter begins with a broad overview of the treaty allocation rules adopted by tax treaty partners around the globe in respect of income from services, focusing on the tax treaties entered into since the late 1990's. It demonstrates the wide range of approaches used to tax income derived from the provision of services and the potential impact of each in determining source country taxing rights.

This Chapter also addresses the issue of source based withholding taxes, typical in the national laws of many countries with respect to payments to non-resident service providers and the potential burden that withholding tax may impose on both the non-resident and the recipient of the services; a burden that may be particularly difficult to justify⁴¹⁷ if there is ultimately treaty relief in the form of a reduced withholding tax rate or an exemption. The discussion then moves to the non-discrimination obligation, if any, that applies based on how the source country characterizes payment for services and the particular allocation rule that is applied.

The Chapter concludes with some observations about the potential for the imposition of discriminatory tax measures when income is derived from the provision of services. Income from services, it appears more than income from any other source is potentially subject to a diverse range of tax treatments under a tax treaty. Further, there are few limits on the

⁴¹⁶ See Ariane Pickering, "Taxation of Non-Resident Service Providers" *supra* note 414.

⁴¹⁷ The use of withholding taxes is generally justified as a straightforward mechanism to ensure compliance with and the enforcement of tax obligations.

discretion of source country revenue authorities when interpreting and applying the tax treaty to a non-resident service provider.

B. The Tax Treaty Allocation Rules

The tax treaty allocation rules provide the broad framework for the operation of a tax treaty. A useful place to begin the discussion is with an overview of their purpose and operation.⁴¹⁸

The basic mechanisms used to avoid double taxation under the OECD and UN Model Tax Treaties are first, the allocation of taxing rights over income between the treaty partners to limit source country taxation, and second a requirement that the country of residence relieve double taxation for any taxation at source that is levied in accordance with the tax treaty. The tax treaty allocation rules serve to avoid double taxation by determining which of the residence and source country has the primary right to tax. In addition, as will be discussed further below, the tax treaty allocation rule applied also dictates the general tax treatment relating to that category of income, including its source for treaty purposes, the nexus required for taxation and in some cases the basis for taxation.

From a broad conceptual perspective, the tax treaty allocation rules provide for two classes of income that can be derived by a non-resident; active income and passive income.

For the purposes of this discussion, active income earned by a service provider in a treaty partner country from the provision of services includes income from business activities and income from independent services income. In general, a tax treaty removes source country taxing rights with respect to active business income unless the service provider has a permanent establishment, or in the case of independent personal services, a fixed base,⁴¹⁹ in the source State. If active business income is earned by an enterprise through a permanent establishment in the source State expenses associated with generating the income are

⁴¹⁸ See also discussion in Chapter 2.2.

⁴¹⁹ There are a variety of nexus tests used to determine tax liability in the source state for income from independent personal services including time tests. See Ariane Pickering, General Report, *supra* note 1.

normally deductible (Article 5).⁴²⁰ This may not be the case if the income is derived from independent personal services through a fixed base.

Active income may also be derived in a treaty partner country from either independent personal service (Article 14) or as business profits (Article 7) absent a permanent establishment or fixed base in the source country. Although such income is generally exempt from source country taxation under a tax treaty it may nonetheless be subject to interim withholding tax. As discussed further below, income from independent personal services, may also fall under the business profits article in some tax treaties. For purposes of Article 7 and Article 14 there is general agreement among the majority of tax treaty partners that the source of income from services is the place where the services are performed.⁴²¹

Passive or non-business income for tax treaty purposes includes dividends, interest and royalties. Such income may be earned in a treaty partner country without any physical or representative presence in that jurisdiction. Passive income is generally considered to be sourced where the payer is resident. It is irrelevant where the services are provided. Passive income may be taxed by a source country on a gross, withholding basis with no deductions permitted, at rates that often range from 15 to 35% for royalties⁴²² under domestic law. Gross taxation is generally considered acceptable in the case of passive income as it is not generally subject to significant expenses.

Many countries include fees for services associated with transfers of technology or know-how in the royalty article or include a specific provision on fees for technical services.⁴²³

⁴²⁰ A permanent establishment may be created in a number of ways including through a commercial or industrial establishment (physical presence), or alternatively via an agent (representative presence). See discussion in Chapter 2.

⁴²¹ See Ariane Pickering, General Report *supra* note 414. Some countries nonetheless take the position that the source on such income is where the payer resides.

⁴²² See Shee Boon Law, “Chapter 4: Withholding Taxes on Services Income - A 21st Century Outlaw or a Necessary Evil?” in Carlos Gutiérrez & Andreas Perdelwitz, eds *Taxation of Business Profits in the 21st Century* (IBFD 2014.) This paper includes a good summary of withholding tax rates for income from services under a selection of tax treaties.

⁴²³ Regardless of whether they would regard technical services or technical assistance as the provision of knowhow, a few countries specifically include, in the definition of “royalties” or within the scope of the royalties article, payments for technical assistance in connection with the granting of rights, property or information covered by the definition. Australia and New Zealand extend the definition of “royalties” to include subsidiary and auxiliary services necessary for the application or enjoyment of rights, property or information otherwise covered in the definition. See IFA, 2012 Congress Boston, “Enterprise Services” 66th Boston Congress 2008, *Cahiers de droit fiscal international*, v.97a.

The source rules under the allocation rules that include passive income typically authorize the country where the payer is resident or where the permanent establishment (or fixed base) bearing the costs is located to impose withholding tax. This may have important consequences for the non-resident. This issue is discussed further below.

The OECD and UN Model Tax Treaties also provide a general rule relating to income not dealt with under the other allocation rules in the tax treaty (Article 21). In theory this article could apply to either active or passive income and has been used by some countries to tax income from services. This provision does not specify any method of taxation. The OECD but not the UN Model exempts such income in the source country.

C. The Treatment of Services in Tax Treaties: A Survey of Country Practices

The OECD and UN Model Tax Treaties include a range of tax treaty allocation rules that potentially apply to income derived by a non-resident from the provision of services. The broad categories include income from business, income from independent personal services, royalty income, income from technical service fees and other income. These and variations of these provisions have been included in the bilateral tax treaties sprinkled around the globe.

In 2011, research on the use of the UN Model Tax Treaty provisions that apply to services was carried out by the International Bureau of Fiscal Documentation (IBFD) at the request of the Committee of Experts on International Co-Operation in Tax Matters.⁴²⁴ The final report also included a careful examination of the OECD rules. In total more than 1,500 tax treaties were analyzed. The report provided a comprehensive picture of both the number of treaty articles that potentially apply to the taxation of services, including for example Article 8 (Shipping Profits) and Article 15 (Employees) as well as the various approaches used to tax services in general.⁴²⁵ Select data collected and reported by the IBFD in this report is used as

⁴²⁴ W Wijnen, J de Goede & A Alessi, “United Nations/OECD - The Treatment of Services in Tax Treaties” (2012) 66:1 Bulletin for International Taxation [hereinafter the “Wijnen Study”]. This paper provides a detailed study of the service provisions employed in tax treaties between 1997 and 2011.

⁴²⁵ Other Articles include supervisory and other services relating to construction activities in Article 5(3) of the OECD Model and Article 5(3)(a) of the UN Model; services provided by dependent agents within the meaning of Article 5(5) of the UN and OECD Models; services provided by insurance agents within the meaning of Article 5(6) of the UN Model; services relating to international shipping

the basis for the immediate discussion. As will be seen, a significant number of countries include nexus rules that would allow source country taxation of income from services if earned through a fixed place of business or fixed base in that country and a number of countries treat income from services like royalties under the applicable tax treaty.

For purposes of the discussion, six main variations are identified as being in wide use in tax treaties to allocate taxing rights in respect of services being performed by legal persons or individuals deriving income from carrying on business or performing independent personal services for other persons.⁴²⁶ These are:

1. The regular UN provisions dealing with services in various articles;
2. The regular OECD approach not containing specific provisions on services;
3. The OECD optional services provision included in the Commentaries (2008);
4. The inclusion of (types of) services in the royalty article;
5. A separate article provision for a withholding tax on (technical) services; and
6. The application of the “other income” article.

Each of these approaches is described briefly below.

1. The Regular UN Provisions Dealing with Services

Payments made to a non-resident service provider under the regular UN approach may be subject to the Independent Personal Services⁴²⁷ or Business Profits Articles.

Pursuant to Article 14 (Independent Personal Services), income from professional and other independent services performed by a resident of one country in the other country may be taxed in the other country if the resident has a “fixed base” in the other country or if the resident’s “stay in the other Contracting State is for a period or periods amounting to or

and air transport in Article 8 of the UN and OECD Models; dependent personal services performed by employees within article 15 of the UN and OECD Models; services performed by artistes and sportspersons within Article 17 of the UN and OECD Models; and services carried out offshore as specifically dealt with in a number of bilateral treaties, in respect of which there are no provisions included in the UN and OECD Models, only recommendations in the related Commentaries.

⁴²⁶ These six categories summarize the eight categories identified in the Wijnen study, *supra* note 424.

⁴²⁷ The UN in this respect did not follow the OECD’s lead in removing the independent personal services article from the Model Tax Treaty.

exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned.”

The services included under this provision are broadly defined as income from services of an independent nature including scientific, artistic, literary, and educational teaching activities as well as the independent activities of physicians, lawyers, architects and accountants. This has led to speculation about precisely what services are included under this Article and not the Business Profits Article and whether the Article applies only to individuals and not other legal entities.

If the income from services is considered business profits reference must be made to Article 7 (Business Profits) and to Article 5 (Permanent Establishment). The UN Model Tax Treaty adopts the general OECD approach in finding that a permanent establishment exists if the non-resident carries on business through a fixed place of business. The illustrative list found in Article 5(2) of the UN Model Tax Treaty. It expands the circumstances in which a permanent establishment exists to include special provisions dealing with the provision of services. Under the UN Model Tax Treaty a permanent establishment includes the furnishing of services, including consultancy services through employees or other personnel engaged by the enterprise for such purpose, if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months in any twelve-month period.⁴²⁸ It is clear that the understanding under the UN Model Tax Treaty is that “the provision regarding the furnishing of any service may lead to taxation as a deemed service permanent establishment even if an enterprise has no fixed place of business in the taxing state as required under Article 5(1).”⁴²⁹

The UN Model Tax Treaty also expands the permanent establishment concept to include broader host country taxation rights providing for a six-month duration test for building and construction permanent establishments as compared with the OECD Model Tax Treaty twelve-month test. The UN Model Tax Treaty also expressly includes supervisory activities within the provision, as well as the activities of certain “independent” agents.⁴³⁰

⁴²⁸ UN Model Tax Treaty Article 5(3)(b).

⁴²⁹ See UN Committee of Experts on International Cooperation in Tax Matters, *Report on the Seventh Session*, UN Doc E/C.18/2011/CRP.2/Add.1 (24-28 October 2011) at 12.

⁴³⁰ UN Model Article 5(7).

Once a permanent establishment is found to exist, any ‘profit’ attributable to the permanent establishment is subject to tax in the host country and the host country is subject to the non-discrimination obligation in Article 24(3) in levying taxation with respect to those profits.⁴³¹ If there is no permanent establishment in the host country there is no applicable treaty non-discrimination obligation.

2. The Regular OECD Approach (not containing specific provisions on services)

According to the OECD Model Tax Treaty, a non-resident service provider will have a permanent establishment in the host country if the provider meets the general rule in Article 5(1), that is, if the non-resident service provider carries on business in the host country through a fixed place of business. No time test is associated with this provision. An illustrative list in Article 5(2) provides examples of specific kinds of activities that *prima facie* come within this general rule, including especially a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.⁴³² This is followed by specific deeming rules in Articles 3 through 7 to include or exclude certain activities within the meaning of permanent establishment. For example activities that are considered to be largely of a preliminary nature, such as collecting information, storage, advertising or displaying goods are excluded. In contrast an enterprise is deemed to have a permanent establishment in that State in respect of any activities that dependent agents who habitually conclude contracts on behalf that enterprise, undertake for the enterprise. A third deeming rule provides that “an enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.” A fourth

⁴³¹ See discussion *infra* at note 447.

⁴³² The list provides an indication that a permanent establishment may exist; it does not provide that one necessarily does exist. The OECD is clear that the conditions in the general rule in Article 5(1) must also be met before a permanent establishment exists. OECD, Committee on Fiscal Affairs, *Model Tax Convention on Income and on Capital*, (2008) at Article 5(2) para 12.

deeming rule clarifies that a building site or construction or installation project constitutes a permanent establishment if it lasts more than twelve months.⁴³³

If the non-resident has a permanent establishment in the other Contracting State, the non-discrimination obligation in Article 24(3) applies. If there is no permanent establishment in the other Contracting State, there is no applicable treaty non-discrimination obligation.

3. The OECD Optional Services Provision Included in the Commentaries (2008)

The OECD Model Tax Treaty also provides for an alternative permanent establishment provision in respect of services that some newer double taxation agreements have adopted.⁴³⁴ It includes two deeming rules for enterprises of a Contracting State that perform services in the other Contracting State. The first applies if the services are provided through an individual who is present in that other State during a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 percent of the gross revenue attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual. The second rule applies if during a period or periods exceeding in the aggregate 183 days in any twelve month period, services are performed for the same project or for connected projects through one or more individuals who are performing such services in that other State or are present in that other State for the purpose of performing such services. In either case, the activities carried on in that other State in performing these services are deemed to be carried on through a permanent establishment that the enterprise has in that other State, unless these

⁴³³ Article 5(3). Unlike the Commentary with respect to the illustrative list in Article 5(2), there is no mention in the Commentary on Article 5(2) that the requirements in Article (5)(1) must also be met before a permanent establishment exists. Perhaps for this reason there is debate as to whether Article 5(3) is a stand-alone provision. See discussion under part F. Differing Non-Discrimination Obligations.

⁴³⁴ The optional provision was included in the OECD, Centre for Tax Policy and Administration, *2008 Update to the OECD Tax Convention*, (18 July 2008) [hereafter the 2008 OECD Commentary] at para 42.23.

services are of a preparatory or ancillary nature.⁴³⁵ The suggested wording in the Commentary is clear that these rules apply notwithstanding the requirements in Article 5(1).

As will be discussed further below, this type of provision may cause serious compliance problems for a non-resident service provider and administrative problems for the host government, particularly if a treaty exemption is being sought. It also leaves considerable opportunity for potentially discriminatory country practices both with respect to withholding obligations and subsequent tax refunds.

4. The Inclusion of (Types of) Services in the Royalty Article

The OECD and UN Model Tax Treaties do not provide for any specific rules that would result in the inclusion of income from services in the Royalty Article. Commentaries to the UN and OECD Model Tax Treaties, do however address mixed contracts that cover the supply of know-how and the provision of services.⁴³⁶ According to the Commentaries, the appropriate course to take with such contracts is that, if the services are only of an ancillary and largely unimportant character, the treatment for the supply of know-how should generally be applied to the whole amount of the consideration, including the payment for the services. A number of tax treaties have adopted this view through express language in the Royalty Article.

In some cases the royalty regime in a tax treaty may extend to all services (generally described as technical services) and not just to those of an ancillary character.⁴³⁷ The genesis for inclusion of these service provisions in the Royalty Article appears to be the India-United States Income Tax Treaty (1989)⁴³⁸ and accompanying Memorandum of Understanding. The Royalty Article in that treaty provides as follows:

⁴³⁵ These activities are limited to those mentioned in the OECD Model Treaty Article 5(4), which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

⁴³⁶ UN Model Commentary (2001) on Article 12 at para 12 and OECD Commentary (2010) Article 12 at para 11.6.

⁴³⁷ The Wijnen Study, *supra* note 424 at 2.7.2, reports that 83 of the 1,586 treaties examined added some variation of the royalty article to include services.

⁴³⁸ See the Wijnen Study, *supra* at 2.7.1 and the *Convention Between The Government Of The United States Of America And The Government Of The Republic Of India For The Avoidance Of Double*

Article 12
Royalties and Fee for Included Services

Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed: ...

The term "royalties" as used in this Article means:

- (a) payments of any kind received as a consideration for the use or, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use or disposition thereof; and ...

For purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services:

- (a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or
- (b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

Variations of the above Article can be found in a number of current tax treaties. In general these tax treaties also provide for a gross withholding tax. The current discourse about source based taxation rights for technical service fees makes clear the potential impact of national laws in the tax treatment of a non-resident service provider⁴³⁹

5. Separate Treaty Article for Services (Technical Services)

In some tax treaties the Royalty Article is also applied to payments for services regardless of whether they are provided independently of royalty payments. This type of provision

Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, 12 September 1989 (entered into force 18 December 1990) online: Internal Revenue Service <<http://www.irs.gov/pub/irs-trty/india.pdf>> [hereinafter the India-United States Income Tax Treaty]. The protocol to the India-United States Income Tax Treaty also makes it clear that consultancy services that are not technical in nature are not included under the royalty article and that the concept of fees for technical services cannot apply if technical knowledge is not made available through such services.

⁴³⁹ See e.g. S Sanghvi & R Shaktawat, "India – Taxation of Fees for Technical Services and Royalties" (2012) 18:6 Asia-Pacific Tax Bulletin 425. Taxes imposed under these particular national laws are arguably not protectionist, but rather are focused on revenue collection, however they make plain the potential impact of national laws as applied within a treaty context on the tax treatment of a non-resident service provider.

generally applies to technical service fees and is generally found in a discrete paragraph in the Royalty Article or in a separate treaty article.⁴⁴⁰ A typical example can be found in Article 13 in the India-Malaysia Income Tax Treaty (2001) which provides as follows:⁴⁴¹

1. Fees for technical services arising in a Contracting State which are derived by a resident of the other Contracting State may be taxed in the other State.
2. However, fees for technical services may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the recipient is the beneficial owner of the fees for technical services, the tax so charged shall not exceed 10 per cent of the gross amount of the fees for technical services.
3. The term “fees for technical services” means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Article 14 and Article 15 of this Agreement.

6. The ‘Other Income’ Article

Both the OECD and UN Model Tax Treaties include a general treaty rule to address classes of income not included under other treaty articles. Article 21(3) of the UN Model Tax Treaty reads as follows: “Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contract State not dealt with in the foregoing Articles of this Convention and arising in the other Contracting State may also be taxed in the other State.”

Some countries apply Article 21(3) of the UN Model Tax Treaty, otherwise applicable to other income, to income from services. The rationale for this treatment is that under the national law in that country income from services is not treated as business profits,⁴⁴² and therefore the Business Profits Article in a tax treaty does not apply. The default tax treaty article that is generally applied in such circumstances for income sourced in that country is

⁴⁴⁰ In general, the term “technical services” in tax treaties refers to a wide range of activities. Apart from technical services, it also covers managerial and consultancy services.

⁴⁴¹ This example is taken from the Wijnen Study, *supra* note 11 at 2.8.1 *The Agreement Between the Government of Malaysia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 14 May 2001, as used in the Wijnen study has since been updated in 2012, however the content of Article 13 has remained the same.

⁴⁴² For instance, BR: Ruling COSIT 1/2000 (as cited in the Wijnen Study, *supra* note 424), which allows the tax authorities to apply the other income article of Brazil's tax treaties in respect of certain payments for technical assistance or technical services. See discussion Chapter 8 Mercoursor countries.

Article 21, which provides for the host country to retain its domestic law taxing rights. There is no non-discrimination obligation with respect to income that is subject to host country taxation under this Article.

Threshold Issues Raised

From the variety of approaches adopted by the countries examined in the Wijen Report it is clear that significant discretion is exercised by local revenue authorities in the determination of whether service activities are sourced in the country, whether any applicable threshold for source income has been met, the amount of income that may be taxed and the method of imposing or collecting the tax.⁴⁴³ This discretionary process begins with a determination of the applicable tax treaty allocation rule article. The tax treaty allocation rule that is applied will also determine the basis for taxation.

D. The Basis of Taxation

The basis for taxation will vary depending on what tax treaty allocation rule is applied. If the activities of the non-resident service provider are sufficient to create a permanent establishment in the source state, the permanent establishment is subject to tax on its profits. Profits are determined based on Article 7 of the Model Tax Treaties and national laws.

If the payment for the provision of services is subject to the Royalty Article, or a separate treaty Article dealing with Technical Services, the amount is generally subject to withholding tax on a gross basis at a withholding tax rate determined under the applicable tax treaty.

There is no tax treaty rule with respect to how income from independent personal services is to be taxed unless the income falls under the business profits article. Income from independent personal services may thus be subject to net or gross based taxation. The same is true of income subject to tax under Article 21, the ‘other income’ Article in the tax treaty.

⁴⁴³ See Ariane Pickering, “Taxation of Non-Resident Service Providers” *supra* note 424. Pickering refers to these determinations as administrative issues at page 13. This is simply the other side of the coin.

E. The Method of Collecting Tax

Tax treaties do not prescribe the method to be used by a country in exercising its taxing rights under a treaty allocation rule nor does it specify how tax is to be collected. These are both matters to be determined by the country applying the treaty. One of two methods is generally employed, deduction at source in the form of a withholding tax or self assessment.

1. Self Assessment

Many countries levy tax on the income from services derived in their country by a non-resident on a self assessment basis.⁴⁴⁴ The apparent drawback of this approach from a tax administration perspective is verification of income and expenses in particular with respect to short term, mobile service providers who, apart from the notable exceptions of sportspersons and entertainers, may leave few footprints with respect to their income earning activities in the tax treaty partner's country. As a result many countries, including developing countries, impose a withholding tax on fees paid to a non-resident for the provision of services instead of relying solely on self assessment. The withholding tax levied may serve as a final tax or an interim tax pending taxation by self assessment. A refund of the withheld tax may also occur if the tax treaty rate is lower than the domestic withholding tax rate.

The following addresses a number of general issues that arise when withholding taxes are imposed. A detailed discussion of the withholding tax practices of select countries including Canada and the Mercosur Group is provided in Chapter 8.

2. Withholding Tax

Withholding taxes form an integral part of the national tax systems of most countries. They are often used in the context of income from services because they provide a simple and effective tax collection mechanism.⁴⁴⁵ On the other hand, because withholding taxes are

⁴⁴⁴ See Ariane Pickering, "Taxation of Non-Resident Service Providers" *supra* note 414 at 31.

⁴⁴⁵ The OECD, for example, endorsed the use of withholding taxes, as they are "effective tax collection mechanisms due to their inherent ability to collect tax at the point that income is earned, promote voluntary compliance through third party reporting and ensure stable and timely cash flows to government".

typically imposed on the gross amount of income, they do not take into account expenses that may have been incurred in earning the income. When these expenses are significant, they can represent a significant burden to the non-resident.

Recall that withholding tax is typically imposed on passive income such as dividends, interest, royalties, rent and capital gains. The logic is that the generation of this type of passive income does not generally involve significant expenses. Nevertheless, a significant number of countries also apply withholding taxes to income from services that do involve significant expenses including income from services related to transfers of technology or know-how, technical services and personal or professional services.⁴⁴⁶

The issue of whether the imposition of withholding tax is a potential detriment to a non-resident has been the subject of recent literature.⁴⁴⁷ An obvious detriment is the cash flow disadvantage that may arise for the non-resident as compared to a resident taxpayer. A non-resident may also be negatively impacted by the taxable base used and the tax rate applied when gross withholding tax is imposed.

Of particular interest is recent literature from the European Union (EU) which focuses both on the possible discriminatory effects of withholding taxes as well as whether withholding taxes that discriminate against non-residents can be justified by the need to ensure the effective collection of taxes.⁴⁴⁸ The claim of discrimination in this context is based on the violation of EU law and in particular Member obligations with respect to the four freedoms.⁴⁴⁹ Whether the behavior is discriminatory under EU law is measured based on a

⁴⁴⁶ IFA, 2012 Congress Boston, “Enterprise Services” 66th Boston Congress 2008, Cahiers de droit fiscal International, v.97a.

⁴⁴⁷ See Ariane Pickering *supra* note 414, Shee Boon Law *supra* note 422, etc. See Karin Simader, *Withholding Taxes and the Fundamental Freedoms* (Kluwer Law Intl, 2013). See also e.g. Karin Simader, “Withholding Taxes and the Effectiveness of Fiscal Supervision and Tax Collection” (February 2010) 115 Bulletin for International Taxation and Frans Vanistendael, “Taxation and Non-Discrimination, A Reconsideration of Withholding Taxes in the OECD” (June 2010) 175 World Tax Journal.

⁴⁴⁸ *Ibid* Samider and Vanistendael.

⁴⁴⁹ The *Treaty on the Functioning of the European Union* (TFEU) (entered into force 1 December 2009) grants four fundamental freedoms: the free movement of goods, the freedom to provide services, the free movement of workers together with the freedom of establishment, and the free movement of capital. Although direct taxation is still a competence of the Member States themselves, all of these protection provisions have a high influence on the national tax laws of the Member States. The case law of the European Court of Justice (ECJ) in the field of direct taxation has rapidly increased during the last 25 years. Even though the wording of the freedom and non-discrimination articles is rather vague, the ECJ has extensively made use of its monopoly on interpretation of EU legislation and has demonstrated the limits for national legislators. Tax laws may be in conflict with the fundamental

test that asks whether the withholding taxes lead to an unfavorable treatment or a higher tax burden for a non-resident than for a resident and whether the resident and non-resident are in comparable circumstances. If so the discriminatory treatment is prohibited as a violation of one or more of the four freedoms.⁴⁵⁰

Neither the GATS, the NAFTA nor the other free trade agreements under discussion include similar obligations to those imposed by the Treaty on the Functioning of the European Union (TFEU) for Members of the EU. Nonetheless the ongoing discussion in the EU about whether the imposition of withholding taxes on a non-resident is, or could be considered discriminatory, raises the obvious point that withholding taxes imposed by the source State can operate to disadvantage the competitive position of a non-resident service provider. The following therefore discusses the use of withholding taxes with a view to demonstrating when and how such taxes might be employed by a source country in the context of a tax treaty to the disadvantage of a non-resident service provider. It also provides an illustration of why a non-discrimination obligation might usefully be included in the OECD and UN Model Tax Treaties.

3. When Are Withholding Taxes Imposed?

Assuming that the national law of the tax treaty partner creates a liability for tax, withholding taxes may be imposed on the non-resident service provider in five broad circumstances.

First, where there is liability for withholding under the applicable treaty and treaty article. This would be the case for example, where services are included in the Royalty Article or under a separate Article for Technical Services and subject to a specified rate of gross withholding tax.

freedoms whenever they lead to a discriminatory treatment of cross-border situations within the EU or – under application of the free movement of capital – with third countries. Thus, withholding tax regimes can potentially conflict with the fundamental freedoms if they are applied in a discriminatory manner. This is determined by comparing the tax treatment in a cross-border transaction with the tax treatment if the transaction takes place in one Member State. “Thus, tax laws governing international transactions are never per se in conflict with the fundamental freedoms, but only if the taxation in the internal situations is more favorable.” See Karin Simader, *Withholding Taxes and the Fundamental Freedoms*, *supra* note 447.

⁴⁵⁰ See also the discussion in Chapter 5.

Second, where the liability for source country taxation is based on national laws and the rate of gross withholding is determined by applying national law. This would be the case for example where the services are excluded from the Business Profits Article under national laws and the Other Income Article is applied. In these circumstances there may be no treaty limitation on the applicable withholding rate, such as that seen in the Royalty Article.

Third, where there is no tax liability under the applicable treaty but national law nonetheless imposes an obligation on the payer in the source state to withhold at source.

Fourth, where the non-resident service provider is deemed to have a permanent establishment in the source State and is therefore subject to tax on profits, but payment is nonetheless subject to a gross interim withholding tax.

Fifth, where the non-resident service provider is subject to the Independent Personal Services Article and is therefore subject to tax on income, but payment is nonetheless subject to a gross interim or final withholding tax.

A useful starting point in a discussion of the source countries rights in each of these four circumstances can be found in the OECD Commentary which provide as follows:

A number of Articles of the Convention limit the right of a State to tax income derived from its territory..., the Convention does not settle procedural questions and each State is free to use the procedure provided in its domestic law in order to apply the limits provided by the Convention. A State can therefore automatically limit the tax that it levies in accordance with the relevant provisions of the Convention, subject to possible prior verification of treaty entitlement, or it can impose the tax provided for under its domestic law and subsequently refund the part of that tax that exceeds the amount that it can levy under the provisions of the Convention. As a general rule, in order to ensure expeditious implementation of taxpayers' benefits under a treaty, the first approach is the highly preferable method.⁴⁵¹

⁴⁵¹ OECD, Commentary to Model Tax Convention on Income and Capital (2010) on Article 1 at para 26.1 (hereafter the 2010 OECD Commentary).

The Commentary goes on to provide that if a refund system is needed, “it should be based on observable difficulties in identifying entitlement to treaty benefits” and that “it is extremely important that the refund be made expeditiously, especially if no interest is paid on the amount of the refund, as any undue delay in making that refund is a direct cost to the taxpayer.”⁴⁵²

As can be seen the both OECD and UN Model Tax Treaties, by design leave the method of application of the provisions of the tax treaty up to the domestic law of each Contracting State. There are few rules in the OECD or UN Model Tax Treaties or Commentaries with respect to how the specific provisions of the tax treaty should be applied. The source State thus has full control over when, how and at what rates it will levy withholding tax. This is consistent with the overall approach of allocating taxing rights between the Contracting States without specifying the manner in which these rights should be exercised.⁴⁵³

In the first circumstance, where the Royalty Article applies to a payment for non-resident services, and the source State’s taxing right is limited to a maximum rate under a tax treaty, it is up to the national law of that State to make certain that the maximum treaty rate is not exceeded. If, however, the national law prescribes a withholding tax rate higher than that prescribed by a treaty and the obligation to withhold is on the recipient of the services (the payor) with personal liability following from non-compliance, the person charged with responsibility as the withholding agent is unlikely to use the reduced treaty rate absent substantial reassurance by the non-resident or the local revenue authorities with respect to the correct applicable rate. A range of potentially discriminatory behaviors may be introduced. For example, proof of a treaty exemption or assurances from revenue authorities may be difficult to secure or it may be subject to undue delay or verification or it may be arbitrarily withheld.

The same issues will arise in the third, fourth and fifth circumstance described above, that is where there is no liability or liability will be reduced because the non-resident will ultimately be taxed on profit rather than on the gross payment. If the non-resident service provider is not liable for tax, but withholding tax is nonetheless required, two negative results occur. First

⁴⁵² *Ibid.*

⁴⁵³ Ault Hugh J & Jacques Sasseville, “Taxation and Non-Discrimination: A Reconsideration” (2010) 2:2 World Tax Journal.

the tax operates to transfer funds away from the non-resident service provider, second it imposes an administrative burden on both the recipient of the services, to withhold and remit and on the non-resident service provider to seek a refund.⁴⁵⁴

4. The Obligation of the Withholding Agent

The recipient of the services provided by a non-resident may also be subject to additional obligations. Specifically, the recipient is required to withhold on behalf of revenue authorities. As one author describes this obligation, the recipient assumes the role of tax collector. “Due to the withholding obligation of the payment debtor, the public duty of tax collection is transferred to the latter. The withholding agent acts in a sovereign manner on behalf of the tax authority. Through the outsourcing, the sovereign state gives up part of its administrative duties. Typically the withholding agent receives neither a reimbursement for the incurred expenses nor any other form of payment from the state authorities for this fulfillment of public duties.”⁴⁵⁵

In order to rightly assess this withholding obligation, the recipient of the services must determine whether the non-resident service provider is subject to withholding tax and whether the payment itself constitutes income that is subject to withholding tax. The recipient may or may not be required or permitted to take into account tax exemptions that are applicable to the payment. As discussed a withholding obligation for the recipient of services may continue, for example, even if the income on which the withholding tax is levied is tax-exempt. Conversely, the source country may allow the application of a tax treaty at withholding, where it results in a loss of the source state’s taxing right and correspondingly discharge the recipient of services from withholding obligations.

It follows that the more onerous the obligations and administrative burden on the recipient of services the less likely the recipient will be inclined to hire a non-resident service provider. The administrative obligation imposed on the resident recipient of services and the threat of

⁴⁵⁴ If the non-resident is ultimately liable to tax on profits because of the deemed permanent establishment rule, the withholding tax will generally be levied at an earlier point time than would otherwise occur for tax residents under an assessment system and on a higher amount of income. This result occurs because any applicable exemptions, lower tax rates or deduction for expenses will be considered in the later refund process. See Simader, *supra* note 33 at Chapter 2.

⁴⁵⁵ See Simader, *supra* note 33 at Chapter 2.

liability for the agent for error is within the control and discretion of the State where the recipient resides.

5. Summary

Withholding taxes are considered to be an integral part of the tax collection machinery in most national tax systems. They are generally levied on gross payments. The imposition of withholding taxes on a non-resident service provider clearly results in different income tax treatment than that afforded to a resident.⁴⁵⁶ When and how such withholding taxes are imposed by the source country may disadvantage the non-resident in a number of ways. For example, the withholding tax may lead to an earlier payment of tax compared to a tax assessment procedure. Withholding taxes may also lead to taxation despite the lack of a tax liability⁴⁵⁷ with the result that the taxpayer is burdened with the administrative vagaries of a refund procedure.”⁴⁵⁸

F. Differing Non-Discrimination Obligations

The various approaches used to address the tax treatment of non-resident service providers in tax treaties even when limited to the most general provisions in the treaty also give rise to very different outcomes in respect of the applicable non-discrimination principle. The following provides a summary of the potentially applicable Article under each of the OECD and UN Model Tax Treaties and the corresponding non-discrimination obligation if any. The following discussion proceeds on the assumption that the payment for services is not subject to a specific treaty article in respect of services, such as Article 17 of the OECD Model Tax Treaty which applies to entertainers and sportspersons.

For purposes of simplification, the general treaty articles potentially applicable to payments made to a non-resident service provider have been reduced to four main categories:

⁴⁵⁶ One of the questions posed later in this research is whether withholding taxes provide the best approach in policy terms, having regard to the substantial progress in developing agreements in cross border assistance in tax administrations, particularly with respect to the exchange of information and assistance in the collection of taxes.

⁴⁵⁷ This occurs in cases of a tax exemption, deductible expenses, or reduced tax rates that are not considered when withholding tax is imposed.

⁴⁵⁸ Simader, *supra* note 447, at page 40.

1. Payments for services subject to the Business Profits Article;
2. Payments for service subject to an Independent Personal Services Article;
3. Payments for service subject to tax as royalties or under the Royalty Article; or
4. Payment for service subject to tax as technical service fees under the Other Income Article (or a separate article).

Non-discrimination obligations analyzed on the basis of the UN and OECD Model Tax Treaties and the most common variations found in the Wijnen report:⁴⁵⁹

Article in the UN and OECD Model Tax Treaties:	Services: Issue to be Determined	Applicable Treaty Non-discrimination Obligation
Articles 5 and 7	Are services subject to the business profits article? Is there a permanent establishment?	If no permanent establishment: none If permanent establishment: taxation shall not be less favorably levied
Article 5(2) of the UN and OECD Model Treaties	List of examples constituting prima facie a permanent establishment (services)	If no permanent establishment: None If permanent establishment: taxation may not be less favorably levied
Article 5(3)(b) of the UN Model	Furnishing of services	“”
Optional provision on services in the OECD Commentary	Furnishing of services	“”
Article 5 of the UN and OECD Models: other provisions	Specific PE provisions in tax treaties dealing with services	“”
Article 14	Are services subject to the independent personal services article?	None
Article 14(1)(a) and (b) of the UN Model	Independent personal services	None
Article 14(1)(c) of the UN Model (1980)	Source state taxation for services on the basis of the amount of the remuneration	None
Article 14 of the OECD Model	Provisions on independent personal services as they existed until 2000	None

⁴⁵⁹ This table is adapted from a table presented in the Wijnen study, *supra* note 11.

Article 14: other provisions	Specific provisions in tax treaties dealing with independent personal services	None
Article 12	Are services subject to the royalty article?	None
Article 12: (technical) services	Specific withholding tax provisions on (technical) services in tax treaties related to royalties	None
Articles 12, 12A or 13: (technical) services	Specific withholding tax provisions on (technical) services in tax treaties not related to royalties	None
Article 21 (Other Income)	Are services technical service fee or other income?	None
Article 21(3) of the UN Model: other provisions	Specific provisions in tax treaties for services under the other income article.	None

As seen, under the regular UN Model Tax Treaty provisions, payments for services are potentially subject to the Business Profits Articles (Article 5 and 7) or the Independent Personal Services Article (Article 14).⁴⁶⁰

1. Business Profits

If payment to the non-resident service provider is subject to the Business Profits Article because the service provider has a fixed base in the source country or is subject to a deeming provision under Article 5, any business profits attributable to the permanent establishment are subject to tax but benefit from the non-discrimination obligation in Article 24(3). It requires that taxation shall not be less favorably levied than the taxation levied on enterprises of the other Contracting State carrying on the same activities. This non-discrimination obligation does not necessarily extend to administrative or procedural requirements.

Contrast the wording of the permanent establishment non-discrimination obligation with that found in Article 24 paragraph 1 that applies to nationals of one Contracting State that are resident in the other. Paragraph 1 applies to taxation and “any requirement connected therewith.” Thus it would not be in contravention of the tax treaty if a Contracting State

⁴⁶⁰ The discussion proceeds on the assumption that the payments for services are not subject to a specific treaty article in respect of services, such as Article 17 which applies to artists and sportspersons.

imposed different requirements on the non-resident service provider in respect to the income of the permanent establishment as long as the taxation of the permanent establishment is not “less favorably levied.” It follows that a Contracting State may apply a different mode of taxation and related procedural requirements to non-resident service providers with respect to the profits earned by the permanent establishment. This difference in treatment may lead to initial gross basis taxation subject to a refund and different filing obligations. The test to be met according to the Commentary is the ‘result’ of the taxation.⁴⁶¹

Some UN based treaties also include a limited force of attraction provision that would apply to services in Article 7(1)(c).⁴⁶² If applicable, once a permanent establishment exists in the source State through which services are provided, all income from services of the same or similar kind provided in the source state may be attributed to that permanent establishment whether or not the services are actually provided through that permanent establishment. Such income would be subject to the non-discrimination obligation in Article 24(3) discussed above.

In contrast, if the payment for services falls under the Business Profits Article but the non-resident service provider does not meet the permanent establishment threshold there is no tax treaty non-discrimination obligation. The income is also exempt from taxation in the source country under the tax treaty. The source State may nonetheless employ its domestic law as it chooses in taxing the business income, subject to the requirement that ultimately any tax is refunded to the non-resident, to the extent that the income is exempt under the tax treaty.

⁴⁶¹ 2010 OECD Commentary Article 24 para 26.

⁴⁶² This provision is based on the UN Model Tax Treaty. In full, this provision reads as follows: The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

2. Independent Personal Services

If payment for the services is instead taxable under the Independent Services Article as a result of the fixed base or a time test, there is no direct non-discrimination obligation. This is because the current non-discrimination obligations in Article 24 do not extend to a fixed base. The only obligation with respect to the non-resident service provider in these circumstances is indirect. Any payment made by a resident of a Contracting State to a non-resident service provider must be deductible under the same circumstances as when a similar payment is made to a resident.⁴⁶³

The Independent Personal Services Article also omits any rules for the computation of the income attributable to the fixed base or to income derived from services performed in the other Contracting State. As a result there is ample opportunity for a country to take the view that such income may be taxed by way of gross withholding at the applicable rate under its national laws.

In summary, the source State may employ its domestic law as it chooses in taxing income from independent personal services. It may do so even if the income is earned through a fixed base in the source State.⁴⁶⁴ This means the source State may impose interim or final withholding taxes or any filing requirements that it deems appropriate with respect to that income. Thus, regardless of whether the service provider liable to tax in the other Contracting State the non-resident may still find themselves subject to gross interim withholding tax.

As will be seen in Chapter 8, the imposition of an interim non-final withholding tax on income from professional or other independent personal services is not uncommon, whether or not the business profits or independent personal services article applies.

⁴⁶³ OECD Model Tax Treaty Article 24(4).

⁴⁶⁴ If a treaty adopts the language of the pre-2000 OECD Model Article 14, the article may be interpreted to provide no difference in outcome to Article 7. However many countries that retain Article 14 in their tax treaties are of the view that it has a different meaning than Article 7. That view also extends to how profits are computed and tax calculated in the two articles. See IFA, 2012 Congress Boston, *supra* note 423.

3. Royalties

If payments for services are considered royalties under the relevant treaty, or fees for technical services are covered under a separate treaty article, the payments are generally subject to a gross withholding tax set by the treaty partners. As a royalty or a technical service fee, any payment is generally subject to tax in the source State regardless of where the services are performed and if provided in the source State, regardless of the length of the stay and regardless of the amount earned. There is also no threshold to exclude short-term preparatory or auxiliary activities. There is no applicable non-discrimination obligation.

If the technical service fees are viewed as business profits, the profits would be exempt under a tax treaty. Further difficulties may arise if appropriate procedures are not in place to refund amounts withheld to a service provider claiming the benefit of a tax treaty including a reduced rate of withholding tax

4. Other Income

If payments for services are taxed as other income under the ‘Other Income’ article of a tax treaty (instead of as business profits under Article 7), the payment will be generally be subject to gross withholding at the applicable domestic rate in the source State. There is no applicable non-discrimination obligation.

G. An Example⁴⁶⁵

The approach taken by a country to the taxation of services, can lead to wide variations in source country taxation rights, in the tax burden that is imposed on a non-resident service provider and in the non-discrimination obligations that apply in the tax treatment of the non-resident services provider.

⁴⁶⁵ This example is adapted from G.D. Sprague, “Enterprise Services” (2012) 66:9 Bulletin for International Taxation.

For purposes of illustration assume that a non-resident provides architectural services to a resident of a tax treaty partner. The project requires that a revolving team of specialists be present from time to time in the source State over the duration of the project. The treaty partner adopts one of the following three approaches to determine host country taxation rights:

1. The OECD approach: income from services is treated in the same way as any other business income. There is no treaty right to source taxation if the service provider does not maintain a permanent establishment in the jurisdiction to which the services income is attributed.
2. The UN approach (and the similar, but not identical, approach in the OECD's "alternative provision" regarding services): Article 5 includes a special deemed service permanent establishment provision, basically based on time spent performing the service in the jurisdiction.
3. The royalty approach: income from certain services (typically technical services) is treated like royalties under the UN Model, and subject to withholding tax.

Each approach results in different taxing rights for the treaty partner in the country where the services are provided if we assume that the rotating consultants do not maintain a traditional permanent establishment in that country. The project could be subject to no source country taxation, net basis tax on an amount of attributable profits based on the special deemed permanent establishment time test; or (3) gross-based taxation on all or a portion of the fee.

The non-resident service provider is also subject to different non-discrimination principles in the source country. There is no applicable non-discrimination obligation if the first (OECD approach) or third (royalty approach) is adopted by the source State. Under the second UN approach, the non-discrimination Article states that taxes on the permanent establishment cannot be less favorably levied. Notwithstanding, this non-discrimination obligation does not exclude the ability to impose gross interim withholding tax, it merely requires a final reckoning of the taxes due.

H. Conclusions

In summary, there is no treaty non-discrimination obligation under a tax treaty if the income earned by a non-resident carrying on an enterprise in a treaty partner country is not attributable to a permanent establishment in that treaty partner country.

There is no non-discrimination obligation if the income is subject to the independent personal services article whether or not that income is earned through a fixed base.

There is no tax treaty non-discrimination obligation with respect to passive income such as royalties.

There is no non-discrimination obligation with respect to how income from services is categorized by a source State under the tax treaty allocation rules.

There is also no non-discrimination obligation requiring a source State to categorize income from services that is earned by a resident in the same manner as income earned from a non-resident for tax purposes. Fees for technical services may be treated as ordinary income under national law if paid to a resident but as royalty income if paid to a non-resident.

There is no non-discrimination obligation that prevents a source State from systematically categorizing all payments that have a connection to services as falling within the tax treaty allocation rule that yields the maximum rate of source State taxation.

The only non-discrimination obligation in the tax treaty that applies to a non-resident service provider is that the taxation of business income earned by an enterprise through a permanent establishment must not be less favourably levied.⁴⁶⁶

The sheer volume of work undertaken in recent years by both the OECD and the UN in examining and reexamining the provisions impacting the cross-border trade in services is clear evidence that the status quo is not considered good enough in appropriately taxing income from services. The 2011 review by the UN when updating its Model Tax Treaty highlights many of the issues inherent in the current provisions and their application. As one

⁴⁶⁶ OECD Model Tax Treaty Article 24(3).

leading authority noted “...the provisions of both the OECD Model Tax Treaty and the UN Model Tax Treaty – and the bilateral treaties based on those Models – dealing with income from services are a mess.”⁴⁶⁷ It is therefore of no surprise that the non-discrimination obligations in respect of the tax treatment of service providers are also inconsistent, incoherent and, in the colloquial terms of that author - a mess.

If one returns to the simple objective of trade agreements, to reduce barriers to cross border trade in services together with the decision to relegate non-discrimination obligations to tax agreements, one begins to wonder whether the reality of what occurs as the result of the application of a bilateral tax treaty was fully considered. Clearly we do not have consistency, reliability, national treatment, most favored nation treatment or transparency under the current provisions in OECD and UN based tax treaties.⁴⁶⁸

⁴⁶⁷ Arnold BJ, “The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess” (2011) 65 *Bulletin for International Taxation* 2 at 59.

The simplest option to resolve these problems is to abandon the notion of source country taxation absent a permanent establishment. For a variety of reasons, including the host countries concern with revenue collection, this is not a feasible alternative at this point.

Another option is to ensure that consistent principles with respect to the tax rate and tax base are used in applying the tax treaty provisions a non-resident service provider. For example the tax treaty could clarify whether taxes are to be imposed on a gross or net basis or set a cap on the appropriate applicable withholding rate if gross withholding is anticipated. Such measures will not, however, address procedural issues in administering the treaty, which must occur through broad non-discrimination obligations.

Chapter 8: Tax Treatment where Services Income is Subject to Withholding Tax

A. Overview

This Chapter examines the tax treatment of a non-resident service provider in the State in which the person paying for the services (payor) is liable to tax. As will be seen, a non-resident service provider is often subject to different tax treatment than a resident service provider in these circumstances. The differences in tax treatment can be found in the domestic law or administrative practices of the “source” State.⁴⁶⁹ One of the most significant differences is the imposition of withholding tax by the source State, typically on a gross basis, on income for services paid to the non-resident.⁴⁷⁰ This difference is generally justified on the ground that a non-resident service provider poses collection and enforcement problems. Liability for withholding generally falls on the resident payor.⁴⁷¹ As will be seen, practices vary in different countries as to whether the withholding tax is interim or a final obligation.⁴⁷² Practices also vary as to whether or not a withholding tax will be imposed notwithstanding a tax treaty exemption.

Whether or not the withholding tax is final, the withholding tax liability is likely to represent a substantial tax burden. The rate of withholding imposed on income from services can range

⁴⁶⁹ As will be discussed, although views may differ on the “source” of service income, the tax treatment of the non-resident service provider is generally based on how source is interpreted by the “payor” state.

⁴⁷⁰ Many countries, are very concerned about securing their source country rights over income from services and do so through withholding tax. The point of this Chapter is not to argue that withholding taxes are not appropriate in many circumstances. Rather the objective of the Chapter is to demonstrate the wide variances in practice in the imposition of withholding taxes and the potential impact this may have on a non-resident service provider.

⁴⁷¹ See Karin Simader, *Withholding Taxes and the Fundamental Freedoms* (Kluwer Law Intl, 2013).

⁴⁷² See IFA, 2012 Congress Boston, “Enterprise Services” 66th Boston Congress 2012, Cahiers de droit fiscal international, v.97a. Some countries such as Australia, Canada, Israel, New Zealand, Portugal and the United Kingdom impose withholding taxes on services income when payments are made to non-residents. However refunds may be granted if the non-resident files a tax return and the net tax liability is less than the withholding tax. Other countries impose a final withholding tax on income from services rendered by non-residents, especially when the non-resident does not have a permanent establishment in the countries. These countries include Argentina, Brazil, Chile, Chinese Taipei, Columbia, Czech Republic, France, India, Italy, Japan, Mexico, Peru, South Korea, Spain, Uruguay and Venezuela. Withholding taxes imposed by these countries are final in that they represent the non-residents’ final tax liability in these countries and will not be refunded (unless a lower rate applies under an applicable tax treaty).

from 15% in the Czech Republic to 35% in Argentina, Brazil and Chile.⁴⁷³ These rates may be higher if the payments are made to residents subject to a preferential tax regime or in a low-tax jurisdiction. Because the withholding taxes are applied to the gross amount of income, they may represent a substantial tax burden on net services income after taking into account related expenditures.⁴⁷⁴

There may also be differences in administrative practices in the source State that may negatively impact a non-resident service provider.⁴⁷⁵ Taxing agencies are generally given broad discretion in establishing administrative practices that can increase the impact of tax provisions already negatively affecting a non-resident service provider. It is no surprise that the imposition of gross withholding taxes⁴⁷⁶ on non-resident service fees may interfere with the ability of the service provider to do business in the other country. Conversely, the ability to secure a waiver or exemption from withholding tax in circumstances where there is no ultimate tax liability in the other country will clearly be a benefit to the service provider.

As discussed in previous Chapters, the non-discrimination Articles in the OECD and UN Model Tax Treaties do not currently include a non-discrimination principle applicable to a non-resident service provider in these circumstances. The potentially applicable non-discrimination obligations in both the OECD Model Tax Treaty and the UN Model Tax Treaty are limited to situations where the non-resident service provider has a permanent establishment in the host country or applies indirectly with respect to the deductibility of expenses.⁴⁷⁷

The intent of this Chapter is to examine some of the differences in tax treatment between resident and non-resident service providers around the globe. The objective of the discussion is not to argue that these differences, and in particular the imposition of withholding tax, are

⁴⁷³ Ariane Pickering, General Report, in IFA Enterprise Services Cahiers 2012 Volume 97A (IFA: Online Books, 2012).

⁴⁷⁴ See Shee Boon Law, “Chapter 4: Withholding Taxes on Services Income - A 21st Century Outlaw or a Necessary Evil?” in Carlos Gutiérrez & Andreas Perdelwitz, eds *Taxation of Business Profits in the 21st Century* (IBFD 2014.)

⁴⁷⁵ See e.g. *Income Tax Regulations*, CRC, c 945, s 105 [hereinafter Regulations] dealing with withholding taxes and the waiver process.

⁴⁷⁶ “Gross withholding taxes” is defined in Vern Krishna, *The Fundamentals of Canadian Income Tax*, 8th ed (Toronto: Thomson/Carswell, 2004) at 1725 as: “In international tax law, a withholding tax is a tax levied by the country in which income arises (the source country) at a flat rate on the gross amount of the income paid by a resident of the country to a nonresident. The tax is usually collected by the resident taxpayer and remitted to the government on behalf of the nonresident person.”

⁴⁷⁷ See discussion in Part I Chapter 2.

necessarily discriminatory. The objective is to determine whether or not these differences may impact the competitive position of the non-resident service provider and to consider whether such tax treatment should be subject to an overriding non-discrimination principle.⁴⁷⁸

The Chapter begins with a brief examination of some preliminary issues in determining whether income from the performance of services is subject to host country taxation and if so, how the income is taxed. An examination of the domestic tax regimes in a number of countries follows, beginning with Canada.

The survey of the Canadian tax regime provides detail about the tax treatment of a non-resident service provider who provides services in Canada. The examination explores the impact of current domestic tax measures in Canada on the non-resident service provider and the additional obligations and potential liabilities imposed on the payor of the non-resident services. The discussion although factual is intended to be illustrative only and can be easily repeated using legislation and administrative practices in many other source countries.

Examples of the tax treatment of non-resident service providers in the Mercosur Countries, and Chinese Taipei follows.⁴⁷⁹ The focus is again on the use of withholding tax on payments for services made to a non-resident.

B. Taxation of Services - Applicable Domestic Law

Ascertaining the tax imposed on income from the provision of services by non-residents is a two step process. First one must determine how the income related to the provision of the particular services will be characterized under the domestic law of the source State. Second, one must determine the basis used in domestic law for taxation of that type of income.

⁴⁷⁸ It has been suggested that there is no need to expand the scope of the Non-Discrimination Article in the OECD Model Tax Treaty as there is no evidence of tax discrimination in the case of non-residents or that current tax practices have harmful economic effects. See Arthur J Cockfield & Brian J Arnold, "What Can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model" (2010) 2:2 World Tax Journal.

⁴⁷⁹ The material for these countries is drawn from current literature including Pickering, above note 5, and discussions with colleagues in the selected countries.

Determining what constitutes income from services is not always a straightforward task. The distinction between goods and services and in particular intangible goods is also not always clear. Some jurisdictions also treat income from the provision of particular services such as services associated with the transfer of technology or know-how as royalty payments. Countries may also impose different tax rates or withholding tax rates on different types of services, including services associated with transfers of technology, technical services, and personal and professional services including management fees. Whether or not the payments are subject to withholding tax also varies widely. Some jurisdictions impose tax on the payment for services if the services are performed in their territory. Other jurisdictions impose tax on the payments regardless of where the services are performed if the source of payment is from within their country.⁴⁸⁰ This is the case in a number of countries in the Mercosur Group including Brazil⁴⁸¹ and Uruguay.⁴⁸²

1. Country Examples

(i) *Canada*

Canada collects tax imposed on the income earned by non-residents performing services in Canada by way of withholding tax.⁴⁸³ Specifically, the *Income Tax Regulation* 105 provides that "every person paying to a non-resident person a fee, commission or other amount in respect of services rendered in Canada, of any nature whatsoever, shall deduct or withhold 15 percent of such payment" and remit it to the Canada Revenue Agency (CRA).⁴⁸⁴ Tax withheld pursuant to this provision operates, in effect, as an installment in respect of the non-resident's potential Canadian tax liability for income tax. Potentially significant penalties and

⁴⁸⁰ The US takes a third approach and requires the income to be "effectively connected to the conduct of a trade or business" thus limiting its scope to tax non-resident service providers.

⁴⁸¹ See Sergio Andre Rocha, "Branch Report, Brazil" in *IFA Cahiers 2012-Volume 97A, Enterprise Services (IFA 2012)*, (IBFD Online Books, 2012) 155 at 156.

⁴⁸² See Luis Aisenberg & Alejandro Horjales, "Branch Report, Uruguay" in *IFA Cahiers 2012-Volume 97A, Enterprise Services (IFA 2012)*, (IBFD Online Books, 2012) at 740.

⁴⁸³ In addition to withholding taxes, there may be liability for indirect taxes such as the GST. For Goods and Services Tax ("GST") purposes, the threshold for non-residents being required to register, collect and remit GST is very different. For GST purposes, the service provider must only be carrying on business ("COB") in Canada. Thus, while a non-resident may be exempt from Canadian income tax under a tax treaty, they may not be exempt from being required to register, collect and remit GST. Since in many cases this GST would be recovered by the payer, there is no net tax revenue generated by the CRA in these circumstances, only the administrative and compliance burden.

⁴⁸⁴ Regulation, *supra* note 475.

interest charges apply to the procurer of services for failure to withhold, remit and report as required under the *Income Tax Act* (ITA).

The broad language of Regulation 105 casts a wide net over payments that may be subject to withholding.⁴⁸⁵ The reference “every person paying a fee” includes individuals, corporations, trusts, partnerships and legal representatives, whether resident or non-resident of Canada. The CRA has taken the position that each member of a partnership is responsible for Regulation 105 withholding. Also included in Regulation 105 are payments made by third parties and tax-exempt parties.

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

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

A non-resident may apply for a waiver of the withholding tax if it can show, before performing the services in Canada, that the tax liability is less than the amount to be withheld, either due to a tax treaty exemption or an estimation of its income and expenses.⁴⁸⁶ Under most tax treaties, business income earned by a non-resident in Canada is taxable in Canada only if the non-resident carries on the business through a permanent establishment in Canada. Despite the perceived benefits, this waiver process is cumbersome and therefore rarely utilized.

⁴⁸⁵ Regulation 105 lists the exempt forms of payments, which include remuneration to non-residents, payments made to a registered non-resident insurer, and payments made to an authorized foreign bank in respect of its Canadian banking business.

⁴⁸⁶ This income and expense waiver application would normally include information and documentation relating to the contract to be performed in Canada, including the gross amount of the contract, any allocation of services inside and outside of Canada and identifiable expenses such as travel, per-diems, etc. relating to the services to be performed in Canada. The Canada Revenue Agency, Information Circular 72 – 6R2 “Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada” (23 February 2005) includes information pertaining to the CRA Regulation 105 waiver process.

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

The costs and administrative duties associated with Regulation 105 compliance are significant for any Canadian entity. Regulation 105 imposes a duty on the payor to withhold, remit and report. Anecdotal evidence confirms that these requirements frustrate Canadian businesses facing significant administrative responsibilities for another person's tax liability. If a payor fails to deduct and remit the amount in accordance with the ITA and Regulation 105, they will be liable for the entire amount together with interest and penalties. The penalties can be severe.⁴⁸⁷

Canadian payors will assume a number of additional tax obligations if they hire a non-resident when compared to their obligations if they hire a Canadian resident. For example, regardless of whether the non-resident obtains a waiver the payor is obliged to annually report to the CRA all amounts paid to non-residents.⁴⁸⁸ It must also issue a special information return to the non-resident or face additional penalties. As will be discussed below, the Canadian payor may assume considerable risk with respect to its proper basis for withholding.⁴⁸⁹

The Canadian payor will also be concerned about whether the non-resident renders his or her services inside or outside of Canada. As payments for services performed outside of Canada

⁴⁸⁷ See *Income Tax Act*, RSC, 1985, c 1 (5th Supp) [hereinafter ITA] subsection 227(8). Under certain circumstances, this penalty could be increased to 20 percent; ITA paragraph 227(8)(b). In addition, interest will also be due on amounts not withheld; ITA subsection 227.

⁴⁸⁸ The information is reported on a T4A-NR Information Return. This return must be filed by the last day of February for all payments made during the preceding year. "RC445 T4A-NR - Payments to Non-Residents for Services Provided in Canada" online: Canada Revenue Agency <<http://www.cra-arc.gc.ca/E/pub/tg/rc4445/README.html>> is updated annually.

⁴⁸⁹ *Weyerhaeuser Co. v R*, 2007 TCC 65, 2 CTC 2408 [*Weyerhaeuser*] at para 4. In *Weyerhaeuser*, the CRA charged a Canadian payor almost a million dollars for withholding tax, interest and penalties. The Canadian payor had paid over \$14 million to non-resident independent contractors in the ordinary course of its business and remitted 15% based on that amount. At issue was the failure to withhold on amounts paid to reimburse expenses and for services identified in invoices as rendered outside Canada. Fortunately for the taxpayer, the court found that withholding applied only to amounts paid as fees or other remuneration. This favorable finding may have done little to detract from the time and costs to defend against an assessment triggered by the hiring of non-residents. It did not extend to the reimbursement of out of pocket expenses.

are not subject to Regulation 105 withholding, a reasonable allocation of the payment will be required and evidenced by precise documentation. To the extent the services are performed outside Canada, the payer's ability to claim Scientific Research and Experimental Development and Investment Tax Credits may be impacted. This can be at a substantial loss to the corporation.

For the purpose of this study it is important to make clear that it is not just the existence of Regulation 105 that is problematic. It is also how regulation 105 is interpreted and administered by tax authorities. The CRA has stated that it broadly interprets the wording "payments in respect of" services rendered in Canada. As a result, in 2007 the CRA imposed interest and penalties on the Canadian taxpayer for failure to withhold an amount under Regulation 105 with respect to expenses reimbursed to non-resident service providers for such things as travel costs, telephone, fax and postage charges, and photocopying.⁴⁹⁰ The CRA's position was that these amounts were "in respect of" services rendered in Canada as specified in Regulation 105. The Tax Court of Canada found that the operation of Regulation 105 did not extend beyond requiring the payor to deduct and withhold amounts from payments that were in the nature of fees or commissions that, in the hands of the recipient, had the character of income earned in Canada. Although the taxpayer was ultimately successful one cannot over estimate the disruption in the market place during the intervening period and the impact of the CRA's position on the decision about whether to hire a non-resident service provider.

In addition to requiring withholding on amounts paid to reimburse contractors for their disbursements, the CRA also required withholding on amounts paid for time spent traveling to Canada. Canadian courts have now also clarified that Regulation 105 only applies to payments for services rendered in Canada. The CRA has stated that whether a payment to a non-resident person is for services rendered in Canada "is a question of fact that can only be determined after an analysis of all of the relevant facts and circumstances, including all of the relevant agreements."⁴⁹¹ The CRA is also of the view that the requirement to withhold or deduct pursuant to Regulation 105 applies to payments for services rendered, or to be rendered, in Canada.⁴⁹²

⁴⁹⁰ *Ibid.*

⁴⁹¹ CRA Document No 2009-0325921E5, "Regulation 105 withholding" (May 13, 2010).

⁴⁹² CRA Document No 2010-0355591E5, "Regulation 105" (March 23, 2010).

Will these withholding requirements have a negative impact on a non-resident's ability to compete in providing services in Canada? The answer to this question has not been extensively studied. However, in a 2008 review by the Advisory Panel on Canada's System of International Taxation, a number of potentially distortive effects were identified with respect to interim withholding obligations on income from trade in services.⁴⁹³ These included costs to both Canadian businesses and service providers. In particular, Canadian businesses reported additional administrative responsibility for the non-resident's tax liability, significant costs associated with compliance and a trend by service providers of grossing-up their fees to offset the withholding tax, resulting in additional costs and hampering the ability to engage skilled workers from outside Canada. Non-resident service providers also reported the negative impact of both the administrative costs associated with the refund process and reduced or delayed revenues and cash flow problems if they did not receive a gross-up from the payer.⁴⁹⁴ Similar concerns were expressed in respect of withholding obligations for non-resident employees despite a tax treaty exemption.⁴⁹⁵ The affirmative answer to the question whether this less favorable tax treatment inhibits a non-resident's ability to compete in Canada and thereby inhibits the cross-border flow of trade in services seems obvious. How could this less favourable tax treatment fail to affect the non-resident's competitive position?

This reality is becoming a lobbying point for important tax groups in Canada. For example, the Taxation Committee of the Chamber of Commerce submitted the following to the Minister of Finance in 2010:

It is becoming increasingly common for organizations to staff projects based on a global skill set rather than looking only to the resources available in their home jurisdiction. The present withholding

⁴⁹³ Advisory Panel on Canada's System of International Tax, *Final Report: Enhancing Canada's International Tax Advantage* (Ottawa: 10 December 2008).

⁴⁹⁴ As a result the Advisory Committee recommended eliminating withholding tax requirements related to services performed and employment functions carried on in Canada where the nonresident certifies the income is exempt from Canadian tax because of a tax treaty.

⁴⁹⁵ ITA Regulation 102. In the Canadian context the withholding obligation under Regulation 102 "applies to such a broad range of situations, it places a significant administrative burden on the nonresidents, as well as Canadian corporations who carry out the administrative duties on behalf of related nonresident employers. For example, where a nonresident performs employment duties in Canada for just one day, a withholding obligation is placed on the employer. Although a waiver can be obtained if the employee ultimately will not be taxable in Canada, the time delay is often considerable, making the process unhelpful. In practice, it is difficult for nonresident companies to set up a process to withhold and remit various Canadian taxes for what may be small amounts."

requirements, as set out in Regulation 105, are severe deterrents to allowing Canadian organizations to effectively compete for global resources. The burden resulting from compliance with the requirements is carried by the organization contracting for services in terms of withholding, tracking, reporting and remitting. This impairs Canadian businesses' ability to effectively procure the skills needed for them to effectively compete on a global basis. There is also an undue burden on the service provider in terms of additional reporting requirements and cash flow, and on the CRA in their administration of the program. Additionally, the requirement drives an unintended result in that many nonresident suppliers merely increase their prices to account for the withholding taxes levied under this regulation. The OECD has recognized that the implementation of withholding taxes in situations where a permanent establishment does not exist can lead to excessive taxation.

Concerns regarding Regulation 105 were also raised during consultations undertaken by the Advisory Panel on Canada's System of International Taxation. The Panel heard that the costs associated with complying with Regulation 105 are significant; service providers commonly gross-up their fees to offset the withholding tax, which can result in additional costs to Canadian businesses and hamper their ability to engage skilled workers from outside Canada; the waiver process is cumbersome and so it is not used as often as it should be; and the service provider may suffer reduced or delayed revenues and cash flow problems if the service provider has not received a gross-up from the payer.

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

How are non-resident service providers taxed in other countries? The following discusses this question in the context of the Mercosur countries.

(ii) *The Mercosur Countries⁴⁹⁶ and Associated Members*

Mercosur is a customs union formed in 1991 by Argentina, Brazil, Paraguay and Uruguay by way of the Treaty of Asunción (the “Mercosur Treaty”). Bolivia, Chile, Colombia, Ecuador and Peru are associated countries but not full Members, but are referred to as of the Mercosur Group. Venezuela also has a sui generis status in the Mercosur Group: while it is not a full Member or an associated country, it participates in all the negotiations between Mercosur Countries and third parties.⁴⁹⁷ Venezuela’s full membership to Mercosur is subject to the Paraguayan and the Venezuelan Congresses ratifying the 2006 Protocol.⁴⁹⁸

As Table 1 below demonstrates, all countries in the Mercosur Group impose withholding tax obligations with respect to payments made to non-resident service providers. Brazil and Uruguay also boast source rules that permit those countries to tax payments for services that are provided abroad, as does Colombia, Ecuador and Peru.

The tax legislations in the MERCOSUR Member Countries (Argentina, Brazil, Paraguay and Uruguay) also impose restrictions on deductions for payments made to non-residents. Specifically, Argentina limits deductions that relate to consultancy services.⁴⁹⁹ According to one author, Paraguay also limits deductions that relate to technical or consultancy services.⁵⁰⁰ In the case of Argentina the deduction limit extends to financial advice or any other kind of technical assistance provided from abroad including know-how.⁵⁰¹ Uruguay limits deductions in respect of any person subject to the non-resident income tax.⁵⁰² In some cases the impact

⁴⁹⁶ This discussion relies heavily on information found in Carlos Forcada, “MERCOSUR/Argentina/Brazil/Paraguay/Uruguay - The Economic Effect of Taxation on the Flow of Software Copyright Royalties in MERCOSUR” (2011) 65:7 Bulletin for International Taxation.

⁴⁹⁷ Protocolo de Adhesión de la República Bolivariana de Venezuela al Mercosur (2006), Article 9 [2006 Protocol].

⁴⁹⁸ *Ibid*, Article 10.

⁴⁹⁹ Argentina has established that deductions for technical service fees should not exceed (1) 3% of the sales or income on a contractual basis in respect of the consultancy fees; or (2) 5% of the investment based on the consultancy: Decreto 1344/98, available online: < <http://infoleg.gob.ar> > (as cited in Forcada, *supra* note 28). Deductions are not permitted for payments made to non-residents that arise from technology transfer agreements not registered with the competent authority (Instituto Nacional de la Propiedad Intelectual): Ley de Transferencia de Tecnología 22.426; Decreto 1853/93 and Resolución 328/05 (Instituto Nacional de la Propiedad Intelectual).

⁵⁰⁰ Payments for advice and consultancy fees that are not directly related to activities performed in Paraguay are deductible at up to 2.5% of the net income taxed (as cited in Forcada, *supra* note 496).

⁵⁰¹ Cecilia Goldemberg, “Transfer Pricing in Argentina” (2005) 59 Bulletin for International Taxation 387.

⁵⁰² Uruguayan Ley 18.083 (Sistema Tributario) taxes individual and corporate income at a 25% tax rate. If the non-resident is subject to a tax similar or higher than the Uruguayan tax rate at home, he or she will be allowed to fully deduct the expense most of the time. However, if the non-resident is subject to a

of these restrictions is minimized by the non-discrimination clause in an applicable tax treaty.⁵⁰³ Other countries including Brazil limit the deductibility of payments that qualify either as "technical, scientific, administrative services or the like", or as "royalties".⁵⁰⁴

Although many countries in the Mercosur Group view the withholding tax as the final tax, some also require that the non-resident file a tax return. For example, a non-resident who derives Venezuelan-source income is required, irrespective of the amount, to file a tax return.

Some of these countries will provide administrative relief if a tax treaty is in place; for example, Argentina.⁵⁰⁵ Colombia will also apply a reduced treaty rate at source if the appropriate residence certificate has been presented to the withholding agent making the payment.⁵⁰⁶ However, if the taxpayer does not comply with the formal requirements set forth in Colombian domestic law, the benefits of a tax treaty will be granted only as a tax refund. In contrast, in Peru, if a lower treaty rate applies, the refund of excess tax must be claimed directly by the non-resident.

The obligation to withhold on payments made to a non-resident service provider generally falls on the resident payor in the Mercosur countries. For example, according to Article 406 of the Colombian Tax Code (*Estatuto Tributario Colombiano*), any person that makes payments to non-resident companies has the obligation to withhold the corresponding tax amount. Withholding agents are also required to be registered, to file monthly withholding tax returns to pay the amounts withheld, and to provide taxpayers with a certificate of the amounts withheld. Similar provisions can be found in Peru.⁵⁰⁷

lower tax rate at home, the expenses will be deducted proportionally to that reduced rate. Ley 18.083, Article 20 (as cited in Forcada, *supra* note 496).

⁵⁰³ See Forcada, *supra* note 496.

⁵⁰⁴ Payments that qualify as "royalties" or "technical, scientific, administrative or similar assistance" cannot be deducted in certain circumstances: Lei 4506, Articles 52 (parágrafo único) and 71 (as cited in Forcada, *supra* note 496).

⁵⁰⁵ A reduced treaty rate may be applied at source if the appropriate residence certificate has been presented to the withholding agent making the payment (Resolución General A.F.I.P. 2228/07).

⁵⁰⁶ The IBFD Research Platform reports as follows: "On 31 March 2009, the tax authorities (Dirección de Impuestos y Aduanas Nacionales) issued Resolution 3283 providing the rules related to the issuance of tax situation certificates which may be required by treaty partners to provide treaty benefits." This refers to Resolución DIAN 3283 (31 March 2009). See also Dr. Irma Johanna Valderrama, "The International Tax Treaty Policy of Columbia" 67:4/5 Bulletin for International Taxation.

⁵⁰⁷ Persons or entities paying any kind of income to non-residents must withhold and remit the tax to the tax authorities within the first 12 days of the following month. The withholding agent must provide a withholding certificate. If a lower treaty rate applies, the refund of excess tax must be claimed directly by the non-resident.

Each of the Mercosur Countries has detailed withholding tax rules with respect to fees for services paid to non-residents and in particular fees related to technical services. The rates range from 12 to up to 35% of gross income. The withholding tax rates for each of the Mercosur countries are summarized in Table 1 below.

Table 1

The following provides a summary of the withholding obligations in respect of payments for services including the additional rules for payments to non-residents where applicable in the other Mercosur Countries.

Country	Services Subject to Withholding Tax	Withholding Rates
Argentina	Payments to non-residents in respect of technical assistance. Argentinean-source taxable income is presumed to be, without right of rebuttal, 60% of the gross payment of fees for services comprised in the Transfer of Technology Law which consist of: (i) technical assistance services; (ii) engineering services; or (iii) consulting services under an agreement duly registered with the INPI. ⁵⁰⁸ Such services include: (i) engineering services and (ii) consulting services (thus, subject to registration), but only where such services involve technical knowledge applicable to the productive activity of the local company and the transfer of such knowledge to this company or its personnel by means of training and advisory services, detail of mechanical and technical procedures, supply of plans, reports and studies. If the service is outside the scope of the Transfer of Technology Law, but involves technical assistance- notional income is 90% of the payment (effective rate 31.5%).	35% on notional taxable income ⁵⁰⁹
Brazil	Royalties and payment of fees as consideration for the transfer of technology and for technical, administrative and scientific assistance including technical services that do not involve the transfer of technology. Withholding tax is due even when a tax treaty applies (Ruling 01/2000). ⁵¹⁰ Royalties paid by resident entities to non-residents as consideration for the transfer of technology, trademarks and patents,	15% of gross amount ⁵¹¹

⁵⁰⁸ In order to apply the 60% notional income rule, certain additional requirements must be met: for example, the payment for the services must not be based on a royalty calculated by reference to the sales price or the production volume of licensed products or services.

⁵⁰⁹ The Argentinean-source notional income increases to 80% of the payments if the requirements for the 60% rate are not met and the technical assistance involves a transfer of technology and the relevant contract is registered with the INPI. If the agreement is not registered with the INPI, the deemed taxable income is 90% of the payments. Effective withholding tax rates on gross payments are 21%, 28% and 31.5% respectively.

⁵¹⁰ Until the Supreme Court decision in COPESUL, BR:SC, 17 May 2012, *National Treasury v. Companhia Petroquímica do Sul* as cited in Shee Boon Law *supra* note 6, the tax authorities in Brazil argued that payments of technical service fees should not be classified as business profit (Article 7), but rather as gross income (before deductions), according to Brazilian domestic legislation. Therefore, Article 21 of tax treaties would apply. Article 21 in the tax treaties signed by Brazil normally do not follow the OECD Model Tax Treaty and grant exclusive taxing rights to the source country.

⁵¹¹ A 25% rate applies to royalty payments made to beneficiaries located in low-tax jurisdictions.

	and for the supply of technical, administrative or scientific assistance are also subject to the contribution for intervention in the economic domain (CIDE). This contribution is imposed directly on the Brazilian payor.	
Paraguay	Fees and commissions paid to non-residents are subject to a tax of 30%, which is withheld at source. The withholding rate is applied on 50% of the payment.	Effective rate of 15%.
Uruguay	Service fees derived by a non-resident company (or individual) performed within the country. Technical services fees performed for resident taxpayers even if the service is performed abroad. ⁵¹² Technical services encompass management, technical, administrative or advisory services.	12% of gross amount
Venezuela ⁵¹³	Non-resident individual earning non-commercial professional fees.	34% on 90% gross
	Technical assistance fees.	34% on 50% gross
	Technological services fees. (Withholding tax also applicable to residents)	30% on 50% gross
Bolivia	Domestic-source income derived by non-residents without a permanent establishment in Bolivia is generally subject to a final withholding tax levied on the gross amount. Bolivian-source service fees paid to non-resident beneficiaries are subject to a final withholding tax at the rate of 25%, which is imposed on 50% of the Bolivian-source income.	Effective rate 12.5% of gross
Chile	Chilean-source income derived by non-residents without a permanent establishment in Chile is generally subject to a final withholding tax. Remuneration paid to non-residents for engineering and technical works or professional or technical works supplied through an advice, report or survey (plano), carried out in Chile or abroad.	15% ⁵¹⁴
	Income from services supplied abroad (non-resident income tax) subject to exemptions. ⁵¹⁵	35%
Colombia	Colombian-source service fees and commissions paid to non-residents.	33% of gross
	Payments to non-residents in connection with consulting services, technical services or technical assistance supplied in Colombia or from abroad.	10% of gross

⁵¹² Effective 1 January 2012 (Decree 493/011), the total amount of the income derived by non-residents from independent technical services performed abroad is subject to tax as Uruguayan-source income if the services are performed for taxpayers who earn income subject to Uruguayan tax and this income is directly related to these services.

⁵¹³ Venezuela joined in 2006, but its formal accession is still awaiting approval by the Paraguayan congress. See Forcada, *supra* note 496.

⁵¹⁴ The rate is 20% if the creditor or beneficiary of the payment (i) is incorporated, domiciled or resident in a country included in the tax haven list (ii) holds or participates directly or indirectly in 10% or over of the capital or of the profits of the payer or debtor; or (iii) if creditor and beneficiary are under a common control of a partner or shareholder that holds or participates directly or indirectly in 10% or more of their capital or profits.

⁵¹⁵ Payments made abroad are exempt in the case of freight services, loading and unloading charges, storage, weigh-in, product sampling and analysis, insurance and reinsurance operations, commissions, international telecommunications and for smelting, refining, and other special treatments of Chilean products. The exemption also applies to amounts paid in the case of exportable goods and services, advertising and promotion, market analysis, scientific and technological research, legal advice, and legal defence before the administrative, arbitration or judicial authorities of the country in which the services are supplied.

Ecuador	Service fees, including those for technical services rendered in Ecuador or abroad, paid to non-resident enterprises.	23% on gross
	Professional income derived by non-resident individuals.	25% on gross
Peru	Service fees paid to non-resident enterprises including fees paid to non-domiciled companies for digital services, performed within Peru or abroad if services used in Peru.	30% on gross
	Technical service fees paid to non-domiciled companies for technical assistance services, performed within Peru or abroad if certain conditions are met. ⁵¹⁶	15% on gross
	Professional income derived by a non-domiciled individual is subject to a final withholding tax at the rate of	30% on 80% of gross

The domestic law of each country also frequently contains detailed provisions and varying rates of withholding tax based on the services provided. The following table⁵¹⁷ provides an example of the additional detail required when determining withholding taxes for technical service fees paid to a non-resident under the regime in Argentina. As can be seen the provisions outlined in Table 2 below are complex and will certainly provide a challenge to both the non-resident service provider and the Argentinean taxpayer who hires that provider.

Table 2 – Withholding Tax Rates for Technical Assistance Fees in Argentina

Technical assistance fees may be subject to withholding tax rates of 21%, 28%, 31.5% or 35%. If the technical assistance qualifies as “technology” under the Transfer of Technology Law, and thus the underlying contract is subject to registration, the applicable rate will be:

- 21% if the contract is registered and the technical assistance is not available in Argentina;
- 28% if the contract is registered and the technical assistance is available in Argentina; and
- 35% if the contract is not registered but it should have been.

If the technical assistance does not qualify as “technology”, the fees are subject to the residual 31.5% rate.

⁵¹⁶ Conditions: (1) the services are used in Peru, (2) a sworn statement from the non-domiciled company is submitted to the tax administration stating that the company will provide the technical services and keep a record of the receipts from those services, and (3) a report from an internationally recognized auditing company, certifying that relevant services were actually provided, is also submitted. IBFD Research Platform Country Analysis.

⁵¹⁷ Source: International Bureau of Fiscal Documentation Research Platform Online <<http://www.ibfd.org/>>.

Accordingly, in order to determine the relevant withholding tax rate, the rules under the Transfer of Technology Agreements must be complied with. The competent authority (Instituto Nacional de la Propiedad Industrial, INPI) has also issued regulations on the matter.

Resolution P-328/05 issued by the INPI, published in the Official Gazette of 19 October 2005 (“Resolution”), limits the concept of technology, describing the services excluded from a technology characterization, thus preventing companies from applying the preferred tax treatment where the services supplied from abroad are not in fact technology, in the opinion of the INPI, but simple services giving rise to income not subject to the reduced tax rates.

According to Resolution P-328/05, services will only be characterized as technical assistance, engineering and consulting services (“technology” services and thus subject to regulation) if the service agreements demonstrate (i) a technical knowledge applicable to the productive activity of the local company and (ii) the transfer of such knowledge to the local company or its personnel by means of training and advisory services, details of mechanisms and technical procedures, supply of plans, reports and studies. The satisfaction of these conditions must be demonstrated in the agreement in a concrete and accurate way.

In the same sense, the Resolution specifically states that the following are not deemed “technology”:

- technical assistance or consulting services, licensing of either know-how, information, knowledge or application methods in financial, commercial, legal and/or marketing and sales areas, as well as any other consideration that does not evidence in a clear and concrete manner the effective incorporation of technical knowledge directly applicable to the productive activity of the local company;
- software licences and their updating;
- repair, supervisory, maintenance and start-up services of plant or machinery which do not include the transfer of knowledge (i.e. teaching) to personnel of the local company; and
- in general, all activities which represent the direct hire for tasks that are inherent to the regular operation of the local firm

Only the proportion of the fees paid under a particular contract which is attributable to “technology” services subject to regulation qualify for the rates applicable to “technology”.

As mentioned above, if the services do not qualify as “technology” – in terms of the Transfer of Technology Law and its regulations – the applicable withholding tax rate is 31.5% on the gross amount paid (i.e. residual rate for payment of income from services to non-residents).

Other taxes in addition to withholding tax may also be imposed on a non-resident service provider. In Brazil for example, a non-resident service provider is subject to a municipal service tax on services provided to a Brazilian resident of between 2 and 5 %. This tax must be withheld by the Brazilian entity or individual. The Brazilian entity or individual that hires a non-resident service provider may also be subject to additional levies. Under Brazilian law, a contribution of 10% is required for amounts paid for technical services, technical assistance and administrative assistance services provided by a non-resident to a Brazilian resident. The 10% contribution is described as a contribution for intervention in the economic domain to fund technology research. (CIDE). In addition, social contributions in the amount of 9.25% are required on services contracted by Brazilian residents from a non-resident service provider.⁵¹⁸ These contributions are not required if the payment is made to a resident service provider.

Table 3 below illustrates the combined taxes on amounts paid to a non-resident when the withholding taxes and additional taxes on the service contractor by the Brazilian payor are combined.⁵¹⁹

Table 3 – Importation of services without gross-up clause⁵²⁰

	Tax rate (%)	Amount (%)
Imported service value		100
Amount to be invoiced to Brazilian Contractor		100
Brazilian taxes		40.17
Municipal tax on services (ISS)	5	5.000
WHT	15	15.000
CIDE	10	10.000
PIS import	1.65	1.814
COFINS import	7.6	<u>8.354</u>
Tax burden on amount invoiced		40.17

⁵¹⁸ See Sergio Andre Rocha, *supra* note 13 at 156. The contribution rate of 9.25 per cent is a combination of (1.65 per cent PIS and 7.6 per cent COFINS). These are referred to as import contributions in Law no. 10,685. The authors note that these contributions are designed to avoid the application of Brazilian tax conventions as this type of economic double taxation would not be prevented by tax treaties.

⁵¹⁹ *Ibid* at 157.

⁵²⁰ The reference to the gross-up clause is to indicate that the Brazilian payor has not undertaken the financial burden of the tax liability. If the Brazilian payor undertakes the tax liability the taxable basis would be grossed up to include the withholding tax.

(iii) Withholding Tax Practices in Other Countries

Taiwan (Chinese Taipei)

Source taxation on cross-border services provided by a non-resident service provider has been the” the most controversial tax issue in Chinese Taipei for many years.”⁵²¹

Prior to 2009 deductions were generally allowed for payments made to a non-resident if payment for the services was subject to withholding on a gross basis in Taiwan. Some clarification of when withholding was required was introduced in 2009 with the introduction of Source Income Recognition Guidelines. These guidelines are very broad in scope. Predictably, the income of a non-resident service provider is sourced in Taiwan for income tax purposes if the activities are performed in Taiwan, but as well the source is considered to be Taiwan if the services are performed both on and offshore or if the services are performed offshore” but can only be completed through the participation of an onshore individual or enterprise residents who offer resources of equipment, manpower, knowhow and technology to the foreign service provider.”⁵²²

Earnings from “undertaking business” are not sourced in Taiwan if all the business activities are performed and completed offshore by the foreign enterprise. This can include services. However there is no definition of services for corporate income tax purposes and the withholding tax obligations with respect to services is generally applied.

There is also considerable debate about what threshold for ‘undertaking business’ or the provision of services must be crossed before the non-resident becomes subject to source taxation in Taiwan. Since there is no clear threshold for the taxation of cross border services there is also debate about the taxable base for withholding.

According to a Taiwan national reporter, any doubt is generally resolved in favour of gross withholding at a rate of 20% under domestic law:⁵²³

⁵²¹ See Yishian Li, “Branch Report, Chinese Taipei” in *IFA Cahiers 2012-Volume 97A, Enterprise Services (IFA 2012)*, (IBFD Online Books, 2012) 209 at 209.

⁵²² *Ibid* at 211.

⁵²³ Royalties paid to a non-resident service provider are subject to a withholding tax of 20% on the gross amount as are certain professional fees.

“For income tax compliance purposes, the resident payer usually imposes withholding tax on both royalties and payments for services without trying to determine whether source taxation applies on a gross basis or a net basis because non-compliance penalties on withholding tax are quite high. It is the obligation of a non-resident SP to distinguish royalties from services fees in a mixed contract that provides both for the transfer or licensing of property and the provision of services, such as knowhow contracts that include a services element. If there is no convincing evidence to separate services fees from the whole consideration, the whole amount is subject to withholding tax on a gross basis. If there is a persuasive method to make the tax authorities accept the amount for services fees, it is possible that the tax authorities may grant the tax exemption on the services fees and refund the excess taxes from withholding to a non-resident SP. However, it is usually very time consuming to present a lot of information to obtain a tax exemption permission from the tax authorities on the portion of services fees.”

The disadvantage to the non-resident is considerable in these circumstances. In contrast, payments made to a domestic service provider are subject to 10% withholding tax rate⁵²⁴ and the amount withheld can be offset against the recipient’s income tax liability.

Amounts paid to a foreign enterprise engaged in providing contract construction services or technical services in Taiwan are also subject to a 20% gross withholding tax. However the enterprise may, in theory, apply for approval from the Ministry of Finance for a reduced tax rate. Withholding tax is then collected based on the assumption that 15% of the enterprises total revenue is its taxable income.⁵²⁵ This deemed taxable income rule will apply only where it can be clearly demonstrated that new technical services were provided and not merely that existing technology is being made available for use. Such qualifying technical service fees are then subject to income tax at a flat rate of 20%, resulting in an effective tax rate of 3%. In many cases, however, technical service fees are treated as royalties and subject to a 20% gross withholding tax.

⁵²⁴ Country analysis, Taiwan, IBFD Research Platform, updated as of August 1, 2014.
⁵²⁵ According to article 25 of the ITA. *Ibid.*

There are mechanisms to reduce the tax liability to a net basis however a private ruling is always necessary.⁵²⁶ However, applying for a ruling is a very lengthy procedure and may necessitate a certain degree of tax audit on the payer, who may be reluctant to undergo such scrutiny.

Matters improve marginally if there is a tax treaty in place between the State of residence of the non-resident service provider and Taiwan. According to the national reporter a number of Taiwan's tax treaties include a services permanent establishment provision based on that found in Article 5(3)(b) of the UN Model treaty, which generally provides a threshold of 6 months or 183 days within a 12 month period before there is source based taxation. The result is the result is that there is no source based taxation of income from services performed outside Taipei but non-resident service providers "have to prove it for themselves when treaties apply. That is a private ruling for the application of articles 5 and 7 in the treaty to confirm no PE, no source taxation is necessary for the local payers or business agents of service fees to waive their withholding obligation."⁵²⁷

The arrival and departure records of persons entering and leaving Taipei are readily accessible by tax authorities who are easily able to determine if the minimum presence requirements for a services permanent establishment have been met. If so the business profits attributable to the permanent establishment are subject to Taiwan tax. Whether or not a permanent exists it would appear that payments made in respect of services performed by a non-resident service provider will be subject to gross withholding tax.

In practice, while the services fees are paid to a non-resident SP (service provider), the whole amount generally still subject to withholding tax and non-resident SPs may file corporate income tax returns on a net basis to claim a tax refund...

It is also possible for a non-resident SP to apply for an advanced income tax ruling under the provision of article 7 to obtain a pre-approved net basis business profits with a deemed profit ratio. The payer of service fees can follow the ruling to make the withholding on a net basis instead of a gross basis.... However, this is not a widely acceptable procedure for local tax authorities.⁵²⁸

⁵²⁶ *Supra* note 521 at 221.

⁵²⁷ *Supra* note 521 at 222.

⁵²⁸ *Supra* note 521 at 223.

As of August 2014, royalties, technical assistance and management fees approved by the Ministry of Economic Affairs for payment to non-residents are deductible by the payer.⁵²⁹

C. Conclusions

The tax treatment of a payment made to a service provider often differs depending on whether the payment is made to a resident or a non-resident. The difference in tax treatment may include withholding tax obligations imposed under a country's domestic law with respect to payments to a non-resident service provider. These provisions are frequently complex and often impose onerous obligations on both the non-resident service provider and on the person paying for the non-residents services. Further, revenue authorities may impose withholding tax in a manner that is both burdensome and potentially discriminatory for the non-resident service provider, including in circumstances where there is a clear tax treaty exemption.

The non-resident payor may also be subject to additional taxes and levies if a non-resident is hired. The additional social taxes that must be paid by a Brazilian taxpayer when a non-resident service provider is hired provides an excellent example of this. The use of withholding taxes or other taxes of this type when a non-resident is hired will clearly impact the ability of a non-resident service provider to compete with a resident service provider. The question is the use of withholding taxes potentially discriminatory or is it merely a form of revenue collection? This is an important question given that there is no non-discrimination obligation in either tax or trade agreements against which to measure withholding tax measures.

⁵²⁹ *Supra* note 524.

Chapter 9: Are the Current Non-Discrimination Obligations in Trade and Tax Agreements Sufficient: the FATCA example?

A. Overview

In addition to providing a government with revenue, tax measures can be used to influence the behavior of taxpayers and this objective may be the rationale for a particular tax measure. This is the case with the *Foreign Account Tax Compliance Act*⁵³⁰ (FATCA) regime recently implemented by the United States (US). Under the FATCA, the threat of a gross withholding tax is used to coerce non-resident entities liable to US source tax to enter into reporting arrangements with the US government. This chapter discusses the FATCA and whether tax measures of this kind are in violation of any tax or trade agreement. It does not comment on the merits of or potential benefits of the FATCA regime in policing tax avoidance transactions. The discussion is important because measures such as those imposed under the FATCA could also be used to protect a country's service sector from competition abroad. The provisions in the FATCA are used as an illustration of the type of measure that a country may impose on non-resident service providers because there is no applicable non-discrimination obligation that would prevent it.

The FATCA was born on March 18, 2010 when the US government enacted legislation targeting US citizens who hold but do not report income from foreign investments. As part of its enforcement machinery the legislation imposes new obligations on a foreign financial institution (FFI) in which US citizens may invest, including the obligation to enter into an agreement with the Secretary of the US Treasury to report any account held by a US citizen in the FFI or face financial penalties in the form of gross withholding tax on their US investments. The extra-territorial reach of the US proposals as well as the threat of economic blackmail for non-compliance begs the question of whether the US treatment of an FFI under the FATCA is in violation of any US trade or tax obligation. This is an important question. As one author notes “the withholding tax penalty created for failing to meet the reporting requirements is a drastically different use of withholding from existing systems. While existing systems use withholding as a preemptive means of tax enforcement, FATCA

⁵³⁰ *Foreign Account Tax Compliance Act*, 26 USC (2010) Pub L No 111-147.

employs it as a coercive tool to force foreign banks into compliance with reporting obligations.”⁵³¹

This chapter examines the impact of the FATCA provisions on non-resident service providers against the non-discrimination obligations in bilateral tax treaties based on the OECD and UN Model Tax Treaties, and two of trade agreements previously discussed, the WTO Agreement and the NAFTA. The chapter builds on a number of premises discussed in earlier chapters. First, non-resident service providers are often subject to different tax treatment than resident service providers, and this difference in tax treatment may impact the non-residents’ ability to effectively compete against resident service providers in the home market of the resident service provider. Second, the non-discrimination obligations in trade agreements are not broad enough to prevent these differences in tax treatment between resident and non-resident service providers including differences in tax treatment that will affect their competitive position. Third, the non-discrimination obligations in tax treaties based on the OECD Model Tax Treaty are not broad enough to prevent the use of tax measures that may be considered discriminatory to non-resident service providers.

This chapter provides an example of a how tax measures may be used in a manner that is arguably discriminatory as it affects the ability of non-resident service providers to compete with resident service providers in the US market place. It also demonstrates that, notwithstanding that the threat by the US to impose gross withholding tax on the US sourced income of foreign financial institutions is employed solely as a means to coerce co-operation by those institutions with the new US reporting obligations, there appears to be no tax or trade non-discrimination obligation that would discipline this use of a tax measure. In summary, this chapter examines the FATCA measures and poses the obvious question: Are the measures imposed by the FATCA acceptable in the treatment of non-resident service providers or should broader non-discrimination obligations be considered in tax or trade agreements to prevent or restrict the use of such measures?

⁵³¹ Melissa A Dizdarevic, “The FATCA Provisions of the HIRE Act: Boldly Going Where No Withholding Has Gone Before” (2011) 79 Fordham L Rev 2967.

B. Foreign Account Tax Compliance Act

FATCA is the name commonly used to refer the US reporting and compliance provisions for “foreign investments entities.” These provisions are part of the *Hiring Incentives to Restore Employment Act*⁵³² (*HIRE Act*) that was enacted by the US in 2010. Section 511 of the *HIRE Act* adds section 6038D to the US Internal Revenue Code (the Code). Under subsection 6038D(a), any US citizen who, during any taxable year, holds an interest worth more than 50,000 USD in a financial account maintained by a foreign (i.e., non-US) financial institution must report that interest in his or her US income tax return.⁵³³ The US Department of Treasury background material to FATCA makes it clear that its purpose is to curtail tax evasion by US citizens who do not report income from non-US investments.⁵³⁴

To enforce section 6038D, several other provisions were added to the Code.⁵³⁵ Under these provisions, it was anticipated that a FFI would enter into an agreement with the Secretary of the Treasury (essentially with the Internal Revenue Service (IRS)) to, among other things, report any account held by a US citizen in that FFI. This reporting obligation would extend to a wide range of financial institutions including banks and investment and brokerage houses.⁵³⁶

If the FFI enters into an agreement with the IRS it is considered a participating FFI. As a participating FFI its reporting and withholding obligations to the IRS include the obligation to report to the IRS taxpayer identification numbers, account balances, receipts and withdrawals from accounts held by persons who are US taxpayers. Participating FFIs are also required to withhold from US source income and principal payments made to a range of

⁵³² *Hiring Incentives to Restore Employment Act*, Pub L 111-147, 71 Stat (2010) [hereafter the *HIRE Act*]. Subtitle A of Part V of the *HIRE Act* is entitled Foreign Account Tax Compliance and contains the *FATCA provisions*.

⁵³³ IRS Form 8938, Statement of Specified Foreign Financial Assets.

⁵³⁴ See e.g. the US Department of Treasury’s Fall 2011 Statement of Regulatory Priorities online: Department of Treasury <http://www.reginfo.gov/public/jsp/eAgenda/StaticContent/201110/Statement_1500.html>.

⁵³⁵ Section 501 of the *HIRE Act* adds sections 1471-1474 to the Code.

⁵³⁶ The *Internal Revenue Code*, 26 USC section 1471(d)(5) defines a financial institution as any entity that: (i) accepts deposits in the ordinary course of a banking or similar business; (ii) as a substantial portion of its business, holds financial assets for the account of others; or (iii) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities, except to the extent provided by the Secretary.

account holders. This includes the obligation to withhold 30% of any “passthru payment”⁵³⁷ if the account holder is a “recalcitrant account holder,”⁵³⁸ or a non-participating FFI.

If the FFI fails to enter into agreement with the IRS, then any person paying a “withholdable payment”⁵³⁹ to the non-participating FFI must withhold 30%.⁵⁴⁰ A withholdable payment is defined to mean: (i) any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income (FDAP income), if such payment is from sources within the US, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the US.⁵⁴¹ For example, interest income earned on a US Treasury bond is a withholdable payment, and the gross proceeds from the sale or other disposition of a US Treasury bond is a withholdable payment. As noted above, this obligation to withhold on payments to non-participating FFIs also extends to participating FFIs who must withhold whether the payment to the non-participating FFI is made to it on its own account or on behalf of its customers. Thus there is a strong incentive for every FFI to comply with the FATCA, so that the FFIs customers, whether US resident or not will be exempt from FATCA imposed withholding obligations.

A FFI may alternatively elect to be treated as a US financial institution (USFI) and to follow those procedures. However an electing FFI will still be treated differently than its US counterpart.⁵⁴²

Non-resident FFIs were quick to note that the financial cost of the FATCA measures are imposed primarily on them and would clearly give a competitive advantage to their US rivals.

⁵³⁷ “Passthru payment” is defined as dividends, interest, rent, or gains from the sale of any property giving rise to those kinds of income.

⁵³⁸ “Recalcitrant account holder” is defined as an account holder who will not give the FFI the required personal information or who will not waive the right to invoke the laws of the country of the FFI to prevent such disclosure of information. If the account holder waives local privacy laws the FFI would be able to determine whether the account holder is a US taxpayer.

⁵³⁹ Defined to be the same as a Passthru payment. See note 537.

⁵⁴⁰ The 30% may be reduced at the end of the year to the withholding rate under an income tax treaty. So while the net tax rate under FATCA is the same as under a tax treaty, there is a cash-flow differential.

⁵⁴¹ The Code Section 1473(1).

⁵⁴² The Code section 1471(c)(2) permits a FFI to elect to be treated as a USFI in respect of certain kinds of income paid to the FFI (rents, dividends, interest). A FFI that elects under section 1471(c)(2) will still not be in the same position as a USFI. For example, a USFI need not enter into an agreement with the IRS but an electing FFI must. A USFI need not close down an account for a recalcitrant account holder but an electing FFI must. A USFI is not required to withhold 30% of a payment to a recalcitrant account holder or be subject to 30% withholding itself.

1. International Response to the FATCA

The international community immediately acknowledged the potential threat of gross withholding tax on payments to FFIs for failure to comply with the requirements of the FATCA. The move towards intergovernmental cooperation was swift. The first steps were in February of 2012 when a joint statement with five European governments, France, Germany, Italy, Spain, and the UK indicated that FFIs in those countries would enter intergovernmental agreements in which they would report to their own governments, followed by the automatic transfer of that information to the US.⁵⁴³ In June 21, 2012 two more countries entered intergovernmental cooperation agreements to implement the FATCA. Joint statements with Japan and Switzerland indicate that these agreements provide for reporting by FFIs directly to the US, supplemented by the exchange of information on US accounts that are identified as held by recalcitrant holders, upon request.⁵⁴⁴ The move by these foreign governments to enter into agreements strongly suggests that there were also of the view that the provisions were not in violation of US obligations under the WTO Agreement, in particular the national treatment obligation, and that they were not contrary to non-discrimination obligations under any tax treaty. This is no doubt a reasonable conclusion by these foreign governments as the discussion below indicates.

2. Non-Discrimination Obligations under the WTO Agreement

As outlined in Chapter 2, the commitment to provide national treatment to non-resident providers is negotiated under the GATS.⁵⁴⁵ Once committed, the Member concerned may not impose discriminatory measures benefiting resident services or service suppliers. The extension of national treatment in any particular sector may be made subject to conditions

⁵⁴³ On July 26, 2012, the US Treasury Department issued the first model for an Intergovernmental Agreement (IGA) for complying with the FATCA provisions.

⁵⁴⁴ As of November 2012, the US was engaged with more than 50 countries with a view to concluding intergovernmental agreements on FATCA, online: IRS <<http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA>>.

⁵⁴⁵ The GATS Article XVII provides that “each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers”. The GATS limits the application of this standard to those sectors specified in each Member's Schedule of Concessions, and allows Members to set forth any applicable conditions.

and qualifications. One of the most significant areas in which national treatment⁵⁴⁶ qualifications have been claimed under the GATS is in the area of taxation.⁵⁴⁷

Specific provisions in the GATS also further limit the national treatment obligation with respect to direct (income) tax matters and include limitations on the national treatment obligation as it relates to the tax treatment of services. These limitations are listed under the General Exceptions to Article XIV of the GATS. It provides that any Member may adopt or enforce direct tax measures that are inconsistent with national treatment, provided that they do not constitute “arbitrary or unjustifiable discrimination” in trade or services and “provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Member countries.” The meaning of the expression “equitable or effective” is defined in a footnote that provides illustrations of taxes and tax policies that may be excluded from national treatment requirements.⁵⁴⁸ These include, for example, the right to impose withholding tax.⁵⁴⁹ This allows Member governments to exercise wide powers to safeguard their tax base.

⁵⁴⁶ See e.g. WTO, *The United States of America: Schedule of Specific Commitments*, WTO Doc GATS/SC/90 (1994), online WTO <<http://docsonline.wto.org>> at 9 – 10, setting forth limitations on national treatment for foreign employee benefit trusts and excise taxes on transfers to foreign entities. See also Jeffrey Lang & Robert Stack, “What Tax Lawyers Should Know About Trade Law” (2000) 29:10 *Tax Management International Journal* 566.

⁵⁴⁷ A quick review of the schedules reveals that many countries, including Canada, the US and Mexico, have claimed most favored nation exemption with respect to tax provisions. See e.g. WTO, *Trade in Services - Canada - Final List of Article II (MFN) Exemptions*, WTO Doc GATS/ EU16 (1994), online: WTO <<http://docsonline.wto.org>> at 3, detailing the exemption from taxes on income of nonresidents from international transport on the basis of reciprocity with the resident country. The US has also listed tax measures relating to favorable treatment for Mexican and Canadian residents, the Caribbean Basin Initiative, international transport income (including aircraft and rolling stock) derived by residents of countries with reciprocal measures, earnings from communication satellites and denials of deductions for residents of countries participating in international boycotts or maintaining discriminatory tax regimes. See WTO, *United States of America - Final List of Article II (MFN) Exemptions*, *supra* note 546 at 2 – 11.

⁵⁴⁸ Specifically, the footnote refers to the following activities: Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:

- apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
- apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
- apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
- distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or

One might assert that the use of a withholding tax to enforce compliance with the FATCA reporting obligations does not meet the general exception in Article XIV and is therefore in violation of the national obligation under the GATS. Such an assertion would be based on the argument that the FATCA measure imposing a withholding tax is “arbitrary and unjust” and that it is “not aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Member countries.” However, even if this assertion is correct it will do little good for most countries seeking to claim that the FATCA measures violate the GATS national treatment obligation. The reason is that trade discipline with respect to discriminatory treatment in direct tax matters has been largely carved out of the national treatment obligation under the GATS if a bilateral tax treaty is in effect between the Member countries.

As discussed in Chapter 2, the non-discrimination article in existing bilateral tax treaties has primacy over the GATS national treatment provisions in resolving disputes involving the taxation of services and service suppliers.⁵⁵⁰ Tax disputes relating to non-discrimination obligations must therefore be resolved exclusively under the non-discrimination provision in the applicable tax treaty using the competent authority mechanism provided in the tax treaty. Access to the WTO Agreement dispute resolution procedures is denied if the disputed matter falls within the “scope” of a tax treaty. A footnote to Article XXII (3) of the GATS further provides that if there is a disagreement about whether the matter falls within the scope of a tax treaty and the tax treaty was in existence at the time the WTO Agreement was entered into force, one country cannot unilaterally challenge the issue of the treaty's scope under WTO procedures.⁵⁵¹

In summary if a tax treaty was in place between the US and the country of residence of the service provider at the time the WTO Agreement was signed, one must look to the non-discrimination obligations in that tax treaty unless the US competent authority agrees

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

Tax terms or concepts in Article XIV (d) and in the footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure. See The GATS Article 14.

⁵⁴⁹ The footnote also specifies that tax terms or concepts listed in the footnote describing the 'carve out' to national treatment, be determined according to tax definitions and concepts or their equivalent under the domestic law of the Member taking the measure. See the GATS Article XIV (d).

⁵⁵⁰ The GATS Article XXII (3).

⁵⁵¹ See also the GATS Article XXII (2).

otherwise. The provisions in the non-discrimination article in the applicable tax treaty will thus be the key for most countries in determining whether the US has violated a non-discrimination obligation in respect of cross border service providers.⁵⁵²

C. Non-Discrimination Obligations under the OECD Model Tax Treaty

As discussed in Chapter 2, the principle of non-discrimination as expressed in Article 24 of the OECD Model Tax Treaty is considerably narrower than the GATS national treatment obligation. Article 24 of the OECD Model Tax Treaty prohibits differences in tax treatment in four major areas as follows:

A state shall not:⁵⁵³

- Subject non-nationals to “other or more burdensome taxation” than nationals who are “in the same circumstances.” (Article 24(1));
- Levy tax on a permanent establishment of a foreign enterprise “less favourably” than a domestic enterprise of carrying on the same activities. (Article 24(3));
- Prevent the deduction of interest, rents, royalties or other disbursements paid to a treaty partner if “paid under the same circumstances” and a deduction is available if paid to a resident. (Article 24(4)); or
- Subject “foreign-owned enterprises” to taxation that is “other or more burdensome” than the taxation and connected requirements applicable to “similar” domestic enterprises. (Article 24(5)).

⁵⁵² If there is no tax treaty between the country of residence of the FFI, resolution of the issue of whether the national treatment obligation under the GATS has been violated will depend on the specific commitments made by the US, any exceptions claimed and a finding that the FATCA measures constitute arbitrary and unjustifiable discrimination.

⁵⁵³ The obligation applies to taxes of every kind and description (that is, to all direct and indirect taxes) levied by, or on behalf of, the State, its political subdivisions or local authorities. OECD Model Tax Treaty Article 24(6).

The OECD Commentary is clear that unless the specific listed criteria are met, the non-discrimination clause does not become operative.⁵⁵⁴ Thus if unequal treatment results from circumstances not mentioned in Article 24, the non-discrimination provisions do not apply.

A wide range of discriminatory tax behaviour is therefore entirely permissible, at least in so far as the non-discrimination provisions in OECD and UN Model Tax Treaties are concerned. For example, there is no protection against tax discrimination for non-resident taxpayers, including corporations, cross-border service providers and investors. The applicable test is comparability. In order to determine whether a tax measure in the source state is discriminatory for purposes of Article 24(1) the national of the other state must be “in the same circumstances as the national of the source State, in particular with respect to residence.” This means that differences in withholding taxes on dividend and interest income paid to a non-resident as compared to a resident investor are not considered discriminatory under either the UN or OECD Model Tax Treaties as the circumstances of the resident and the non-resident are not the same. It follows that if the FATCA provisions apply to a non-resident differently than to a resident, that would not be considered a violation of the non-discrimination obligations found in OECD or UN Model based tax treaties.

Clearly it is the view of US legislators that the FATCA does not violate its obligations under the WTO Agreement or under any of its tax treaties.

1. The North American Free Trade Agreement

Is Canada or Mexico’s position different than that of other nations impacted by the demands of the FATCA because they are NAFTA trade partners? The discussion below examines whether the FATCA violates the non-discrimination obligations in the NAFTA.

Canada, Mexico, and the US agreed to basic rules for regulating trade in services both within and across their respective borders in the NAFTA Block. Non-discrimination is one of the basic principles of the NAFTA, and the foundation for the most favored nation and national treatment obligations incorporation into the agreement. The national treatment obligation

⁵⁵⁴ See Discussion *supra* Chapter 2, Non-Discrimination Obligations.

requires that the host country treat non-resident service providers and domestic service providers similarly or comparably. In addition, the NAFTA investment provisions introduce as a minimum standard of treatment, treatment in accordance with international law, including fair and equitable treatment.

Chapter 12 of the NAFTA defines the cross-border provision of a service as providing a service: (1) from the territory of one Party into the territory of another Party, (2) in the territory of one Party by a person of that Party to a person of another Party, or (3) by a national of a Party in the territory of another Party. In the investment provisions of Chapter 11, the NAFTA also anticipates the supply of services through a commercial presence in the other country.⁵⁵⁵

The NAFTA additionally covers measures that affect performance requirements. These provisions provide protection to NAFTA service providers who are investors in the other country. The Agreement contains general prohibitions that prevent NAFTA Parties from imposing certain conditions on the “establishment, acquisition, expansion, management, conduct, operation or sale” of an investment by an investor in its territory.⁵⁵⁶ Seven different types of practices are prohibited by the NAFTA, including the requirement to achieve a given level or percentage of domestic content, to purchase, use, or accord a preference to goods produced or services provided in its territory, or to provide a preference to purchase goods or services from persons in its territory.

In addition to these general prohibitions, the NAFTA prohibits certain performance requirements made in connection with a government’s conferred benefits, including, for example, the requirement to buy locally in order to receive subsidies, financing assistance, and tax concessions.⁵⁵⁷

The protections provided in the NAFTA are, however, limited by the exceptions attached to them including a number of exceptions related to direct taxation.

⁵⁵⁵ Other chapters of the NAFTA address specific types of services, including telecommunications, financial services, and temporary entry for businesspeople. The chapters are complimented by annexes: land transportation, professional services, and specific reservations and exceptions.

⁵⁵⁶ NAFTA Article 1102(1)-(2), Article 1103(1)-(2), and Article 1106.

⁵⁵⁷ NAFTA Article 1106(3). These performance prohibitions are incorporated into the NAFTA tax provisions and provide that, subject to an applicable tax treaty, the prohibitions shall also apply to tax measures.

Like the GATS, the NAFTA specifically limits or excludes most favored nation and national treatment obligations with respect to direct (income) taxation. Like the GATS, the NAFTA also largely delegates matters of direct taxation to bilateral income tax treaties between individual countries. In addition, as discussed below, a number of other specific exceptions and exclusions with respect to tax measures are included in the NAFTA that will further limit US non-discrimination obligations in direct tax matters.

Article 2103 of the NAFTA contains the principal provisions that relate to direct taxation. It states that no obligation exists with respect to any taxation measure except as specifically provided for in the NAFTA. The NAFTA also provides that income tax conventions are generally to have priority in all cases, including those inconsistent with the NAFTA.⁵⁵⁸ More importantly, the NAFTA provides that nothing in the NAFTA shall “affect the rights or obligations of any Party under any tax convention.”⁵⁵⁹

The few specific protections provided by the NAFTA against differences in tax treatment are also limited by further exceptions. For example, subject to a tax convention, the NAFTA provides national treatment in respect of direct taxes relating to the purchase or consumption of cross-border and financial services.⁵⁶⁰ This NAFTA obligation does not apply to any taxation measures in existence at the time that the NAFTA went into effect (January 1, 1994) or to the renewal or any amendment of a tax measure that does not decrease its conformity. Further, the NAFTA obligations have no application to any new tax measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the parties or arbitrarily nullify or impair benefits accorded under those articles.⁵⁶¹

⁵⁵⁸ There are two exceptions to the primacy of tax treaties in tax matters specifically listed in the NAFTA addressing tax on goods and export taxes on energy in defined circumstances. Article 2103(6) of the NAFTA also provides that Article 1110 (Expropriation) shall apply to taxation measures subject to certain procedural rules. NAFTA Article 2103(6).

⁵⁵⁹ NAFTA at Article 2103(2).

⁵⁶⁰ NAFTA at Article 2103(4)(a).

⁵⁶¹ In the context of performance requirements, a Party is not prohibited from conditioning an advantage in connection with an investment in its territory to a requirement to “locate production, provide a service, train or employ workers, construct or expand particular facilities or carry out research and development in its territory.” Thus, a Party may condition receiving a tax advantage to performing particular local services, an exception that is heavily relied on in both Canada and the US. See the *Income Tax Act*, RSC, 1985, c 1 as amended, section 127 providing that an example of the tax advantage is the Scientific Investment Tax Credits.

2. How does the NAFTA apply to the FATCA Measures?

This question of how the NAFTA applies to the FATCA measures is perhaps best answered by posing some additional questions. The first is how does the NAFTA address income tax matters? The answer is that that NAFTA does not apply to taxation measures *except* as provided in Article 2103. This invites some additional questions:

- Are the FATCA measures tax measures for purposes of the NAFTA?
- Is this a tax measure that falls within Article 2103 and therefore subject to the national treatment obligation? Specifically, is it measure that relates to the purchase or consumption of particular services under 2103(4)?
- If the measure falls within Article 2103(4), does the Canada-US Tax Treaty ‘trump’ the national treatment obligation in the NAFTA?
- If the tax treaty does not trump the NAFTA, do the NAFTA exceptions in Articles 2103(4) (d) or (g) apply to negate the national treatment obligation in Article 1405?

Article 2103(4)(d) provides that the national treatment obligation does not extend to a non-conforming provision of an existing tax measure and Article 2103(4)(g) exempts any new taxation measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the Parties or arbitrarily nullify or impair benefits accorded under those Articles.

(i) Are the FATCA ‘Measures’, Taxation Measures for Purposes of the NAFTA?

NAFTA Article 2103(1) states that except as set out in this Article, nothing in this Agreement shall apply to taxation measures. What is considered to be a taxation measure is defined in the NAFTA by exclusion. Article 2107 provides that “taxation measures” do not include: (a) a “customs duty” as defined in Article 318 (Market Access Definitions); or (b) the measures listed in exceptions (b), (c), (d) and (e) of that definition. The word “measures” itself is defined in Article 201(1) to include any “law, regulation, procedure, requirement or

practice.”⁵⁶² If the phrase “taxation measures” in Article 2103(1) means “a measure that relates to taxation,” then FATCA is a “taxation measure” and must pass the gauntlet of Article 2103(1).

(ii) Article 2103(4)

Does the NAFTA apply to taxation measures imposed on FFIs? Article 2103(4) provides that subject to a tax convention (tax treaty), the national treatment obligation applies in respect of taxation measures on income “... that relate to the purchase or consumption of particular cross-border and financial services.”⁵⁶³

An important threshold issue is who is being protected under the national treatment obligation under Article 2103(4)?

The conventional view of the national treatment obligation in Article 2103(4) as it applies to the financial services chapter and to Article 1405 in particular, is as follows:

- NAFTA Parties must allow their residents to purchase financial services from another NAFTA Party.

- The national treatment obligation in Article 2103(4) applies “with respect to taxation measures on income...that relate to the purchase or consumption of those services.

⁵⁶² If a “*measure*” includes any law, regulation, procedure, requirement or practice, i.e. it is not limited to the enumerated categories it seems logical to assume that a “taxation measure” is also a fairly broad category, which encompasses any tax law, regulation, procedure, requirement or practice. This interpretation is supported by the following quote: “the definition of the term “measure” must therefore be taken to be viewed as a ‘non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions.” See *ADF Group Inc. v. United States of America* (Notice of Arbitration, 2000), para. 40, [online <http://www.state.gov/documents/organization/3351.pdf>](http://www.state.gov/documents/organization/3351.pdf).

⁵⁶³ See NAFTA Article 2103(4)(a) (providing that, subject to any applicable tax treaty, national treatment “shall apply to all taxation measures on income, capital gains, or the taxable capital of corporations, and to ...[the asset tax under the Asset Tax Law of Mexico], to the extent that those taxes relate to the purchase or consumption of particular services.”). As a result certain direct tax measures listed therein (taxes on income, capital gains or the taxable capital of corporations and the Mexican asset tax) are but for listed limitations, subject to the national treatment obligation with respect to the cross-border provision of services, including financial services. However, with regard to financial services subparagraph 4(a) applies only to the cross-border provision of a financial service under paragraph 1405(3). Because the Canada-US and US Mexico treaties address the deductibility of disbursements in the non-discrimination Article in their respective tax treaties, this provision may have little real meaning in the context of the NAFTA.

For example one Party cannot allow a deduction for services purchased locally but deny the deduction if the services are purchased from another NAFTA Party.”

- The measure complained cannot be inconsistent with a tax convention (tax treaty). For example, many tax conventions, including the Canada-US Tax Treaty address the issue of deductibility of amounts paid to non-residents in a tax convention. Specifically, Article 25(7) of the Canada-US Tax Treaty, requires that “interest, royalties and other disbursements” paid by a resident to another resident of the other Contracting State “shall be deductible under the same conditions as if they had been paid to a resident.” If the measure is related to the deductibility of amounts paid to non-residents for services, the Canada-US Tax Treaty is consistent with the provisions of the Tax Treaty but the tax treaty would apply.⁵⁶⁴

In summary, the conventional view of the national treatment obligation in respect of tax measures provided to a service provider under the NAFTA is very limited and indirect. Under the national treatment obligation the US must provide treatment that affords ‘equal competitive opportunities’ to the non-resident service provider. Thus, a Party must not use tax measures in a manner that would cause the purchaser or consumer of services to favour a local service provider over the service provider of another NAFTA Party.

Based on this understanding, in order to determine whether the national treatment obligation under NAFTA has been violated by the requirements imposed by the FATCA, the question is: Would a US consumer prefer to buy from a US as compared to a Canadian service provider as the result of the FATCA measures? This is a difficult question to answer, because it is not the US consumer who is negatively impacted by the FATCA measure, it is the FFI.

Even assuming that one can successfully argue that the FATCA measures ‘relate’ to the purchase or consumption of services because they relate to the service provider (FFI), there are two further arguments that negate any claim that the FATCA measures violate the national treatment obligation under the NAFTA. The first is based on the limitation in Article

⁵⁶⁴ A more difficult question is what is the result if there is no non-discrimination principle under the applicable tax treaty that would otherwise apply to the deduction of expenses? Is it ‘inconsistent’ with the tax treaty to argue there is a right or an obligation under NAFTA? Does such a position contravene the clear statement in Article 2103(2) that nothing in the NAFTA shall affect the rights or obligations of the Parties under a tax convention?

2103(2) with respect to the primacy of tax treaties and the second to the general exceptions in Article 2103(4).

(iii) If the Measure Falls within Article 2103(4), does the Canada-US Tax Treaty ‘Trump’ the National Treatment Obligation?

The NAFTA provides that tax conventions are generally to have priority in all cases, including those ‘inconsistent’⁵⁶⁵ with the NAFTA. The NAFTA also provides that nothing in the NAFTA shall “affect the rights or obligations of any Party under any tax convention.”⁵⁶⁶ As stated, the national treatment obligation in the NAFTA with respect to direct taxes applies only to measures that relate to the purchase or consumption of services. This obligation is itself subject to the proviso that nothing in the NAFTA “shall affect the rights and obligations of any Party under a tax convention.” Assuming for the moment that a successful argument can be made that the FATCA measures relate to the purchase or consumption of services, is a claim that the US has violated its national treatment obligation under the NAFTA with respect to FFIs, ‘inconsistent’ with US obligations under the Canada-US Tax Treaty or the US-Mexico Tax Treaty? Would such a claim affect the rights and obligations of any Party under a tax convention, contrary to the NAFTA?

On a clear reading, the non-discrimination obligations under Article 25(1) of both the Canada and Mexico tax treaties with the US are arguably “inconsistent’ with the imposition of a national treatment obligation on the US with respect to the tax treatment of FFIs under the NAFTA.

Article 25(1) of both tax treaties establish a prohibition, similar to the national treatment obligation found in trade agreements like the NAFTA, against discrimination against nationals of Mexico or Canada who ‘reside’⁵⁶⁷ in the US.⁵⁶⁸ Specifically, nationals of one

⁵⁶⁵ Inconsistent is not defined in the NAFTA.

⁵⁶⁶ In a dispute as to whether a tax is discriminatory, the NAFTA is not clear as to who defines, delineates, and determines the role of a tax treaty. However, in a report from the US Committee on Finance, the Committee states that it “intends that the competent authorities shall consult and determine whether the tax convention prevails in accordance with paragraph 2”... over the NAFTA. See 139 Cong. Rec. S16092-01 (1993) (Committee Statements on the NAFTA). No authority is cited for this conclusion.

⁵⁶⁷ The word residence is used in most tax treaties. In the Canada-US Tax Treaty the expression is “taxable on worldwide income” to accommodate special provisions in the US taxation system.

Contracting State cannot be subjected to tax in the other Contracting State that is “more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances⁵⁶⁹ are or may be subjected.” It is important to note that a non-resident alien is not in the same circumstances as a resident national and that Article 25(1) of both tax treaties does not prohibit discrimination against non-residents.⁵⁷⁰ Thus, the potential benefit of this provision in matters of tax discrimination is extremely limited. If a provision discriminates based on the non-resident status of the taxpayer, the discrimination is permitted under both the Canada-US and the US-Mexico Tax Treaties.⁵⁷¹ Is it inconsistent to impose a national treatment obligation under NAFTA in these circumstances? This is another question difficult to answer.

One argument is that the non-discrimination article in the tax treaty with the US does not apply to Canadian (or Mexican) FFIs because they are non-residents and therefore there is no bar to a claim that the FATCA violates the national treatment obligation with respect to a Canadian (or Mexican) FFI who is not a resident of the US under the NAFTA.⁵⁷² An alternate argument is found both in the wording of Article 25(1) of the tax treaties, which address the treatment of non-resident nationals and in the wording of Article 2103(2) of the NAFTA. The latter provides that nothing in the NAFTA “shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency... the convention shall prevail.” Since the FFI’s rights as a non-resident national and the US obligations to non-residents appear to be well established under the tax treaty, does this provision end any legal complaint about tax discrimination under the NAFTA? It would seem so. If one were to infer a right

⁵⁶⁸ Note that the provision does not prohibit discrimination against non-residents, only discrimination based on nationals of one Contracting State who are in the same circumstances, particularly with respect to taxation on worldwide income (resident) in the other Contracting State.

⁵⁶⁹ The Commentary to the 1992 OECD Model Tax Treaty states that the expression “in the same circumstances” refers to taxpayers, including individuals, legal persons, partnerships and associations, placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and in fact. The addition of the expression “in particular with respect to residence” has now made it clear that the residence of the taxpayer is one of the factors that is relevant in determining whether taxpayers are placed in similar circumstances.

⁵⁷⁰ Canada-US Tax Treaty, Article. 25(1). It is also important to note that in general neither the Canadian or US tax systems discriminate on the basis of nationality or citizenship, but rather on the basis of residence or location of activities.

⁵⁷¹ The exception to this rule is the indirect protection from tax discrimination found in OECD Model Tax Treaty Article 25(7).

⁵⁷² This argument would be based on the statutory rule of interpretation referred to as *expressio unius*. According to this rule of statutory interpretation a general word or phrase takes its meaning from the specific words and phrases that follows it as well as those that precede it. Expressions of one thing means exclusion of other.

under a trade agreement in these circumstances, it would clearly affect the rights and obligations of the parties under a tax treaty contrary to Article 2103(2) of the NAFTA.⁵⁷³

(iv) If the FATCA Measure Falls within Article 2103(4) and the Tax Treaty does not Trump the NAFTA, do the NAFTA Exceptions in Article 2103(4) (d) or (g) apply to Negate the National Treatment Obligation in Article 1405?

As discussed, the national treatment obligation in Article 2103(4) is subject to a number of exceptions. The key exceptions potentially applicable to the FATCA measures are the exceptions for any existing non-conforming measure and for “any new tax measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the parties or arbitrarily nullify or impair benefits accorded under those articles.”⁵⁷⁴ Withholding taxes are an existing measure. The US position is no doubt that any use of existing withholding tax measures is exempt from the NAFTA national treatment obligation. What is new in the context of the FATCA is how, or more importantly why the withholding tax measure is being used. In this case it is being used as a means to enforce compliance with US reporting obligations. Does this constitute it a new measure?

If one takes the view that this use of a withholding tax measure constitutes the measure a new measure, it must be aimed at “ensuring the equitable and effective imposition of tax” to fall within the NAFTA exemption requirements. This is very broad language.

The FATCA is, in the broadest sense aimed at “ensuring the equitable and effective imposition of tax” on US taxpayers. It does so by gathering information about US taxpayers through the FATCA measures. No doubt this is an exception that the US would point to if other arguments that the measures violated a treaty obligation fail. As stated at the outset, the need to resort to this exception is unlikely. The NAFTA does not appear to impose any national treatment obligation with respect to tax measures that might impact FFIs, other than indirectly through measures that relate to the purchase or consumption of services. The

⁵⁷³ The term “inconsistent” is not defined in NAFTA. Thus there may remain room to argue that the national treatment obligation has been violated under NAFTA notwithstanding the tax treaty.

⁵⁷⁴ NAFTA Article 2103(4)(c)-(h).

FATCA measures do not relate to the purchase or consumption of services at least in so far as that provision has conventionally been understood.

D. Conclusions

There is no question that the FATCA measures place foreign financial institutions (FFIs) at a competitive disadvantage as compared to US financial institutions (USFIs,) even those FFIs that comply fully with the FATCA reporting requirements. The disadvantage to the FFI as compared to the tax situation of a USFI is threefold. First, FFIs will incur additional expenses in order to comply with FATCA. Second, FFIs are required to enter into an IRS agreement. Third, FFIs are required in some circumstances to close the account of a recalcitrant holder. These disadvantages for a participating FFI are not as egregious as the penalty imposed on a non-compliant FFI. A non-compliant FFI is subject to a 30% withholding tax on gross income notwithstanding that the applicable treaty rate may be 15%, 10%, 5% or nil, depending on the type of income. The competitive disadvantage that may result at this level of withholding, in particular the attendant cash flow issues, cannot be overstated for a non-compliant FFI.

It is arguable that the FATCA withholding measure is not truly a “taxation measure” within the spirit and purpose of the trade or tax agreements and therefore not subject to any of the exceptions from the national treatment obligation. The reality is that whether or not it is a tax measure, there is no tax or trade obligation that would appear to prevent the use of this type of measure, in this case as an economic threat to ensure reporting by foreign financial institutions. One can also speculate as to other circumstances in which withholding taxes (or other taxes) might be imposed that would be to the clear and competitive disadvantage of a non-resident service provider. The question – should the non-discrimination article in tax treaties be broad enough to address this type of discrimination if trade agreements do not – is an important one. This chapter provides a compelling example of one reason why the non-discrimination provisions in tax treaties should be expanded – in this case to include a non-discrimination obligation that would prevent the arbitrary use of a withholding tax measure as a punitive tool to coerce the behavior of non-resident service providers.

Part IV: Reconciling Non-Discrimination Obligations in Tax and Trade Agreements

Chapter 10: Part IV Overview

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

This state of affairs is likely to change...”

Yariv Brauner⁵⁷⁵

The earlier chapters demonstrate that although trade agreements were intended to provide broad protection to non-resident service providers against discriminatory or protectionist practices, this protection is not provided in the area of direct taxation. Instead the multilateral GATS agreement, regional trade agreements and bilateral free trade agreements all adopt a pattern in which obligations with respect to direct tax measures and in some cases all tax measures have been either largely or completely carved out of the trade agreements in favour of tax treaties.

Tax treaties based on the OECD and UN Models generally include very limited non-discrimination obligations in tax matters and the tax treaties currently in place do not extend any non-discrimination obligation to non-residents, who are considered for treaty purposes not to be in the same circumstances.

One result, as seen in Part III, is that there are few limits on the free reign of host governments in applying national laws to non-residents. Thus national laws can be used to discriminate against non-residents and to create barriers to trade. Further, as seen in Part III, many source States engage in tax practices that clearly operate to the detriment of the non-resident service provider. Among these practices are gross withholding taxes, and barriers imposed by administration and compliance practices.

In addition, the interaction of tax and trade agreements between the State of residence of the service provider and the source State can lead to the application of very different non-

⁵⁷⁵ Yariv Brauner, “An International Tax Regime in Crystallization” (2005) 56:2 Va Tax Rev 259 at 33.

discrimination obligations even within a single country in the tax treatment of a non-resident service provider.

Based on these observations Part IV of the study poses three broad questions. First, should there be a non-discrimination obligation in respect of the tax treatment of a non-resident service provider and, if so, on what principles should the obligation be based?

A second, and follow-up question is whether tax treaties or, as suggested by many, trade agreements should be used as the basis for a non-discrimination obligation. Although tax and trade agreements have similar objectives, attempts to co-ordinate questions on international tax in a multilateral agreement have been largely unsuccessful.⁵⁷⁶ Chapter 11 therefore proceeds on the assumption that the non-discrimination article in tax treaties can and should serve the role and that the non-discrimination obligations in the Model tax treaties should be expanded to include a non-discrimination obligation with respect to non-resident service providers. The chapter explores potential options for an appropriate non-discrimination obligation and the feasibility of each moving, from a first and best to second best and ultimately to a compromise obligation that might be acceptable to a number of Contracting States.

No doubt some would argue there is no need to expand the tax treaty non-discrimination article and that a proposed expansion of the current non-discrimination article is not practicable. A discussion of these views is reserved for Chapter 12. Chapter 12 also discusses what a new non-discrimination obligation might look like as well as some of the issues that might be raised in the proposed commentary to the tax treaty non-discrimination article.

The third question is whether there is also a role for the World Trade Organization (WTO) with respect to direct matters and the cross border trade in services.

As will be discussed, the WTO still has a clear role to play in upholding the most favoured national obligation with respect to direct and indirect tax measures, and in upholding the national treatment and most favoured nation treatment obligations as they application to

⁵⁷⁶ The proposal was made in the Havana Charter. See also Wolfgang Schön, “World Trade Organization and Tax Law” (2004) 58 IBFD Bulletin 283.

indirect tax measures. The WTO will also have a clear role to play with respect to taxation measures and any potential subsidies agreement on trade in services.

The conclusion in Part IV is that direct tax measures should be excluded from the national treatment obligation in trade agreements in favour of a proposed non-discrimination obligation in tax treaties. There is, however, a clear role remaining for the WTO in addressing tax measures under the GATS. To the extent that tax and trade agreements both address tax issues, the role of each should be clarified.

Chapter 11: Are There Compelling Reasons to include in Tax Treaties Protection for Non-Resident Service Providers against Discriminatory Tax Measures?

“...taxation, and in particular direct (or income) taxation, is, by definition, a barrier to international trade. On the other hand, the elimination of income taxes is unlikely in the near future, as most governments finance their operations to a large extent with income tax revenues. Insofar as the ideal of free trade cannot be achieved, a compromise that both promotes free trade and allows for the existence of tax related trade barriers must be established.”

Yariv Brauner⁵⁷⁷

A. Overview

Chapters 7 and 8 focus on the wide discretion available to source country revenue authorities in the tax treatment of a non-resident service provider. This chapter poses two broad questions. Should non-residents be ‘fair game’⁵⁷⁸ for source state tax authorities? If not, what non-discrimination principle, obligation or standard should apply? These questions are explored in the context of the GATS and the non-discrimination obligations contained therein.

The issue of whether a non-discrimination obligation should apply to tax measures that impact a non-resident (cross border) service provider is not new. It initially surfaced as a trade law matter at the multilateral level in 1993 during the negotiations for the GATS.⁵⁷⁹ Of the four proposed modes of supply⁵⁸⁰ under the GATS, three potentially gave rise to taxation rights in the State in which the income from services was derived.⁵⁸¹ At issue at that time

⁵⁷⁷ Yariv Brauner, “International Trade and Tax Agreements May Be Coordinated, But Not Reconciled” (2005) 25 Va Tax Rev 251 (2005) at 255.

⁵⁷⁸ Fair game is used in this context to refer to a person that is considered a reasonable target for any type of treatment. Its origin is with respect to hunting. It is a quarry that may be legitimately pursued according to the rules of a particular sport.

⁵⁷⁹ The matter was also the subject of discussion during the negotiations for the North American Free Trade Agreement which came into effect in 1994.

⁵⁸⁰ The four modes of supply are discussed in Chapter 2. In summary form they are Mode 1: cross-border supply, Mode 2: Consumption Abroad, Mode 3, Commercial Presence, and Mode 4 :presence of Natural Persons. Article 1.2 GATS

⁵⁸¹ The first of the four modes anticipates the cross border supply of a service, for example an accountant advising a client by telephone. In some countries this may give rise to source country tax obligations, reinforced through withholding tax collected by the consumer. Two of the four broad ‘modes of supply’ that fall under the agreement (Modes 3 and 4) involve the service provider of one Member

was whether these taxation rights should be subject to the national treatment obligation. There are many reports of the ensuing debate and in particular the objection by the United States about according a non-resident service provider national treatment in tax matters. The concern of the United States was that if a national treatment obligation was included in the GATS, the dispute settlement procedures of the WTO would apply in resolving complaints about a Member country's potentially discriminatory income tax practices. The United States' view was that any issues with respect to tax measures could be dealt with adequately through the dispute settlement procedures in income tax treaties. It appears all other participating countries disagreed with the United States position and thought that it was necessary that the GATS include additional protection against discriminatory tax practices.⁵⁸² As noted in Chapter 2, the final agreement adopted a compromise position. Direct tax measures were carved out of the national treatment obligation under the GATS as an exception and the ability to challenge whether the exception had been met in the case of the national treatment obligation was restricted if the matter fell within the scope of a tax treaty.

It appears, thus, that with one exception there was widespread agreement that additional protection from discriminatory tax practices should be included in the GATS to pursue the goal of liberalization of trade in services and while there was not agreement on the optimal placement of protection measures, there was unanimity that there should be some protection from discriminatory tax practices for non-residents. The United States position was simply that a national treatment obligation with respect to tax measures should not be included in the trade agreement under negotiation.⁵⁸³

State being present in the other again giving rise to potential and direct host country rights. Services provided through Mode 3 may benefit from the Treaty Article non-discrimination obligation as it applies to a permanent establishment. There is no non-discrimination obligation in respect of Modes 1 and 4. The non-discrimination obligation that potentially applies to the Mode 2 supply of a service is found in the indirect tax treaty non-discrimination obligation that requires the source state to permit a deduction from income for payment to a non-resident in the same circumstances that it would permit a deduction if made to a resident. This indirect obligation would also apply to services provided through Mode 1.

⁵⁸² Robert Green, "Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes" (1998) 23 *Yale J Int'l L* 79.

⁵⁸³ "At a December 2 news conference in Washington, Treasury Assistant Secretary for Tax Policy Leslie B. Samuels said that the United States opposes language in a proposed trade-in-services agreement that would guarantee tax nondiscrimination. He argued instead that the issue of nondiscrimination is better addressed in the framework of bilateral tax conventions." Of interest is the news comments as he headed for final negotiations. "Samuels plans to leave Washington to return to the bargaining table in Geneva on December 7 to negotiate language that "recognizes that tax laws will have primacy, except and only if they clearly are a disguised trade barrier." See J Turro, "US Tax Concerns Threaten GATT Talks", (1993) 61:10 *Tax Notes* 1151.

Different principles lie at the foundation of international tax law and trade law. On the tax law side, it is accepted that a source country has and should have the sovereign right to tax income derived from within its borders and that residents and non-residents are not alike for tax purposes and should not expect to be treated alike. Differences in tax treatment between residents and non-residents are not therefore inherently discriminatory. Different measures may be necessary and appropriate to accommodate the different challenges in assessing income derived by non-residents and collecting tax due on that income. On the trade law side, it is now accepted that discriminatory measures adopted with the intention of excluding non-resident suppliers from local markets or reducing their competitiveness reduces international and national welfare. The two sets of principles merge where different tax measures for resident and non-resident suppliers are adopted not in recognition of the inherent differences in applying tax law to the two different groups but instead to make a source country very unattractive as a potential market to a non-resident service provider. Such measures might include aggressive interim withholding tax, high gross withholding tax, cumbersome administrative and compliance provisions, lack of transparency, excessive fees and charges and lengthy refund procedures.

The challenge is in finding the right balance between providing protection for the non-resident from discriminatory tax practices on the one hand and preserving the State's right to act freely in pursuing State action on the other.

B. Differing Levels of Protection

Not all non-residents are potential targets for unfair rules imposed by source country tax authorities. The interaction of tax treaties with the GATS, for example, results in different levels of protection from potentially egregious tax practices for a non-resident service provider from a country that is a GATS Member.⁵⁸⁴

The highest level of protection is reserved for a non-resident service provider from a country that does not have tax treaty with the source State. Such a service provider is protected by the

⁵⁸⁴ See discussion in Chapter 2.

national treatment⁵⁸⁵ and most favoured national obligation with respect to indirect tax measures under the GATS. The service provider may also rely on the non-discrimination requirements under the GATS in respect of direct tax measures excepted from the national treatment obligation and tax measures excepted from the most favoured nation obligation as the result of an international agreement. Specifically, an excepted measure may not be “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services” (‘the GATS chapeau’). There is also a potential remedy under the WTO dispute resolution if these non-discrimination obligations are violated.

The next level of protection applies to a non-resident service provider from a country with a tax treaty with the source State. If the measure relates to the equitable or effective imposition of direct taxes, at issue will be whether the measure falls within the scope of a tax treaty. If the answer is yes, a challenge that the measure violates the national treatment obligation is precluded under the GATS and there is no applicable non-discrimination obligation. If the matter does not fall within the scope of a tax treaty, the GATS national treatment obligation and exception applies and the non-resident service provider may rely on the GATS chapeau (see discussion above) in respect of the direct tax measure. The non-resident service provider may also rely on the GATS chapeau in respect of direct tax measures imposed by the source State that violate the most favoured nation obligation. Indirect tax measures also remain subject to both the national treatment and most favoured nation obligations.

The least protection against tax discrimination is provided to a non-resident service provider from a country with a tax treaty with the source State in which the signatories have totally insulated themselves from any national treatment obligation under the GATS with respect to both direct and indirect tax matters.⁵⁸⁶ This is achieved in the tax treaty by specifying that for

⁵⁸⁵ This assumes that the non-resident service provider is ‘like’ a resident service provider, a determination that is not clear-cut. See Cossy, Mireille. “Determining ‘likeness’ under the GATS: Squaring the Circle” (September 2006) Staff Working Paper ERSD-2006-08, World Trade Organization, Economic Research and Statistics Division.

⁵⁸⁶ See for example Article 29(6) of the Canada-US Treaty. A fifth protocol was signed Sept 21, 2007 effective Jan 1 2008 or date of ratification if later. It provides as follows ‘For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that: (a) a measure falls within the scope of the Convention only if: (i) the measure relates to a tax to which Article XXV (Non-Discrimination) of the Convention applies; or (ii) the measure relates to a tax to which Article XXV (Non-Discrimination) of the Convention does not apply and to which any other provision of the Convention applies, but only to the extent that the measure relates to a matter dealt with in that other provision of the Convention; and (b) notwithstanding paragraph 3 of Article

purposes of determining whether the GATS national treatment obligation may be invoked, that a measure falls within the scope of a tax treaty if it relates to a tax to which the non-discrimination article in the tax treaty applies. If the non-discrimination article in the applicable tax treaty includes both direct and indirect taxes, all matters relating to direct or indirect taxes fall within the scope of the tax treaty.⁵⁸⁷ Under such tax treaties the non-resident may not invoke the GATS national treatment obligation or rely on the chapeau that applies to the exception for direct tax measures, to challenge the measure. Effectively there would be no remedy against a violation of the national treatment obligation absent a non-discrimination obligation in the tax treaty. Nonetheless the non-resident may continue to rely on the GATS most favoured nation obligation, the exception and the GATS chapeau with respect to both direct and indirect tax measures.

C. The Do Nothing Option

If it is concluded that the current state of affairs is acceptable, one option is to do nothing. This option results in some protection against discriminatory tax measures for a non-resident service provider from a country with no tax treaty with the source State and no protection for a non-resident service provider providing services to a tax treaty partner with a comprehensive tax treaty that excludes the application of the GATS. Most non-resident service providers will therefore remain potential targets for unfair treatment by the tax authorities of a tax treaty partner but some will not.⁵⁸⁸

XXII (Consultation) of the General Agreement on Trade in Services, any doubt as to the interpretation of subparagraph (a) will be resolved under paragraph 3 of Article XXVI (Mutual Agreement Procedure) of the Convention or any other procedure agreed to by both Contracting States.”

⁵⁸⁷ The 2006 US Model Tax Treaty further limits the applicability of GATS as follows: Notwithstanding the provisions of subparagraph b) of paragraph 2 of this Article: i) for purposes of paragraph 3 of Article XXII (Consultation) of the [GATS, which allows signatories to refer unresolved questions to arbitration], the Contracting States agree that any question arising as to the interpretation or application of this Convention and, in particular, whether a taxation measure is within the scope of this Convention, shall be determined exclusively in accordance with the provisions of Article 25 (Mutual Agreement Procedure) of this Convention; and ii) the provisions of Article XVII of the [GATS, providing for national treatment] shall not apply to a taxation measure unless the competent authorities agree that the measure is not within the scope of Article 24 (Non-Discrimination) of this Convention.”

⁵⁸⁸ If another free trade agreement is in operation between the two Contracting States additional analysis will be required but as seen in Chapter 3, the free trade agreements that include provisions with respect to trade in services generally exclude tax measures and give primacy to tax treaties.

D. The Do Something Option

If it is concluded that non-residents should not be at risk of unfair treatment by the source State tax authorities of tax treaty partners, what principles should govern the tax behavior of source State tax authorities in the tax treatment of a non-resident?⁵⁸⁹ A range of hypothetical alternatives can be considered as possible answers to this question.

1. Non-Discrimination Principles?⁵⁹⁰

Outside the context of international treaties, a cornerstone of most principles is the notion of fairness. It is an ideal that can easily be agreed on.

International treaties do not rely on any precise principles of fairness but rather on the default norm of non-discrimination.⁵⁹¹ Non-discrimination obligations or standards permit one to distinguish between acceptable and non-acceptable domestic law or practice in the treatment of non-residents or non-nationals by relying on default positions. For example, as seen, the default position in international trade agreements is ‘national treatment’ and ‘most favoured nation treatment’. The default positions in bilateral investment treaties include ‘fair and equitable treatment’⁵⁹², and/or a prohibition of measures that are arbitrary, unjustified, unreasonable, discriminatory, or some combination.

There is no general default position of fairness in international tax law or in tax treaties.⁵⁹³ Instead there are specific prohibitions in the OECD and UN Model Tax Treaties about certain

⁵⁸⁹ Perhaps the more pragmatic question, given that the OECD and UN Model Tax Treaties are consensus based-is what principal or norm would countries that base their tax treaties on these agreements, agree to?

⁵⁹⁰ The term ‘principle’ as used in this context refers to an abstract concept or ideal that reflects how states should conduct themselves or not conduct themselves in the tax treatment of a non-resident.

⁵⁹¹ In this paper it is recognized that there is a fundamental distinction between something that is “right” (law) and something that is “good” (morals), and the overriding role of the law in general (and tax law in particular) should not be the promotion of morality. It should, however, promote the notion of fairness.

⁵⁹² Fair and equitable treatment has been described as “an “absolute”, “non-contingent” standard of treatment, i.e. a standard that states the treatment to be accorded in terms whose exact meaning has to be determined, by reference to specific circumstances of application, as opposed to the “relative” standards embodied in “national treatment” and “most favoured nation” principles which define the required.

⁵⁹³ It is widely agreed that the non-discrimination obligations currently provided in tax treaties based on the OECD Model are at best limited in scope. See for example the General Report for the 2008 Congress in Brussels on *Non-Discrimination at the Crossroads of International Taxation*, where the

types of behaviour that the source State has agreed not to engage in.⁵⁹⁴ For example, there is a prohibition requiring that a source State not subject a national to taxation and connected requirements that is ‘other or more burdensome,’ assuming tax residence.⁵⁹⁵ Similarly, there is a prohibition with respect to the tax treatment of a permanent establishment that requires that the source State not ‘levy tax less favourably.’⁵⁹⁶ There is no prohibition with respect to the tax treatment of a non-resident, including a non-resident service provider.

If a prohibition constraining the behaviour that a source State could engage in with respect to the taxation of non-resident service suppliers were to be included in a tax treaty, on what principle should it be based?

One way to determine what an appropriate principle of ‘fairness’ would be in the tax treatment of a non-resident is to ask what goal(s) we would want the non-discrimination article to promote in the context of a non-resident service provider.⁵⁹⁷ For example, if we accept that although the immediate goal of a tax treaty is to prevent double taxation, but the ultimate goal of a tax treaty is to facilitate international trade by minimizing tax barriers-one might ask why minimizing tax barriers is important? The generally agreed answer is that by minimizing tax barriers, the playing field for a non-resident is made more level. When viewed from this perspective, the goal that we would want the non-discrimination article in a tax treaty to promote with respect to a non-resident service provider is similar to that found in trade agreements; ensuring the ability of the non-resident to fairly compete in that market

General Reporters, all EU Members, propose a new version of Article 24 based in part on the European Court of Justice’s interpretation of EU non-discrimination principles.

⁵⁹⁴ The principle of non-discrimination as expressed in Article 24 prohibits differences in tax treatment in four major areas as follows:

A state shall not:

- Subject non-nationals to “other or more burdensome taxation” than nationals who are “in the same circumstances.” (Article 24(1))
- Levy tax on a permanent establishment of a foreign enterprise “less favourably” than a domestic enterprise of carrying on the same activities. (Article 24(3))
- Prevent the deduction of interest, rents, royalties or other disbursements paid to a treaty partner if “paid under the same circumstances” and a deduction is available if paid to a resident. (Article 24(4))
- Subject “foreign-owned enterprises” to taxation that is “other or more burdensome” than the taxation and connected requirements applicable to “similar” domestic enterprises. (Article 24(5)).

⁵⁹⁵ P. Adonnino, General Report, in IFA Congress, Florence, 1992, Cahiers de Droit Fiscal International vol 73.b.

⁵⁹⁶ *Supra* Article 24(3).

⁵⁹⁷ Ruth Mason & Michael S. Knoll, “What Is Tax Discrimination?” (2012) 121 Yale LJ 1014.

place. In short, the non-discrimination obligation, to the extent possible, should help to level the playing field for a non-resident in the source State.

2. The Search for a Non-Discrimination Standard

(i) The General Trade Law Approach

If the goal is to minimize tax barriers with a view to leveling the playing field for a non-resident, an obvious place to start the search for a non-discrimination obligation is with the international trade and investment agreements that provide non-discrimination obligations with a similar goal.⁵⁹⁸

As discussed, the core non-discrimination obligations in trade agreements are most favoured nation treatment and national treatment. Can these non-discrimination obligations be applied in the context of direct (or indirect) taxation and a non-resident service provider?

The immediate answer with respect to the most favoured nation obligation is no. Because tax treaties are negotiated bilaterally and are tailored to the tax systems in each country, it would be inappropriate to extend the most favoured nation obligation to other tax treaty partners. To the extent that the treaty partners wish to include a most favoured nation obligation, for example, with respect to the rate of applicable withholding tax, they are free to do so, and many have done so in their treaties. Some countries have also entered into multilateral tax treaties.

⁵⁹⁸ The OECD took up the challenge of reviewing the non-discrimination article in the Model Treaty in 2007. The Working Party described the following contribution of the Business and Industry Advisory Committee to the OECD (BIAC) to this process: “BIAC has suggested that the general non-discrimination provisions of these other agreements should be a source of inspiration for extending the scope of Article 24. According to BIAC, the Working Group should [...] look at other, non-tax, treaties which contain nondiscrimination articles or clauses, e.g., bilateral investment treaties, trade agreements, other bilateral or multilateral agreements, where the concept is applied much more broadly. Article 24 should be contrasted with the “national treatment” and “most favored nation” clauses of these other treaties. The intention should be to provide additional guidelines for determining when a case is to be regarded as discriminatory (either by amending the Treaty language or the Commentary), so that taxpayers can rely on the protection of the nondiscrimination article. We think this would be most instructive, leading, perhaps, to a more reasonable interpretation of nondiscrimination in a tax context.”

What of the national treatment obligation, which effectively requires that foreigners and locals be treated equally? Can this non-discrimination obligation as expressed in a trade agreement be applied in the context of direct (or indirect) taxation?

This question is best answered by returning to the precise wording of the national treatment obligation in Article XVII of the GATS which provides as follows:

1. ...Each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.
2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.
3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

The requirements that flow from the national treatment obligation in the GATS, if adapted and included in the non-discrimination provisions in a tax treaty would clearly address most source country tax discrimination issues in respect of a non-resident. The requirements are also completely unrealistic in regulating direct taxation in the source State as they are oblivious to a host of key issues central to direct taxation including tax sovereignty, tax policy and potentially, enforcement and collection matters.

Thus a tax treaty non-discrimination obligation that prohibits a source country from imposing a tax measure that “is less favourable than it accords to its own “like” service providers” is simply not practicable. This is the reality that was recognized in the negotiation for the GATS and is reflected in the other regional and bilateral trade agreements that form part of this study.

Thus another non-discrimination obligation and /or a lesser standard must be considered.

(ii) *Investment Agreements*

One avenue is to draw from obligations found in investment agreements. These provide a number of benchmark standards that apply to investors and their investments that might be adapted in a tax treaty context. As will be seen there are inherent limitations on the use of these standards in a tax treaty, one of the most significant of which is the lack of the bargain upon which the obligations under an investment agreement are based. The bargain under an investment treaty is that the investor agrees to assume the risk of investing ‘property’ in the host State in return for assurances or commitments from the host State about how the State will treat the investor and the investment. This would include, for example, protection from expropriation, the ability to freely remit profits and so on. A violation of the commitment by the State results in compensation for the investor. The equivalent level of risk is not generally borne by a non-resident service provider, who for purposes of this discussion is assumed not to have an investment⁵⁹⁹ in the source State. Notwithstanding, the standards or principles applied in the context of investment treaties may provide some insight into an appropriate tax treaty non-discrimination obligation. Two such standards are examined below.

Arbitrary, Unreasonable, Unjustifiable or Discriminatory

Investment treaties employ a number of standards to protect investors and their investments. For example, many bilateral investment treaties (BITs), generally contain clauses that protect investors from arbitrary/unreasonable/unjustifiable or discriminatory measures. These agreements usually do not define the terms ‘arbitrary’ or ‘unreasonable’ measures with the result that arbitral Tribunals have used different methods to establish whether the standard has been breached. An approach frequently followed by tribunals relies on that adopted by the International Court of Justice (ICJ) in the ELSI⁶⁰⁰ case where the court defined arbitrariness as a violation of ‘the rule of law.’

⁵⁹⁹ A non-resident with an investment may be protected by the non-discrimination obligation applicable to a permanent establishment which provides that tax shall not be levied less favourably.

⁶⁰⁰ *Ellettronica Sicula S.P.A (ELSI) (United States of America v Italy)*, [1989] IJC Rep 15.

Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. (...) It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.⁶⁰¹

According to this test, the requirement to find State behaviour arbitrary is that one must find elements such as “acts which shock or at least surprise a sense of judicial propriety or which violate due process of law.”⁶⁰²

More recently, in *Seimens v Argentina*⁶⁰³, the tribunal adopted the following meaning of the term arbitrary:

In its ordinary meaning arbitrary means “deprived from mere opinion”, “capricious”, “unrestrained”, “despotic”. Black’s law Dictionary defines this term as “fixed or done capriciously or a pleasure”; “without adequate determining principle,” depending on the will alone, without cause based upon the law”.... The Tribunal considers that the definition in ELSI is the most authoritative interpretation of international law and is as close to the ordinary meaning of the term emphasizing the willful regard of the law.⁶⁰⁴

Although one can certainly agree that behaviour by a host government of this type is behaviour that one would want to protect a non-resident from in a tax treaty, this benchmark alone seems very low at least from the perspective of the non-resident concerned about a level of fair tax treatment that would not hinder their ability to effectively compete in that market.

Fair and Equitable Treatment

Another standard and perhaps the most important standard seen in investment treaties is that of “fair and equitable treatment.” This standard appears either as a stand alone obligation or in addition to the prohibition against arbitrary or unreasonable measures in most investment agreements.⁶⁰⁵

⁶⁰¹ Christoph H. Schreuer, “Protection against Arbitrary or Discriminatory Measures” in Catherine A Rogers and Roger P Alford, *The Future of Investment Arbitration* (Oxford University Press, 2009) 183, Chapter 10 at 187.

⁶⁰² *Ibid.*

⁶⁰³ *Seimens v Argentina* [2007] ICSID Case No. ARB/02/8.

⁶⁰⁴ *Supra* at 25.

⁶⁰⁵ Outside the NAFTA some tribunals considered the fair and equitable treatment standard and the arbitrary/unreasonable or discriminatory standard as closely related. See U Kriebaum "Arbitrary/

The history of the fair and equitable treatment standard is of some interest in particular its relatively recent introduction to commercial arrangements and its controversial evolution. For example, although attempts to include the fair and equitable standard were initially made in the Havana Charter in 1948, the language did not successfully form part of an investment treaty until 1959.⁶⁰⁶ Its precise meaning today remains unclear.

Many scholars argue that the words “fair and equitable treatment” merely repeat in treaty form the minimum standard required by customary international law. The level of protection is, according to this view, limited to that which States generally and consistently provide to foreign investors.⁶⁰⁷ This sets a very low bar for government behaviour and would require “convincing evidence of a pronounced degree of improper governmental action”, “an obvious error in the administration of justice, or fraud or a clear outrage.”⁶⁰⁸ It is a minimum standard that is meant to serve as a floor, an absolute bottom, below which conduct is not accepted by the international community. As was the case with the prohibition against arbitrary treatment, the fair and equitable standard sets a potentially very low benchmark from the perspective of the non-resident concerned about fair treatment in a foreign market.

Others are of the view the fair and equitable standard is an independent and evolving treaty standard that may or may not include customary international law. Tribunals that have adopted this broader view have interpreted the standard to include a variety of specific requirements including “a State’s obligation to act consistently, transparently, reasonably,

Unreasonable or Discriminatory Measures”, in M Bungenberg, J Griebel, S Hobe, A Reinisch (eds), *International Investment Law* (Baden Baden: Nomos, 2013).

⁶⁰⁶ The first reference to “equitable” treatment is found in the 1948 *Havana Charter for an International Trade Organization*, United Nations Conference on Trade & Development, Final Act and Related Documents, art. 46.1, U.N. Doc. E/Conf. 2/78 (1948) [hereinafter the *1948 Havana Charter for an International Trade Organization*]. Its Article 11(2) contemplated that foreign investments should be assured “just and equitable treatment”. The Article provided that the International Trade Organization (ITO) could: 1. make recommendations for and promote bilateral or multilateral agreements on measures designed...2. to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another. Some major developed countries did not ratify the Charter due to unresolved issues, bringing the first post-war multilateral effort on trade and investment to an unsuccessful conclusion. It was not successfully incorporated into a treaty until 1959.

⁶⁰⁷ It is a set of customary international law norms that governs the treatment of aliens. States, regardless of their legislation and practices, must respect these norms when dealing with foreign nationals and their property. The MST is often understood as a broad concept intended to encompass the doctrine of denial of justice along with other aspects of the law of State responsibility for injuries to aliens. However, specific meaning of the concept is still rather indeterminate. Under the existing definition, customary international law results from a general and consistent practice of States that they follow from a sense of legal obligation (*opinio juris*). UNCTAD Series on Issues in International Investment Agreements II “Fair and Equitable Treatment” (United Nations Conference on Trade and Development, New York and Geneva, 2012) at 44.

⁶⁰⁸ *Ibid* at 46.

without ambiguity, arbitrariness or discrimination, in an evenhanded manner, to ensure due process in decision -making and respect investors' legitimate expectations.”⁶⁰⁹

One could also read into an evolving fair and equitable standard, good faith in the conduct of a party, consistency of conduct, recognition of the scope and purpose of laws, due process, prohibition of harassment, a reasonable degree of stability and predictability of the legal system, and perhaps recognition of the legitimate expectation on the part of the investor.

Could the fair and equitable standard be applied in a tax treaty context? The idea of an evolving and open-ended fair and equitable standard certainly has some appeal from the perspective of a non-resident taxpayer. It no doubt would have little appeal from the perspective of the host government. An expansive approach to the interpretation of the fair and equitable standard could result in highly complex and contentious issues about the types of administrative and governmental action that could be reviewed under the standard as well as the degree of seriousness of breach that is required. This would not sit well with any government concerned about its tax sovereignty.

In summary, the fair and equitable standard at this stage in its evolution holds some appeal as an independent tax treaty standard. That appeal however, is more in its potential. The fair and equitable test reflects that fact that no State would argue that international law admits an unfair and equitable treatment. However, the fair and equitable standard has not solved the difficult task of spelling out the scope of an appropriate obligation. To the contrary, in the investment context, the fair and equitable standard has proven itself in some cases to be overly broad in scope and no doubt the same unwieldiness in its interpretation and application would spill over in a tax context. The fair and equitable standard is also inconsistent with the language used in the GATS that currently addresses the non-discrimination obligation otherwise applicable to tax measures. Perhaps more importantly it imposes obligations on the source State with respect to tax measures that exceed those currently included in the GATS.

⁶⁰⁹ UNCTAD Series on Issues in International Investment Agreements II “Fair and Equitable Treatment” *supra* note 607.

A range of other options might be considered. One is offered below as an example, but has been rejected for purposes of this study as unworkable. For reasons discussed further below, adapting the approach currently used in the GATS and in some of the other trade agreements in this study may provide the best alternative for an appropriate non-discrimination obligation in a tax treaty.

(iii) *The Treaty for the Functioning of the European Community (TFEU)*

A third approach to establishing a non-discrimination obligation would be to adopt principles developed under the TFEU.⁶¹⁰ Because many of the OECD countries are signatories to the TFEU, a standard based on non-discrimination principles developed in ECJ case law has obvious appeal. Some have gone so far as to argue that because the majority of the Member Countries of the OECD are EU Member States “it is not appropriate to put forward changes to the non-discrimination Article or the Commentary that would run contrary to the relevant decisions of the ECJ in respect of the EU Treaty.”⁶¹¹ With respect this seems too narrow an approach,⁶¹² first because almost a third of the OECD countries are not bound by the commitment of an integrated trade block and second because many countries other than OECD countries utilize the provisions of the OECD Model Treaty. EU Members can continue to rely on internal standards under the TFEU with respect to obligations with other EU Member States as these take priority over tax treaties. Accordingly, EU law will apply where Member’s tax laws create restrictions on trade in services with its EU partners and the OECD Model provisions to measures with non-member States.⁶¹³

⁶¹⁰ EU, *Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union*, 26 October 2012, OJ C 326/01.

⁶¹¹ TAXREP 48/07 – OECD Public Discussion Draft on the Non-Discrimination article in the OECD Model Convention, Written Response Submitted on 5 July 2007 by the ICAEW Tax Faculty Relating to the Public Discussion Draft on the Non-Discrimination Article in the OECD Model Convention issued by OECD on 3 May 2007 at para 12, online: OECD <<http://www.oecd.org/tax/treaties/39450236.pdf>>.

⁶¹² Other Commentators have also questioned whether or not EC law should be a role model for the concept of non-discrimination in a tax treaty. See Silke Bruns, “Taxation and Non-Discrimination: Clarification and reconsideration by the OECD” in *The 2008 OECD Model Tax Convention Special Issue*, European Taxation (September 2008) 491 at note 42.

⁶¹³ For an interesting comparison of the non-discrimination obligations in Article 24 of the OECD Model Tax Treaty and the law in the European Union, see Niels Bammens, *The Principal of Non-Discrimination in International and European Tax Law* (IBFD, 2012).

(iv) New Tax Treaty Standard

Another approach to finding the appropriate non-discrimination obligation in a tax treaty is to identify the circumstances in which differences in tax treatment between residents and non-residents can be justified and conversely when they cannot. Such an approach would be based on the generally accepted idea that a source State would not provide national treatment to a non-resident, but would nonetheless agree not to use the national tax system in a way that would derogate from a ‘national treatment–like’ obligation for a reason other than to pursue the country’s legitimate tax policy objectives. These objectives are traditionally viewed as equity, neutrality, efficiency, revenue collection, administration and compliance. Identifying the circumstances in which differences in tax treatment can be justified could prove a painstaking and complex task but one which no doubt could be achieved over time over time. As an alternative, it is proposed that a good starting place to develop an appropriate tax treaty non-discrimination obligation to accord to a non-resident service provider is with the approach adopted in the GATS, an approach that focuses on when differences in tax treatment between a resident and a non-resident are not considered acceptable.

Under the GATS, the core obligations of national treatment and most favoured nation treatment apply to all direct and indirect tax measures. The exception to the national treatment obligation in the GATS for “direct measures aimed at the effective imposition or collection of taxes” and the accompanying footnotes is just that—an exception. It recognizes important structural elements of a national tax system, most importantly that residents and non-residents are not alike from the perspective of their tax obligations in the source State. There is always an element of discrimination in the imposition of differing tax measures on a non-resident. However, the mismatch between the carve out from the national treatment obligation with respect to tax measures under the GATS, is in effect filled with a lesser obligation or minimum standard against which national tax legislation and its administration can be measured. Specifically the measure is subject to the requirement that it cannot be “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services (the GATS chapeau).”

The GATS standard for regulating source State behaviour with respect to direct tax measures is housed within a simple structure. First an obligation exists. Second there is a well founded reason to provide an exception to that obligation. Finally the GATS chapeau is added to

prevent the abuse of the exception. The focus of the chapeau is thus on the application of a measure found to be inconsistent with obligations under the GATS but falling within an exception. In the context of direct tax measures, the obligation under discussion is the national treatment obligation, and the exception is for certain direct tax measures aimed at the effective imposition or collection of taxes. The Appellate Body in *US - Gambling* describes this as follows:

The focus of the chapeau, by its express terms, is on the *application* of a measure already found by the Panel to be inconsistent with one of the obligations under the GATS but falling within one of the paragraphs of Article XIV. By requiring that the measure be *applied* in a manner that does not constitute ‘arbitrary’ or ‘unjustifiable’ discrimination, or a ‘disguised restriction on trade in services’, the chapeau serves to ensure that Members’ rights to avail themselves of exceptions are exercised reasonably, so as not to frustrate the rights accorded other Members by the substantive rules of the GATS.⁶¹⁴

What is considered “arbitrary or unjustifiable discrimination between countries where the same conditions prevail” for purposes of the GATS?⁶¹⁵

The Appellate Body in *US-Shrimp* provided the following overview of the key elements:

In order for a measure to be applied in a manner which would constitute ‘arbitrary or unjustifiable discrimination between countries where the same conditions prevail’, three elements must exist. First, the application of the measure must result in discrimination. As we stated in *United States — Gasoline*, the nature and quality of this discrimination is different from the discrimination in the treatment of products which was already found to be inconsistent with one of the substantive obligations of the GATT 1994, such as Articles I, III or XI. Second, the discrimination must be arbitrary or unjustifiable in character. ...Third, this discrimination must occur between countries where the same conditions prevail. In *United States — Gasoline*, we accepted the

⁶¹⁴ *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting*, (2005), WT/DS285/AB/R (Appellate Body Report), online: WTO <<http://docsonline.wto.org>> [US Gambling] para 339 citing *United States - Standards For Reformulated And Conventional Gasoline* (1996), WT/DS2/9 (Appellate Body Report) p. 22 at 20 – 21.

⁶¹⁵ As will be discussed further in Chapter 12. The Appellate Body in *US Gambling*, the only decision that has considered the GATS Article XIV chapeau to date, found that previous decisions under Article XX of the GATT 1994 were relevant for the analysis under Article XIV.

assumption of the participants in that appeal that such discrimination could occur not only between different exporting Members, but also between exporting Members and the importing Member concerned.⁶¹⁶

In summary, any direct tax measure imposed by the source State would *prima facie* be considered compliant with the GATS unless it could be established that it resulted in discrimination and that it was arbitrary or unjustifiable in character and the discrimination occurred between countries where the same conditions prevail.

The phrase “between countries where the same conditions prevail” in the chapeau of Article XX has been interpreted to refer to conditions both between the foreign country and other foreign countries and the foreign country and the home country. Put differently the chapeau will apply if a measure results in discrimination, is arbitrary or unjustifiable and the same conditions prevail between the foreign and the home country claiming the right to impose the measure.⁶¹⁷ The GATS standard for source country behaviour in respect of direct tax measures is lower than the national treatment obligation but nonetheless provides an internationally recognized benchmark and a body of legal decisions against which tax measures can be measured.

As discussed the GATS standard of protection against the use of discriminatory tax measures is currently provided to a non-resident service provider from a GATS Member State who is providing services in another Member State that is not tax treaty partner. Can a similar level or standard be adapted and applied in a tax treaty context? This issue is discussed below.

There is no national treatment obligation in a tax treaty, similar to that found in the GATS. Tax treaties are also structured based on the understanding that residents and non-residents are not alike. Nonetheless non-discrimination obligations can be found in a tax treaty in the form of prohibitions that focus on specific types of behaviour. For example, in Article 24(1)

⁶¹⁶ *United States - Import Prohibition Of Certain Shrimp And Shrimp Products* (1998), WT/DS58/AB/R at para 150 (Appellate Body Report), online: WTO <<http://docsonline.wto>>.

⁶¹⁷ With respect to the phrase “between countries where the same conditions prevail”, the question arose whether the notion of discrimination under the chapeau of Article XX referred to conditions in importing or exporting countries (i.e. discrimination between a foreign country or foreign countries on the one hand and the home country on the other) or only to conditions in various exporting countries. The Appellate Body in *US — Gasoline* indicated that it considered both types of discrimination covered by the chapeau. This view was confirmed in *US Shrimp*. See WTO Analytical Index 1994, Article XX online: WTO <http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20C1a>.

of the OECD and UN Model Tax Treaties there is a prohibition against subjecting a national to “any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the other State in the same circumstances, in particular with respect to residence, are or may be subjected.”⁶¹⁸ It operates to prevent a Contracting State from treating two persons who are resident of that State from being treated differently on the basis of their nationality. This “other or more burdensome” standard approximates the intent of the national treatment obligation with respect to a non-national who is a resident. For purposes of this analysis it could be viewed as a proxy for it.⁶¹⁹ As discussed, this obligation does not extend to a non-resident because a non-resident does not meet the requirement in paragraph 1 of being in the same circumstances.

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

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

⁶¹⁸ The prohibition in OECD Article 24(1) is a prohibition against discrimination on the basis of nationality. As a practical matter, because the national of the other Contracting must be in the same circumstances in particular with respect to residence, the prohibition operates to prevent discrimination against a tax resident solely on the basis of nationality. The result is that once a national of one Contracting State becomes a resident of the other Contracting State, the non-discrimination obligation will apply.

⁶¹⁹ This language is borrowed from trade law agreements. See generally Niels Bemmans, *supra* note 37 Chapter 4.

If one applied the GATS structure in a tax treaty context, the questions would be first: Is taxation or any requirement connected therewith other or more burdensome for the non-resident? Second, if the answer is yes: Does it meet the exception for direct tax measures? And third: Does the manner in which the tax measure is applied by the source State meet the chapeau requirement? To answer the third question, an examination of the expression “where like conditions prevail” that is used in the GATS would be required. This language is slightly different than the chapeau in Article XX which uses the expression “the same conditions.” Nonetheless it invites the same comparison between the foreign and home country, with the proviso that ‘like conditions’ may be construed as a less stringent test of comparison than the ‘same conditions.’⁶²⁰

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

Another possible option, if one wanted to adopt the language currently employed in the OECD tax treaty, is to adopt the language used in Article 24(3), the provision that applies to the tax treatment of a permanent establishment. Article 24(3) requires that taxation on a permanent establishment “shall not be less favourably levied” in the other State than the taxation on enterprises of that other State carrying on the same activities.” The obvious appeal of adapting the non-discrimination principle in Article 24(3) is that its objective is to prevent discrimination against residents of the other Contracting State in relation to business income earned in that Contracting State. Thus, under this non-discrimination provision, the profits of the permanent establishment are not to be computed less favourably than the profits

⁶²⁰ If one were to adapt this type of comparison in a tax treaty context it opens up some interesting possibilities. For example, it creates the potential for questioning why a high interim withholding tax is being imposed on the non-resident service provider. Is the issue enforcement and collection? If so, are the conditions with respect to the ability to collect taxes in the source state like the conditions in the resident state? Hypothetically, is the withholding tax measure necessary if the ability to collect taxes owing is supported by exchange of information and/or assistance in collection agreements in the non-resident state?

of a national enterprise of the State in which it has its situs solely on the basis that the operator has its fiscal domicile out of that State.⁶²¹

For purposes of this discussion the non-discrimination obligation in Article 24(1) has been selected over Article 24(3) for several reasons. First, the non-discrimination obligation in Article 24(3) addresses the host country tax treatment of business income and is based on the existence of a permanent establishment in the host State. The assumption for purposes of this study is that a permanent establishment in the host State may not exist. Further, as discussed,⁶²² payments in respect of services are not always classified as business income. The payment may be subject to the independent personal services article, the royalty article, the other income article or a specialized article in the relevant tax treaty.⁶²³ Second, the prohibition in Article 24(3) is much narrower than the prohibition in Article 24(1). Specifically, Article 24(3) requires only that taxation not be less favourably levied. Although the words ‘less favourably levied’ approximate the meaning of ‘more burdensome’ that is found in Article 24(1), Article 24(1) also includes ‘connected requirements’. This broader language prevents discrimination in relation to such matters as information requirements, limitation periods, interest and penalties, that would otherwise be captured under the connected requirements in Article 24(1). The Article 24(1) obligation also applies to “other” taxation.⁶²⁴ For all of these reasons the non-discrimination obligation in Article 24(1) is preferred for purposes of the ongoing discussion.⁶²⁵

To be clear, the tax treaty partners are free to devise virtually any principle or language to address the circumstances to which a non-discrimination obligation would apply or to describe the specific host country behaviour that is to be prohibited under a tax treaty. One of

⁶²¹ According to the 1957 Working Party, the discrimination to be eliminated under Article 24(3) was discrimination based on the situs of an enterprise. This is captured in the following passage “...it is not within the intention of the Working Party to judge, in every case, whether and to what extent differences in treatment between persons domiciled and persons not should be eliminated. Nevertheless the Working Party desires to make an exception with regard in particular to the computation of profits realized through a permanent establishment which an operator having its fiscal domicile in one State maintains in the territory of another. *Working Party No. 4 of the Fiscal Committee (Netherlands-France): Report on Tax Discrimination on Grounds of Nationality or Similar Grounds*, Doc FC/WP4(57) 1 (6) (11 January 1957).

⁶²² See Part II, Chapter 7.

⁶²³ The UN Model Tax Treaty for example, has proposed a dedicated tax treaty Article for Technical Service Fees. See also Article 12 of the United States-India Tax Treaty and discussion in Chapter 7.

⁶²⁴ Permanent establishments, in contrast may be subject to a different tax than a resident as long as the quantum of tax is not greater than that payable by a resident See OECD Commentary Article 24.

⁶²⁵ The author acknowledges that the discussion is based on the exploration of options that may be considered total fanciful.

the challenges in doing so is capturing the many approaches to the taxation of income from services found in the OECD and UN Model Tax Treaties and in negotiated tax treaties. As a result, the standard of ‘other or more burdensome taxation and connected requirements’ in Article 24(1) has been selected as a good default position for a non-discrimination obligation, notwithstanding that its intended purpose is to prevent discrimination based on nationality.⁶²⁶

There is also the question of whether a tax treaty non-discrimination obligation should apply to indirect tax measures. Indirect tax measures are currently subject to the national treatment and most favoured nation⁶²⁷ obligation under the GATS and under many free trade agreements.⁶²⁸ They are also included in some tax treaties under the non-discrimination Article.⁶²⁹ There is therefore a potential conflict between tax and trade agreements with respect to what non-discrimination obligation, if any, applies. These and a host of other issues would have to be analyzed before the feasibility of any new non-discrimination obligation can be properly assessed. This analysis takes place in Chapter 12.

E. The GATTS Comparison

This Chapter began with the question: Are there compelling reasons to include in tax treaties protection for non-resident service providers against discriminatory tax measures? The limitations of current agreements in respect of tax measures applying to trade in services are highlighted by a look at tax measures that impact the trade in goods. All tax measures impacting the trade in goods are, in principle, subject to tax discipline. The exactness of those measures can be seen in Article III of the General Agreement on Trade and Tariffs. Article

⁶²⁶ According to one author this will occur with time. As he states: “It is likely and desirable that the international tax regime will develop in the direction of creating an international tax organization. Such an organization will serve, at the least, as a global policy forum with some interpretation authority. The process of increased international coordination of income tax policies is deterministic: it must result in an increased, if not a formal, harmonization of principles. That 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 WITO “national treatment” principle.” See Yariv Brauner, “International Tax and Trade Agreements May be Coordinated, But Not Reconciled.” *supra* note 1 at 301.

⁶²⁷ The issue of most favoured nation with respect to direct tax measures should also be considered. Differences in tax treatment that are based on a tax treaty are generally considered exempt from the MFN obligation. However as has been pointed out by several authors, the most favoured nation obligation is subject to the GATS chapeau. The OECD Tax Treaty commentary could similarly clarify that a measure will not be considered arbitrary or unreasonable if the difference in treatment is the result of a tax treaty.

⁶²⁸ See Generally Chapter 3.

⁶²⁹ See e.g., the Canada-US Tax Treaty.

III(1) communicates the common understanding that legislation should not be applied in a way that protects local from foreign competition. Article III(2) makes plain that imported goods may not be subject to higher taxes than like domestic products.⁶³⁰ Article III(3), provides that the taxes on unlike (services) and on domestic (services) should be comparable to the extent the products compete with each other.

In an ideal world similar non-discrimination obligations would apply to services and service suppliers. Such measures could, in fact, be applied to a service supplier if the service provider was subject to either exclusively residence or exclusively source based taxation. But it is not an ideal world. Generally both source and resident countries tax income from services. Direct tax measures are thus tied directly to the key concepts in international tax law that were discussed at the beginning of the Chapter-tax sovereignty and the reality that residents and non-residents are not alike for tax purposes. The importance of these international tax concepts however, do not detract from the reality that if we continue to exclude a matter as significant as taxation from both tax and trade law discipline, tax measures may totally undermine trade law objectives.

This Chapter attempts to find a bridge between trade and tax treaty non-discrimination obligations. The proposed non-discrimination obligation clearly will not provide the national treatment protection afforded to the trade in goods but it would achieve four important objectives. First, it restores to the non-resident service provider the same level of protection against discriminatory tax practices that is currently available under the GATS if there is no tax treaty between the non-resident's State and the source State. Second, it introduces a minimum standard to be applied in the tax treatment of a non-resident service provider. Third, it requires that the competent authority closely examine complaints against its revenue collection arm to ensure that tax measures are administered in compliance with the minimum standard. Fourth, it invites a closer examination of national measures by national governments against a common internationally accepted standard.

⁶³⁰ This can be equated with the OECD Tax Treaty non-discrimination provision that requires a deduction to the consumer in respect of services to the extent that a deduction would be permitted if the services were acquired locally. The result is that the cost to the consumer in both cases would be the same.

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

The discussion thus far has ignored the so-called “elephant in the room.” Why would a Contracting State agree to the assumption of an additional non-discrimination obligation under a tax treaty? There are a number of reasons they might do so.

While they clearly fall short of comprehensive solution to the problem of non-discrimination, “The current tax treaty nondiscrimination rules ... reflect the political choice of the contracting states to create as source countries a level playing field in respect of taxation for residents of the other country.”⁶³¹ This is a step towards leveling the playing field.

A reciprocal non-discrimination obligation is a good political choice. It provides a minimum standard against which to measure the tax treatment of a country’s service provider and could result in “producing greater national gains than would result from unilateral non-discrimination.”⁶³² In short, in the end the bargain may be worth it.

The proposed non-discrimination obligation acknowledges the importance of tax sovereignty and preserves each countries right to maintain domestic policy objectives under its domestic law. It provides a balance against protectionist tax measure.

Finally, a tax treaty non-discrimination obligation would provide additional clarity about when trade agreements (especially the GATS) would apply to a tax measure and when the tax treaty would apply, an issue that has been given considerable attention in academic literature.⁶³³

⁶³¹ Kees van Raad, “Nondiscrimination in Taxation of Cross-Border Income under the OECD Model and EC Treaty Rules-A Concise Comparison and Assessment” in H van Arendonk, F Engelen and S Jansen (eds), *A Tax Globalist: the search for the Borders of International Taxation* (IBFD, 2005) at 137.

⁶³² R A Green, “The Troubled of Nondiscrimination in taxing Foreign Direct Investment, (1994/1995) 26 *Law & Pol’y Int’l Bus.*

⁶³³ See e.g., Farrell *The Interface of International Trade Law and Taxation*, IBFD Doctorial Series 26 (The Netherlands: IBFD Publications BV, 2013) at Chapter 8: “The WTO Tax Rules: Services” and Servass Van Thiel, “The Agreement on Trade in Services and Income Taxation” in K Byttemier & K van der Borgh (eds), *WTO Obligations and Opportunities: Challenges of Implementation* (UK, Cameron May 2008).

G. Conclusions

The objective of this Chapter was to consider whether the status quo with respect to the non-discrimination obligations that impact a non-resident service provider continues to be acceptable. The conclusion is that a non-resident should not be fair game in tax matters when providing services in another Contracting State and that it may be time to consider a better approach. The approach proposed in this Chapter is to add a non-discrimination obligation to tax treaties that recognizes the unique position of service providers under trade agreements. Such a tax treaty non-discrimination obligation would address the potential for source country tax measures to undermine the trade commitments made to liberalize the trade in services.

The non-discrimination obligation proposed is at best an uneasy compromise that engages the non-discrimination obligation in Article 24(1) of the OECD and UN Model Tax Treaties in a manner that was not anticipated by its drafters. Nonetheless it attempts to safeguard the obligations assumed under trade agreements by introducing a minimum non-discrimination obligation to tax treaties that would not be at the expense of tax sovereignty. The addition of such a non-discrimination obligation to a tax treaty clearly challenges the current notion that a non-resident should not be accorded any non-discrimination obligation by a source State. It also aligns with trade law objectives.

Is the introduction of a new non-discrimination obligation in tax treaties feasible? This issue is discussed in the next chapter.⁶³⁴

⁶³⁴ Two leading international tax experts have noted that the current non-discrimination rules are not grounded in principles of equity but rather the arbitrary demands of practicality. See Hugh Alt J & Jacques Sasseville, "Taxation and Non-Discrimination: A Reconsideration" (2010) 2:2 World Tax Journal 101. An obvious example of practicality is the response to the taxation of non-residents without a permanent establishment in the host country. Non-residents who earn passive income are subject to withholding tax, "a crude, pragmatic, arbitrary response to a realisation that income tax cannot properly be made to work in respect of outward flowing passive income." John Prebble, "A Philosophical and Design Problems That Arise from the Ectopic Nature of Income Tax Law and Their Impact on the Taxation of International Trade and Investment" in *Chinese Yearbook of International Law and Affairs vol 13* (1994-1995). Non-residents who earn income from services may fare considerably worse. They may not rely on any restrictions or limitations on the taxation of income from services in the source country or on any applicable non-discrimination principle.

Chapter 12: Refining the Non-Discrimination Obligation, its Violation and the Process of Resolution

A. Introduction

The last Chapter explored the question of whether a non-resident should be ‘fair game’ for source country tax authorities. It also examined options for a new non-discrimination obligation to be included in tax treaties and concluded that an appropriate starting point could be the adaptation of the standard used in the GATS and other free trade agreements. Under the GATS, a tax measure is excluded from the national treatment obligation only if it does not constitute “arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services.”⁶³⁵

This Chapter proceeds on the assumption that a Contracting State might choose to include a non-discrimination obligation in its tax treaties to address the tax treatment of a non-resident and picks up the task of refining the scope and wording of the obligation. The Chapter also addresses the matter of dispute resolution.

The broad design for the proposed non-discrimination obligation adopts a hybrid approach. The obligation is included in Article 24, the non-discrimination article in the OECD Model Tax Treaty, but the resolution of any dispute with respect to whether the obligation has been contravened is limited to Article 25, the Mutual Agreement Procedure under the tax treaty. The beginning of a proposed Commentary to the new non-discrimination obligation is also provided. The Chapter recognizes that the OECD and UN Model Tax Treaties and related commentaries are consensus based and evolving. The proposal in this chapter is intended only as a starting point for criticism or consensus building. As will soon become apparent there is no easy truce between tax and trade law non-discrimination obligations and the attempt to build a bridge between the two produces some inelegant results.

For purposes of the discussion it is assumed that the non-discrimination obligation in the tax treaty would initially be no broader than the current non-discrimination obligation that would apply to a non-resident service provider under the GATS if there is no tax treaty between the

⁶³⁵ The GATS Article XIV (d).

State where the non-resident service provider is resident and the State where the income from services is derived for tax treaty purposes.⁶³⁶ It is also assumed that a service provider from a country that is a signatory to a regional or bilateral free trade agreement, such as those discussed in Part II and to a tax treaty with the free trade partner, will also rely on the proposed non-discrimination obligation in the tax treaty.

B. What the Non-Discrimination Obligation Might Look Like

The starting point in the proposed design of a non-discrimination obligation for a tax treaty is to replicate the GATS approach to non-discrimination with respect to direct tax measures but to adapt it to the tax treaty form of a prohibition. Such a clause might appear in Article 24 of the OECD Model Tax Treaty as follows:

A Contracting State shall not impose any tax liability on income derived from or paid for trade in services that is arbitrary or unjustifiable discrimination between countries where like conditions prevail or a disguised restriction on trade.

If one wanted to more precisely adopt the GATS language the non-discrimination obligation might appear as follows:

A Contracting State shall not apply any measure to ensure the effective imposition or collection of taxes in respect of compensation for trade in services that is arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade.

Although the language used in either version conveys the message that tax measures may not be imposed in the circumstances described, neither version could be interpreted or administered within the current tax treaty structure using current trade law principles.

Under the GATS the starting point in the determination of whether discrimination has occurred is that an obligation under the GATS has been violated. In this context the relevant

⁶³⁶ The non-discrimination obligation would apply under a tax treaty to a potentially broader spectrum of service providers because the commitment to provide national treatment is negotiated under the GATS on a sector by sector basis.

trade law obligation is that a non-resident must be accorded national treatment; that is - the non-resident must be treated like a resident service provider. An exception is made from the national treatment obligation for direct tax measures, an exception that is subject to specific requirements aimed at preventing the abuse of the exception. If these requirements are not met, the national treatment obligation will apply to direct tax measures in the same way it applies to other measures that impact on cross-border trade.

In contrast to the GATS, under a tax treaty there is no direct non-discrimination obligation in respect of a non-resident service provider who does not have a permanent establishment in the source State. It is simply assumed that all differences in tax treatment between a resident and non-resident taxpayer are acceptable and should not be subject to a non-discrimination obligation. As such, unlike the GATS, there is no starting point or obligation in a tax treaty from which to carve the exception. For discrimination to be found under a tax treaty, if one adopts the GATS approach, a non-discrimination obligation must first be created.

1. Creating an Obligation

Paragraph 1 of Article 24 of the OECD Model Tax Treaty provides as follows:

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. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

As discussed in Chapter 11, the non-discrimination obligation in Article 24(1) is a non-discrimination obligation that prohibits discrimination based on nationality. As a practical matter it operates to prevent discrimination against a person that is a tax resident. It could, therefore, form the basis of the non-discrimination obligation owed to a national who is either a resident or a non-resident, but with a ‘GATS-like’ exception from the obligation for a national who is a non-resident. Consider the following hypothetical paragraph 1A that could follow directly after paragraph 1:

Notwithstanding paragraph 1, Nationals of a Contracting State who are not in the same circumstances with respect to residence as national of that other 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, are or may be subjected.

(a) Nothing in this paragraph shall be construed to prevent the adoption or enforcement by any Contracting State of measures aimed at ensuring the equitable or efficient imposition of direct tax measures, provided such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between (nationals of) countries where like conditions prevail, or a disguised restriction on trade in services.

The meaning of “ measures aimed at ensuring the equitable or efficient imposition of direct tax measures” in paragraph (a) could be clarified by reference to the footnote attached to the exception from the national treatment obligation in the GATS in Article XIV(d) set out in Table 1 below, as well as to the GATS proviso that tax terms or concepts are to be determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Contracting State taking the measure.

Table 1

Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:

- apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
- apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
- apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
- distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
- determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

2. Too Broad

The above proposal for a non-discrimination obligation provides a broad starting point to begin the discussion but as drafted would apply to all non-residents. This is certainly an idea to be considered. However, the argument being made in this study is that a tax treaty non-discrimination obligation should apply to non-resident service providers that would serve to uphold the commitments made in trade agreements. The challenge is to refine the non-discrimination obligation in a tax treaty to target this more precise purpose. This task brings home with startling clarity the difficulty of crossing the chasm between tax and trade law.

The first step in restricting the tax treaty non-discrimination obligation is to determine for tax treaty purposes who will be the subject of the non-discrimination obligation. If the subject of

the non-discrimination obligation is to be the non-resident service provider of the other Contracting State, the service supplier must be identifiable for purposes of the tax treaty. As discussed, the GATS and other regional and bilateral free trade agreements use different definitions to define services and service suppliers. There are also different levels of commitment to the national treatment obligation. Under the GATS, for example, the Members took a bottom up approach to the national treatment obligation. Commitments are made on a sector-by-sector basis and could be made subject to conditions and qualifications. The NAFTA operates in reverse and requires each Party to state explicitly if it does not intend to conform to the general obligations in the agreement including the national treatment obligation.

One option to address who is a service provider for tax treaty purposes is for the OECD and UN to take the lead in the Model Tax Treaties by applying the non-discrimination obligation generally to service suppliers who supply services in the other Contracting State as those concepts are defined in the GATS.

A more tailored alternative would be to include under each tax treaty only those categories of service suppliers for whom national commitments were made under the GATS or that were made under regional or bilateral free trade agreements and that apply to the specific tax treaty partners. This would result in a more precise parallel between trade obligations and tax obligations. It would also mean identifying in the tax treaty exactly what categories of service providers would benefit from the non-discrimination obligation.

A rather cumbersome variation of the non-discrimination obligation between Contracting States that are also signatories to the GATS and that employ the current tax treaty language might appear in Article 24 as follows:

Notwithstanding paragraph 1, Nationals of a Contracting State who provide services in the other Contracting State in a sector in which an unqualified national treatment obligation has been made by that Contracting State under the GATS, but who are not in the same circumstances with respect to residence, shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals who provide services in that other State in the same circumstances, are or may be subjected.

(a) Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this paragraph shall be construed to prevent the adoption or enforcement by any Contracting State of measures aimed at ensuring the equitable or efficient imposition of direct tax measures.

As can be seen the task of meeting the criteria and language used in both tax and trade agreements while retaining the precise intent under both results in a convoluted and almost incomprehensible tax treaty non-discrimination provision.

A simpler version of the non-discrimination obligation, but one which does not follow the OECD Model format of a prohibition might appear as follows:

Notwithstanding paragraph 1, a Contracting State that has agreed to accord national treatment to a service provider of another Contracting State under an agreement with respect to trade in services, shall not subject that service provider to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals who provide service in that other State in the same circumstances, are or may be subjected.

(a) Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this paragraph shall be construed to prevent the adoption or enforcement by any Contracting State of measures aimed at ensuring the equitable or efficient imposition of direct tax measures.

An obvious shortcoming in either of the latter two approaches is that they would potentially result in differing non-discrimination obligations under a tax treaty for the non-resident service supplier of the other Contracting State if no national treatment commitment has been made in a particular service sector. It also invites debate about whether a service provider falls within a particular service sector or is excluded from a sector under a trade agreement with the other Contracting State and therefore not entitled to the protection of the tax treaty non-discrimination article.

3. Further Refinements

Perhaps ironically, because Australia does not favour the inclusion of a non-discrimination obligation in its tax treaties, some further guidance for a non-discrimination obligation may be drawn from one of the few non-discrimination articles that Australia agreed to.⁶³⁷ The Article can be found in the tax treaty entered into with the United States in 1982 (Australia-U.S. Tax Treaty) and adds the following to the clauses typically found in the OECD Model Tax Treaty non-discrimination article:

ARTICLE 23
NON-DISCRIMINATION

....

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

- (a) in force on the date of signature of this Convention;
- (b) adopted after the date of signature of this Convention but which is substantially similar in general purpose or intent to a provision covered by sub-paragraph (a); or
- (c) reasonably designed to prevent the avoidance or evasion of taxes;

provided that, with respect to provisions covered by sub-paragraphs (b) or (c), such provisions (other than provisions in international agreements) do not discriminate between citizens or residents of the other Contracting State and those of any third State.

(3) Without limiting by implication the interpretation of this Article, it is hereby declared that, except to the extent expressly so provided, nothing in the Article prevents a Contracting State from distinguishing in its taxation laws between residents and non-residents solely on the ground of their residence.

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

This non-discrimination article is illustrative of a number of ways in which a tax treaty non-discrimination article can be modified and adapted to the requirements of the tax treaty partners.

Note what this non-discrimination article achieves.

⁶³⁷ Australia had a number of concerns about the potential impact of a non-discrimination obligation on its domestic law and practices.

First, both countries can continue to enforce all of their existing tax measures that were in effect at the time the treaty was signed, or that were adopted after that date but have a substantially similar purpose or intent as the pre treaty provision regardless of whether the provision discriminates against a treaty partner. This is the approach taken in trade agreements like the NAFTA and the ANNZFTA.

Second, the non-discrimination obligation does not apply to any provision of the taxation laws of a Contracting State reasonably designed to prevent the avoidance or evasion of taxes. This approach is also taken in the GATS.

Third, paragraph (c) of the non-discrimination article provides a form of most favoured nation treatment. Specifically, any subsequent tax measure enacted by either treaty partner must treat residents or citizens of the other State no less favourably than residents or citizens of a third State (except where the treatment of residents or citizens of third States is governed by an international agreement rather than by internal law).

Typical of tax treaties, this tax treaty does not provide protection against discrimination to the residents of a treaty partner. This is made clear in the language in paragraph 3. Obviously the wording in this provision would not be included in the proposed non-discrimination obligation, but rather an adaptation of it.

Paragraph 4 of Article 23 in the Australia-U.S. Tax Treaty is of particular interest. The provision provides for competent authority consultation where one of the Contracting States considers that the taxation measures of the other Contracting State infringe the principles set forth in the non-discrimination Article. As will be discussed later in this Chapter, one option if the complaint is with respect to a violation of the proposed non-discrimination obligation, is to similarly provide for and specifically limit recourse to the Mutual Agreement Procedure⁶³⁸ and expressly exclude a private taxpayer remedy under the domestic law of the source State.

⁶³⁸ Although this tax treaty does not state that this is the sole available remedy, the provision offers an excellent precedent to limit recourse only to the Mutual Agreement Procedure.

4. A Proposed Non-Discrimination Obligation

The following provides a proposed non-discrimination provision that adapts the current approach in the GATS agreement with what might appear in a proposed non-discrimination obligation in a tax treaty.

7.

(a) Notwithstanding paragraph 1, Nationals of a Contracting State who provide services in the other Contracting State in a sector in which an unqualified national treatment obligation has been made by that Contracting State under the GATS, but who are not in the same circumstances with respect to residence, shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals who provide services in that other State in the same circumstances, are or may be subjected.

(b) Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this paragraph shall be construed to prevent the adoption or enforcement by any Contracting State of measures aimed at ensuring the equitable or efficient imposition of direct tax measures.

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

- apply to nonresident service suppliers in recognition of the fact that tax obligation of nonresidents is determined with respect to taxable items sourced or located in the Member’s territory (for example, withholding taxes);
- apply to nonresidents in order to ensure the imposition or collection of taxes in the Member’s territory; or
- apply to nonresidents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member’s territory; or
- distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
- determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches or between related persons or branches of the same person, in order to safeguard the member’s tax base.

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

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

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

(iii) reasonably designed to prevent the avoidance or evasion of taxes;

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

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

C. What Remedy?

The choice of remedy, if any, for the non-resident service provider will be important. As it currently operates, if the circumstances as set out in a paragraph in the non-discrimination article are met, the discriminatory provision will not be applied. Instead, the domestic rules that apply to the States own nationals or residents will apply. This may not always be the correct outcome. It may be more appropriate for the outcome to be determined on a case-by-case basis by the competent authority. For example, assume the complaint is that the source State has imposed an excessive interim withholding tax. If the measure was found to be in violation of the proposed non-discrimination obligation, should the non-resident be treated like a resident and not subject to withholding tax at all, or should some other remedy be considered? This issue is discussed further under Dispute Resolution.

D. Dispute Resolution

1. The Mechanics

One of the primary arguments against the addition of a new non-discrimination obligation to the OECD Model Tax Treaty would no doubt be the issue of its interpretation and application. Non-resident taxpayers ordinarily have access to domestic courts for a determination of whether a violation of the non-discrimination has occurred. As a result, some would conjecture that key structural elements of their national tax system could be struck down by over zealous judges not well schooled in tax matters. This is a plausible concern. However, the resolution of issues relating to this proposed non-discrimination provision could be restricted to the Mutual Agreement Procedure and resolution by the competent authorities of the two Contracting States. This approach would also provide symmetry with trade obligations.⁶³⁹ Alternatively, the consent of the competent authority in the residence State could be required as a precondition to a taxpayer bringing a claim. Practically this would require that the tax administration in the State of residence of the

⁶³⁹ Service providers or recipients under the GATS can only request their national government to take action against another WTO Member government if they consider that they are being discriminated against contrary to the GATS; they may not take direct action on their own behalf in any dispute resolution process.

complaining non-resident service provider support the non-resident's claim against the other Contracting State.

The Model Mutual Agreement Procedure in Article 25 of the OECD Model Tax Treaty provides as follows:

<p>Article 25 MUTUAL AGREEMENT PROCEDURE</p>
<ol style="list-style-type: none">1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention. <p>The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives for the purpose of reaching an agreement in the sense of the preceding paragraphs.</p>

As will be outlined below, Article 25 as currently drafted, includes the machinery to effectively interpret and apply the proposed non-discrimination obligation.⁶⁴⁰

Article 25 of the OECD Model Tax Treaty (or 'the Convention') envisions consultation by the competent authorities to resolve by mutual agreement cases that are brought either under paragraph 1 by an individual who is taxed not in accordance with the Convention (individual complaints) or general problems relating to the interpretation or application of the Convention raised under paragraph 3. The procedures under either or both paragraphs could effectively serve to support the proposed non-discrimination obligation with some minor suggested adjustments. For example, the ability of a taxpayer to pursue a claim under the domestic law of the source State could be limited under the non-discrimination article to the Mutual Agreement if the contravention complained of is with respect to the proposed non-discrimination obligation. The consultation process in paragraph 2 could be instituted to

⁶⁴⁰ See generally, Zvi Daniel Altman, *Dispute Resolution Under Tax Treaties*, (IBFD, 2005).

address general issues with respect to the interpretation and application of the proposed non-discrimination obligation. Both procedures for consultations under the Mutual Agreement Procedure are discussed in more detail below.

Individual Complaints

Individual complaints are addressed in paragraphs 1 and 2 of Article 25 of the OECD Model Tax Treaty. These paragraphs provide that the competent authorities “shall Endeavour by mutual agreement to resolve the situation of taxpayers subjected to taxation not in accordance with the provisions of the Convention.” The procedure is set in place by the taxpayer who presents their objection to the competent authority in their State of residence.

Although the Mutual Agreement Procedure is generally pursued by a taxpayer because there has been double taxation, as a result of, for example, a transfer pricing dispute, that is not always the case. The OECD Commentary is clear that the Mutual Agreement Procedure is also applicable in the absence of any double taxation contrary to the Convention, provided the taxation in dispute is in direct contravention of a rule in the Convention.⁶⁴¹ For example, a taxpayer who is a national of one Contracting State but a resident of the other State may be subject in that other State to taxation treatment which is “other or more burdensome” than the tax treatment of nationals of that State, contrary to the non-discrimination obligation in paragraph 1 of Article 24.

The Commentary also anticipates that the Mutual Agreement Procedure can be set in motion by a taxpayer without waiting until the taxation considered by him to be “not in accordance with the Convention” has been charged against or notified to him.⁶⁴² To proceed, the taxpayer must, however, establish that it is probable that the actions of the Contracting State will result in taxation in contrary to the Convention, not that it is merely a possible risk. Actions are described in the widest possible terms in the Commentary to “mean all acts or decisions, whether of a legislative or a regulatory nature, and whether of general or individual application, having as their direct and necessary consequence the charging of tax against the complainant contrary to the provisions of the Convention.”⁶⁴³

⁶⁴¹ Para 13 of the 2010 OECD Model Commentary.

⁶⁴² Para 14.

⁶⁴³ *Ibid.*

Although the Commentary anticipates that resolution of a taxpayer initiated mutual agreement request may occur in the State of residence, this is unlikely with respect to this non-discrimination obligation, as the complaint will be with respect to a tax measure imposed by the other Contracting State. This means that the procedure will enter a second stage where the competent authority of the other Contracting State is approached by the competent authority to which the taxpayer applied. The result is that the procedure moves to the level of dealings between the two States. The important point is that it will not reach that stage without the support of the competent authority in the complaining taxpayer's State of residence.

The operation of the Mutual Agreement Procedure in paragraphs 1 and 2 is based on the principle that tax has been levied on a taxpayer in contravention of the Convention. It follows that without a non-discrimination obligation in the tax treaty that no contravention could occur.

Difficulties of Interpretation and Application

In addition to taxpayer initiated consultations, the Mutual Agreement Procedure envisions consultations with respect to difficulties of interpretation or application. These are described as essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers.

According to the Commentary this provision makes it possible to resolve difficulties arising from the application of the Convention.⁶⁴⁴ Two sets of circumstances are provided. First difficulties of a practical nature, "which might arise in connection with the setting up and operation of procedures for the relief from tax deducted from dividends, interest and royalties in the Contracting State in which they arise." Second, issues "which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators."

A number of examples⁶⁴⁵ are provided in the Commentary which indicates that the resolution of complex issues is anticipated under this provision, including the determination of when,

⁶⁴⁴ *Ibid* para 50.

⁶⁴⁵ *Ibid* para 52 provides as follows: Under this provision the competent authorities can, in particular:

for example, dividends should be considered interest under the thin capitalization rules. The important point is that the consultation process under the Mutual Agreement Procedure can simply be between the two Contracting States, absent taxpayer involvement, and general issues about whether a tax measure is in violation of non-discrimination obligations under the treaty can be discussed and resolved.

Other Administrative Matters

The Mutual Agreement Procedure sets out rules for the process of consultation and provides a detailed mechanism for binding arbitration. The consultation process may include a joint commission. The arbitration process may or may not be a process the Contracting States decide to agree to.⁶⁴⁶ The Contracting States might also agree that binding arbitration would only apply to very specific fact based types of complaints. Unresolved issues might also be referred to the OECD Advisory Board.

2. Effect of Restricting Dispute Resolution Options

Some might query whether introducing a non-discrimination obligation and then restricting dispute resolution with respect to its contravention to the Mutual Agreement Procedure would result in any real change to the current position of a non-resident service provider under a tax treaty. In my view, and as pointed in Chapter 11, the answer is yes. First, the introduction of a non-discrimination obligation introduces a minimum expected standard of treatment in the tax treatment of non-resident service providers. Second, a commitment by a Contracting State to the non-discrimination obligation would encourage the competent authority of that State to closely examine complaints against its own revenue collection arm to ensure that in administering tax measures a minimum standard is met. Third, the

-
- where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty;
 - where the laws of a State have been changed without impairing the balance or stance of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes;
 - determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).

⁶⁴⁶ As drafted, Article 25 paragraph 5 only provides for arbitration of unresolved issues arising from a request made under paragraph 1 of the Article. States wishing to extend the scope of the paragraph to also cover mutual agreement cases arising under paragraph 3 of the Article are free to do so.

introduction of a non-discrimination obligation invites a closer examination of national tax measures against an internationally accepted standard.

If the competent authorities of both Contracting States concur that the complained of tax measure is not in violation of the non-discrimination provision of the tax treaty the matter will end. In case of disagreement, Contracting States could consider the option of binding arbitration under the proposed OECD Mutual Agreement procedure.⁶⁴⁷

E. Proposed Commentary to Article 24

The OECD commentary on how to interpret and apply the proposed tax treaty non-discrimination obligation could draw on guidelines set out in WTO decisions.

The following offers a modest preliminary attempt at this task to serve as an example of how the guidelines developed for trade law purposes could be adapted and applied in a tax treaty context.⁶⁴⁸

1. Paragraph 1 of Article 24 requires equal treatment of nationals in the same circumstances, in particular with respect to residence. This paragraph implicitly recognizes that differentiating in taxation laws between residents and non-residents does not of itself constitute discrimination contrary to any non-discrimination obligation. However it is expected that source countries employ domestic tax measures that result in difference in the tax treatment of a non-resident in good faith and pursuant to legitimate tax policy objectives. In the ordinary case any differences in tax treatment should be based on the fact that residents are taxable on their worldwide income whereas nonresidents in general are taxable only on income from sources within the source state or problems inherent in ensuring administration and compliance with source country taxation rules. Treaty partners may also want to add to this list to include for example, special exceptions for research and development, subsidies for local industries or other targeted measures.

Examples of measures that exceed the good faith requirement above are:

⁶⁴⁷ It is proposed that a new paragraph 5 be added to Article 25 (Mutual Agreement Procedure) of the OECD Model. It would provide for mandatory arbitration of issues arising from cases that the States are unable to resolve within 24 months. The possibility of binding arbitration is also a reason to adopt an internationally recognized standard like “fair and equitable treatment,” which is familiar in arbitration proceedings.

⁶⁴⁸ Regrettably there is only one decision to date under the GATS, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting*, (2005), WT/DS285/AB/R (Appellate Body Report), online: WTO <<http://docsonline.wto.org>> [*US-Gambling*]. This decision is not particularly helpful in this context except in one important facet. It establishes the relevance of jurisprudence under Article XX of the GATT 1994. The Appellate Body in *US-Gambling* considered the similarities between Article XX of the GATT 1994 and Article XIV of the GATS and stated that the article sets out general exceptions under the GATS (services) much in the same way as Article XX of the GATT 1994 does under the GATT (goods). The Appellate Body therefore found previous decisions under Article XX of the GATT 1994 relevant for the analysis under Article XIV.

(a) Domestic legislation that operates as a disguised restriction on trade in services. For example, the host country may impose an excessive and arbitrary gross withholding tax.

(b) Domestic legislation that is administered in a manner that is a disguised restriction on trade. For example, the requirements of the source country to obtain a refund of withholding tax on amounts that are exempt under the tax treaty may be arbitrary or unduly onerous.

(c) A domestic measure that is a disguised tax measure in the form of a penalty, fee or charge. For example, there may be arbitrary additional fees associated with non-resident filings or claims for refunds.

(d) The domestic measure is in respect of indirect taxes.⁶⁴⁹ For example, a higher indirect taxes such as a sales taxes, excise taxes, value added tax, tariff or other similar charge is imposed on a non-resident service provider or imposed on a different basis.

The prohibited use of such measures is addressed under paragraph 1(a). It requires that the source state claiming the right to impose different tax measures on a non-resident must establish that the measure falls within the exception in paragraph 1(a).

2. Paragraph 1(a), while acknowledging that differences in tax treatment between a resident and a non-resident may be justified under the broad policy objectives of a national tax system, also acknowledges that not all such measures can be so justified. Differences in tax treatment based on the list enumerated, including the imposition of withholding taxes, will prima facie be exempted from the non-discrimination obligation in paragraph 1(a). However any excepted measure is subject to the requirement that the measure is not arbitrary, unjustifiable or a disguised restriction on trade [in services].

Two-tier analysis

This will require a two-tier analysis. The first step is to determine if the measure falls within the exception – that is to determine whether the measure is aimed at ensuring the effective imposition or collection of direct taxes. There must be a sufficient nexus between the measure and the interest protected. If the challenged measure falls within the exception, the competent authority should then consider whether that measure satisfies the requirements for the exception- that is whether the measure is arbitrary and unjustifiable or a disguised restriction on trade in services.⁶⁵⁰

The Requirement of Good Faith

The requirement that the measure not be arbitrary, unjustifiable or a disguised restriction on trade in services...” is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state’s rights and enjoins that whenever the assertion of a right ‘impinges on the field covered by [a] treaty obligation, it must be exercised *bona fide*, that is to say, reasonably.’ An abusive exercise by a Member of its own treaty right thus results in a breach of the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting.⁶⁵¹

The Burden of Proof

⁶⁴⁹ Indirect taxes may present additional challenges under a tax treaty. Such taxes remain subject to the national treatment obligation under the GATS and under some free trade agreements.

⁶⁵⁰ Adapted from *Brazil - Measures Affecting Imports of Retreaded Tyres* (2007), WT/DS332/AB/R (Appellate Body Report), online: WTO <<http://docsonline.wto.org>>.

⁶⁵¹ *Ibid.*

If a complaint is made by a Contracting State

The Contracting State against whom a complaint is made must submit a prima facie case showing that the measure is justified. The other Contracting State must rebut that prima facie case, if established.⁶⁵²

“... the fact that a party invokes (the exception) does not mean that it does not need to supply the evidence necessary to support its allegation. Similarly, it does not release the complaining party from having to supply sufficient arguments and evidence in response to the claims of the defending party. Moreover, we are of the opinion that it is not for the party invoking (the exception) to prove that the arguments put forward in rebuttal by the complaining party are incorrect until the latter has backed them up with sufficient evidence.”

F. Limitations of the Proposed Non-Discrimination Obligation

The purpose of this chapter is to illustrate the chasm between tax and trade law non-discrimination obligations as they apply to a non-resident service provider and to propose a form of non-discrimination obligation that might operate within the current tax treaty structure.

The result is at best a modest start. Some of the more significant limitations of the non-discrimination obligation as proposed include the following:

- As drafted, it does not provide a minimum, objective, absolute or non-contingent standard of prohibited behaviour.
- It may not eliminate all of ambiguities that currently exist under the GATS about whether a measure falls under the GATS and it may introduce some of the ambiguities with respect to the interpretation and application of the exception that currently exist under the GATS.
- It creates a second-class non-discrimination obligation and may not significantly advance the case of the non-resident service provider if the competent authorities cannot come to agreement and there is no binding arbitration clause.⁶⁵³

⁶⁵² Adapted from *European Communities - Measures Affecting Asbestos and Asbestos-Containing Products* (2000), WT/DS135/R (Panel Report), online: WTO <<http://docsonline.wto.org>>.

⁶⁵³ Binding arbitration might be considered. The use of arbitrators can adjust for gaps in domestic experience and can be a learning process. The bargain achieved by limiting sovereignty in this way has benefits to a country.

- The proposed non-discrimination obligation does not directly address the use of tax measures (high withholding taxes) for reasons other than ensuring direct compliance by a non-resident. This is the issue raised by the U.S. FACTA regime. Should the non-discrimination obligation in the tax treaty also be framed to preclude a country from using its domestic laws to coerce behaviour by non-residents who are not otherwise liable to source country taxation or who are liable for lesser amounts under a tax treaty? The FACTA example is cited without a position on whether the regime itself can be justified based on the broad objective of collecting information and ultimately tax revenue. The issue is should there be tax treaty non-discrimination obligation to prevent the use of domestic tax provisions for a purpose other than the collection of taxes owed by the parties directly involved in a transaction? This would require a more targeted non-discrimination obligation.

- The proposed non-discrimination obligation does not directly address potential developing country concerns. Among the issues that may lead to complaints of discriminatory tax practices are how income from services is characterized and how withholding tax is imposed. Both of these matters are prominent in developing country tax systems. The characterization of income from royalties or as recently proposed under the UN Model Tax Treaty as technical service fees, results in the imposition of gross withholding tax that may produce an important source of revenue for the host country. The imposition of gross withholding tax may also serve as an efficient way to collect non-resident tax. Developing countries would not want these aspects of their national tax systems challenged, nor should they be.

G. A More Modest Proposal

The challenge of matching trade law non-discrimination obligations with tax treaty non-discrimination obligations is considerable. Although few would challenge the importance of tax sovereignty it is difficult to support the notion that non-residents should remain ‘fair game’ for source country tax authorities. As discussed, one option is to introduce a non-discrimination obligation into tax treaties to establish a minimum standard of treatment by a source State of a non-resident service provider. If such a commitment to a non-discrimination obligation in respect of non-resident service providers is not a bargain a Contracting State wishes to engage in, perhaps a more nuanced approach might be considered.

For example, the Mutual Agreement Procedure set out in Article 25 of the OECD Model Tax Treaty could be expanded to permit a resident of a Contracting State to seek recourse from his or her government in respect of tax treatment that is potentially discriminatory. The competent authority of each Contracting States could then consult to resolve the issue. This would formalize the idea that discriminatory tax practices are not part of the anticipated tax treatment between tax treaty partners, but not impose an obligation on the other Contracting State other than to consult in good faith. It recognizes that bilateral tax treaties rely exclusively on inter-governmental consultation and negotiation to settle intergovernmental disputes.⁶⁵⁴

Such a provision might appear in Article 25 as follows:

1. Where a resident of a Contracting State considers that the tax measures imposed by the other *Contracting State are arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade* in services, the resident may address to the competent authority of the Contracting State of which he is a resident an application in writing stating the grounds for the claim and a request that there be consultation with the other Contracting State with a view to a resolution.
2. The competent authority shall endeavour, if the claim appears to it to be justified and to resolve the case by mutual agreement with the competent authority of the other Contracting State.

What benefit if any does this proposal offer? The primary benefit is that it requires that the competent authority of a Contracting State closely examine complaints against its revenue collection arm to ensure that tax measures are not administered in a manner that would

⁶⁵⁴ See R. A. Green, “Antilegalistic Approaches to resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes” (1998) 23 Yale J Int’l L. 79 at 79.

generate international ill will. It is also a process that may be much easier to get governments to agree to. “It is flexible, informal and provides the necessary non-controversial atmosphere needed for resolving economic disagreements between sovereign states”.⁶⁵⁵ Of course the many deficiencies of the current Mutual Agreement Procedure should not go unnoted. Typically cited deficiencies are the lack of a formal role for taxpayer participation, the lack of an obligation to reach an understanding, the lack of transparency and that there is no time line for dispute resolution.

A developing commentary could provide examples of practices that might be views as discriminatory. This would include both regulatory measures and administrative conduct. The rationale for the commentary would be that although some differences in tax treatment may have a legitimate underpinning, the presence of elements such as, for example, selective enforcement may suggest discriminatory tax treatment. The commentary would acknowledge the difficult task of distinguishing legitimate taxation from the abusive exercise of tax powers and provide a system of “red flags” which might suggest a breach of the non-discrimination obligation. These “red flags” would be tied to generally recognized principles of taxation and accepted good-governance practices. It follows that arbitrariness, conspicuous deviation from international taxation practices or an identifiable intention to discriminate against a non-resident service provider for the benefit a domestic service provider would lead to a presumption that the non-discrimination obligation had not been met.⁶⁵⁶

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

⁶⁵⁵ Dr Zvi Daniel Altman, *supra* note 640.

⁶⁵⁶ See Thomas Walde, “National Tax Measures Affecting Foreign Investors Under The Discipline of International Investment Treaties” in *The Sovereign Power to Tax: 102 Proceedings of the Annual Meeting-American Society of International Law* 51, 2008 at 59. Walde discusses tax issues in the context of investment treaties.

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

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

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

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

H. Conclusions

The proposals in this chapter are intended as a starting point for criticism or consensus building. As seen there is no easy truce between tax and trade law non-discrimination obligations and the attempt to build a bridge between the two produces some very inelegant results.

Chapter 13: Conclusions

This study examines the current non-discrimination obligations in tax and trade agreements as they impact a non-resident service provider. The study was motivated by the significant commitments made in trade agreements in recent years to liberalize the cross border trade in services. These commitments include an undertaking by signatory governments around the globe to provide national treatment, most favoured nation treatment as well as a host of other commitments to such matters as transparency in legislation and administration. The one major area in which these trade commitments were not made was with respect to tax measures. Tax measures were largely excluded from trade agreements in favour of tax treaties.

A. Introduction and Some Observations

In the study the following three general questions were posed.

4. What non-discrimination obligations apply to a non-resident service provider under tax and trade agreements?
5. Do the current non-discrimination obligations in tax and trade agreements adequately address the potential for the discriminatory use of tax measures in the cross border trade in services?
6. Should the OECD and the UN make changes to the non-discrimination obligations in the OECD and UN Model Tax Treaties to respond to the growing global trade in services? If so, what changes?

B. What Non-Discrimination Obligations Apply to a Non-Resident Service Provider Under Tax and Trade Agreements?

The following observations are made in response to question one.

1. The non-discrimination obligations that apply to non-resident services and services providers in areas other than taxation differ widely from those that apply to tax measures and in many cases there is no non-discrimination obligation with respect to tax measures that are imposed by the State in which income from services is derived. This can be to the detriment of the non-resident.
2. In a multilateral agreement like the GATS, some tax measures are subject to trade obligations. Specifically a non-resident service provider must be accorded both national treatment and most favoured treatment with respect to indirect tax measures. Direct tax measures are initially subject to a carve out from both the national treatment and most favoured nation obligations under the agreement but remain subject to more limited trade discipline under the GATS chapeau requirement; specifically that the measure may not be arbitrary, unjustifiable or a disguised restriction on trade in services. The ability to challenge whether a measure falls within the GATS exception from the national treatment obligation is circumvented if the matter falls within the scope of a tax treaty. Who determines whether a measure falls within the scope of a tax treaty may vary depending on when the tax treaty was entered into. Because tax treaties are negotiated bilaterally, the ability to determine whether the matter falls within the scope of a tax treaty may also be limited by the tax treaty. If the matter falls within the scope of a tax treaty there is no non-discrimination obligation in respect of a non-resident. If there is no tax treaty between the Member States the non-resident may rely on the GATS chapeau requirement. As a result, under the GATS structure there are different non-discrimination standards of protection for a non-resident with respect to the tax measures that may be imposed by another Member State.

3. The matter of determining what non-discrimination obligation if any applies to a tax measure that impacts a non-resident service provider can be equally complex if the non-resident is from a Party to a regional trade agreement like the NAFTA. The NAFTA agreement generally excludes all tax measures from the NAFTA non-discrimination obligations but then selectively brings some under trade law discipline. Included taxes are indirect taxes. Excluded taxes are generally direct taxes. The agreement also explicitly provides that nothing under the trade agreement “shall affect the rights and obligations of any Party under any tax convention.” This may negate any non-discrimination obligations under the trade agreement if there is no non-discrimination obligation in the tax treaty. For example, the NAFTA includes a national treatment obligation with respect to all tax measures on income and capital that relate to the purchase and consumption of services. There is no equivalent non-discrimination obligation under any of the tax treaties in the NAFTA Block. Instead there is a more limited obligation with respect to the deductibility of certain disbursements paid to a non-resident.⁶⁵⁷

Trade law protections for indirect taxes may also be negated by the tax treaties in the NAFTA Block. Although indirect taxes are subject to trade law obligations under the NAFTA they are also referenced in the non-discrimination article in all three of the tax treaties in the NAFTA region. However the tax treaties do not include a non-discrimination obligation that would apply to a non-resident with respect to indirect taxes. Because the NAFTA expressly provides that the NAFTA agreement shall not affect the rights and obligations under a tax treaty, it follows that the lack of a non-discrimination respect to indirect taxes in the tax treaty would be sufficient to argue that no non-discrimination obligation exists. These observations are made with respect to the NAFTA. Similar observations can be made about the treatment of tax measures under other regional trade agreements like the AANZTA and the interface between the signatories to such agreements with the bilateral tax treaties that affect them.

The fact that tax measures are not subject to the national treatment and most favoured national obligations found in trade agreements has additional implications in a small regional free trade zone. In particular, the exception from the most favoured nation

⁶⁵⁷ See OECD Model Tax Treaty Article 24(4) and discussion at Chapter 2.B.

obligation can put the service provider of one free trade partner at a distinct disadvantage compared to the a service provider from another free trade partner. Because tax treaties are negotiated bilaterally such issues could be bilaterally addressed or addressed in a regional multilateral tax treaty.

4. Bilateral Free Trade Agreements present their own set of issues and interpretation problems and result in widely varying non-discrimination obligations. For example, Canada's free trade agreements with Columbia and Panama address the issue of which agreement prevails if a similar provision with respect to a taxation measure exists under the free trade agreement and under a tax convention ("tax treaty").⁶⁵⁸ In these circumstances, the free trade agreements make clear that the procedural provisions of the tax convention alone shall be used by the competent authorities identified in the tax convention to resolve any issue related to the provision that arises under the trade agreement.⁶⁵⁹ This provides the competent authority under a tax treaty with the authority to restrict the applicable non-discrimination obligation to the non-discrimination obligations under the tax treaty. It may also resolve the dispute resolution issue that was discussed above if there are similar provisions under a tax treaty and the NAFTA.

A different interpretive problem occurs under the free trade agreements entered into by Australia. These also provide in general, that "nothing in the free trade agreement shall affect the rights and obligations of either Party under any tax convention, and that in the event of any inconsistency relating to a taxation measure between the Agreement and any tax convention, the latter shall prevail to the extent of the inconsistency". Australia rarely includes a non-discrimination article in its tax

⁶⁵⁸ See Chapter 4. Such an overlap could occur, for example, in respect of the non-discrimination obligation found in the OECD and UN Model Tax Treaties as it applies to the deduction of amounts in determining taxable profits with the trade obligation with respect to tax measures affecting the purchase or consumption of services. Both Model Tax Treaties provide that "disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Both free trade agreements include a non-discrimination obligation that would fall within this general wording. Specifically, Article 2204(5) (a) of the Canada Columbia Treaty imposes the national treatment obligation in respect of services for "taxation measures on income, capital gains, or on the taxable capital of corporations that relate to the purchase or consumption of particular services."

⁶⁵⁹ There is no non-discrimination obligation in the Canada-Columbia Tax Treaty similar to that found in the OECD and UN Model Treaty.

treaties⁶⁶⁰ and did not include a non-discrimination article in the majority of its tax treaties with the Parties with whom it currently has a free trade agreement.⁶⁶¹ Does this mean that based on the language in the trade agreement that no non-discrimination obligation will apply with respect to direct tax measures under Australia's free agreements?⁶⁶² The imposition of a non-discrimination obligation with respect to any tax or tax measure that falls under a tax treaty is clearly inconsistent with the rights and obligations assumed by each of the free trade partners under the tax treaty. If this view is correct, the existence of a tax treaty that does not include a non-discrimination article would operate to negate any non-discrimination obligation⁶⁶³ under the free trade agreement. If this conclusion is correct then with the possible exception of Singapore, no non-discrimination obligation currently applies to any tax measure under the majority of Australia's free trade agreements as the result of the interaction of these bilateral tax and trade agreements.⁶⁶³

5. Non-discrimination obligations in tax matters splinter again when one looks at the operation of integrated trade agreements. Service providers from an EU Member State that is a signatory to the GATS are subject to different non-discrimination obligations with respect to tax measures when operating in another TFEU Member State that is a signatory to the GATS than, for example a service provider from a NAFTA Party that is a signatory to the GATS. A service provider from a TFEU Member State may rely on the four freedoms to determine the applicable non-discrimination obligation. The service provider from a NAFTA Party may not. The result is that the non-

⁶⁶⁰ Until 2008 Australia reserved its position on Article 24 in para. 85 of the Commentary on Article 24 of the OECD Model. This reservation was replaced in 2008 as follows: Australia reserves the right to propose amendments to ensure that Australia can continue to apply certain provisions of its domestic law relating to deductions for R & D and withholding tax collection.” Para 86 OECD Model Commentary on Article 24.

⁶⁶¹ The exceptions are the tax treaties with the United States and Chile. A non-discrimination obligation is also included in the *Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, 31 January 2008, [2008] ATS 21 (entered into force 3 December 2008). See the Explanatory Memorandum of Article 26 of the Australia-Japan Tax Treaty, Chapter 1 2008 Australia-Japan Convention, International Tax Agreements Amendment Bill (No. 1) 2008 <http://law.ato.gov.au/atolaw/view.htm?locid='PAC/20080102'&PiT=99991231235958> circulated by the authority of the Treasurer, the Hon Wayne Swan MP, online: <<http://law.ato.gov.au/atolaw/view.htm?DocID=NEM%2FEM200827%2FNAT%2FATO%2F00003>>.

⁶⁶² A potential exception is an indirect obligation that results from the non-discrimination clause in the tax treaties with the United States and Chile as it applies to the deductibility of amounts paid to a non-resident.

⁶⁶³ There is a non-discrimination Article in Australia's the tax treaty with Japan. See Article 26. A Free Trade Agreement with Japan has been signed but at the time if this writing is not in force.

discrimination obligations if any, that apply to a service provider from a country that is a GATS Member when providing services in another GATS Member State, may vary widely if there is an additional integrated trade agreement like the TFEU with that GATS Member State. The non-discrimination obligations affecting service providers from an EU Member State may also vary depending on the terms of the tax treaty between the EU Member States.

6. The non-discrimination obligations that apply to a service provider from a Country that is a signatory to the GATS and other regional or bilateral free trade agreements may be affected by conflicting obligations under these latter agreements. A preliminary assessment is that access to the GATS is not restricted by other free trade agreements. Service providers from Member States that are signatories to the GATS may rely on the obligations in the GATS. It is therefore not inappropriate to assume that the GATS standard is the minimum standard that would apply to a service provider from a Member State.

All of the trade agreements under review give primacy to tax treaties or agreements in determining what non-discrimination obligations, if any, apply to a non-resident service provider. In general, there is no applicable non-discrimination obligation under a tax treaty that would apply to a non-resident absent a permanent establishment in the other Contracting State. Does this matter? That is the subject of question two.

C. Do the Current Non-Discrimination Obligations in Tax and Trade Agreements Adequately Address the Potential for the Discriminatory Use of Tax Measures in the Cross Border Trade in Services.

Part III examined potential differences in tax treatment that could be viewed as discriminatory in three different contexts.

The first was under a tax treaty. Tax treaties are grounded in the allocation of taxing rights between the source States. The tax treatment of income from services by the source state will depend both on the approach adapted under the tax treaty and how the tax treaty is interpreted

and applied. As a starting point three basic approaches to the taxation of what is described as enterprise services have been identified.⁶⁶⁴

OECD approach - where services income is treated in the same way as any other business income, so that no source taxation results if the service provider does not maintain a permanent establishment (PE) in the jurisdiction to which the services income is attributed.

UN approach (and the similar, but not identical, approach in the OECD's "alternative provision" regarding services) - where article 5 includes a special deemed service PE provision, essentially based on time spent performing the service in the jurisdiction; and the royalty approach - where income from certain services (typically technical services) is treated in a similar way to royalties under the UN Model; that is the income is subject to withholding tax.

Variations and exceptions - tax treaty partners have also added their own variations and exceptions. The approach adopted by a particular country to the taxation of income from services has broad implications with respect to where the income is sourced, what constitutes sufficient nexus for source country taxation, whether the income should be taxed on a net or gross basis and whether the income should be subject to interim or final gross withholding tax.

The approach to the taxation of services adopted by a source State also means that there may be differences in treatment with respect to how income from services is characterized under a tax treaty as compared to services provided by a national service provider. There may also be differences in tax treatment depending on how revenue authorities in the source State administer and apply the treaty.

The second context involved a detailed look at how domestic law is applied to a non-resident service provide, using as the primary examples, Canada and the Mercosur Member Countries. This examination provided clear evidence of the potentially negative impact of tax practices in these countries on a non-resident service provider.

⁶⁶⁴ IFA, 2012 Congress Boston, "Enterprise Services" 66th Boston Congress 2012, Cahiers de droit fiscal international, v.97a.

The third context in which the use of tax measures as employed by a source State was examined was in the context of the FACTA introduced by the United States. Although some argue that one result of the FACTA is increased transparency, there can be little doubt that the U.S. decision to impose punitive withholding taxes on a non-compliant non-resident service provider would have a very negative impact on the service provider.

Part III concluded with the observation that non-residents should not be fair game for host country tax authorities and that non-resident service providers were particularly vulnerable to tax practices that were potentially harmful to their competitive position in foreign markets.

D. Should the OECD and the UN make Changes to the Non-Discrimination Obligations in the OECD and UN Model Tax Treaties to Respond to the Growing Global Trade in Services? If so, what Changes?

The third question posed in the study is answered in Part IV which began by posing another broader question - can a non-discrimination principle be found?

In Chapter 11 a number of approaches to finding an appropriate non-discrimination principle that would fit within current tax treaty structure are discussed and the following observations were made.

Tax treaties are based on a number of underlying principles that must be taken into account when considering a non-discrimination obligation. First and foremost is the notion of the Sovereignty of the Contracting State. There are however, at least four other key principles that must be taken into consideration.

The first is that tax treaties are fundamentally bilateral in nature and based on reciprocal obligations assumed by the two Contracting States. That does not mean that tax treaties cannot be multilateral, but it does mean that it would not be appropriate to impose a most favoured nation obligation under a bilateral treaty.

Second, the current tax treaty framework is consensus based. This includes the common consensus on the allocation of taxing rights between Contracting States and the ability of Contracting States to freely exercise the taxing rights allocated to them.

Third, any restrictions on the freedom to exercise allocated taxing rights has also been reached by consensus in the non-discrimination provisions in the tax treaty. The non-discrimination concept as drafted in the tax treaty originates from a general principle of equality. The current restrictions in the non-discrimination article in the tax treaty address specific concerns raised by delegates or the Working Parties.

Fourth, although the purpose of tax treaties in general is to prevent double taxation, the objective of tax treaties is to ensure greater cross border neutrality. Such neutrality promotes the most efficient allocation of resources and thereby maximizes global welfare. Tax treaties promote capital import neutrality by promoting neutrality in the source State in proscribed circumstances.

Finally, tax treaties operate on the principle that treaty provisions should not require States to achieve greater harmonization of their tax systems.

These principles are considered in juxtaposition with the question: Should a non-resident service provider be fair game to source country tax authorities under free trade regimes that otherwise provide protection from discriminatory practices?

E. Proposed Solutions

The ideal solution would be to find a non-discrimination obligation that would address the use of discriminatory tax practices by a source State in the tax treatment of a non-resident. The proposed solution is to include a new non-discrimination obligation in the tax treaty but to use a trade law standard and the interpretive tools developed in a trade law context to apply it. These tools would be applied exclusively by the competent authorities of the Contracting States through the Mutual Agreement Procedure. There would be no right of private access to domestic courts in the source State with respect to an alleged violation of the proposed non-discrimination obligation.

An alternative solution is to proceed without adding a non-discrimination obligation to the tax treaty and to instead include a dedicated process under the Mutual Agreement procedure under which the competent authorities would consult with a view to resolving complaints about potentially discriminatory tax practices.

A third suggested option is to make some very specific changes to the current provisions in the Model Tax treaties to reduce the opportunity for discriminatory behaviour by source country revenue authorities. For example, a cap could be added to the withholding tax rate for independent personal services. The indirect non-discrimination obligation in Article 24(4) with respect to the deductibility of expenses could also be expanded to include tax credits.

Additional guidance could also be added to the tax treaty commentary to address such issues as how and when gross withholding taxes should be imposed, the importance of transparency in administrative formalities and appropriate refund procedures. It would also be useful to add commentary that addresses treaty good country practice with respect to granting a tax treaty exemption.

Whatever option is chosen, if the 2014 OECD proposal to develop a multilateral instrument⁶⁶⁵ to modify bilateral tax treaties is implemented, the changes to the content of negotiated tax treaties could be swift.

⁶⁶⁵ On 16 September 2014, the Organization for Economic Co-operation and Development (OECD) released a report titled *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*. The report examines the feasibility of developing a multilateral instrument to modify tax treaties. The report was issued in connection with Action 15 of the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS).

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Appendix A: SUMMARY OF CANADA’S FREE TRADE AGREEMENTS

The table below summarizes the most salient features of the bilateral free trade agreements entered into by Canada that address the issue of taxation measures that may impact cross-border service providers. These are largely patterned on the provisions in the NAFTA.

NAFTA	Canada - Chile	Canada – Costa Rica	Canada – Peru	Canada – Colombia	Canada – Panama
<p>Article 2103</p> <p>1. Except as set out in this Article, nothing in this Agreement shall apply to taxation measures.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of inconsistency.</p> <p>...</p>	<p>Article O-03</p> <p>1. Except as set out in this Article and in Annex O-03.1, nothing in this Agreement shall apply to taxation measures.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.</p> <p>...</p> <p>If an issue arises as to whether a tax convention prevails over this Agreement, the issue shall be referred to the competent authorities of the Parties. The competent authorities shall consider the issue and decide whether the tax convention prevails. If within six months of the referral of the issue to the competent authorities, they decide with respect to the measure that gives rise to the issue that the tax convention prevails, no procedures</p>	<p>Article XIV.3</p> <p>1. Except as set out in this Article and in Annex XIV.3.1, nothing in this Agreement shall apply to taxation measures.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.</p>	<p>Article 2203</p> <p>1. Except where express reference is made thereto, nothing in this Agreement shall apply to taxation measures.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, the convention shall prevail to the extent of the inconsistency.</p> <p>3. Where similar provisions with respect to a taxation measure exist under this Agreement and under a tax convention, the procedural provisions of the tax convention alone shall be used, by the competent authorities identified in the tax convention, to resolve any issue related to such provisions arising under this Agreement.</p> <p>...</p>	<p>Article 2204</p> <p>1. Except as set out in this Article and paragraph 2 of Annex 1101.5, nothing in this Agreement shall apply to taxation measures.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.</p> <p>3. Where similar provisions with respect to a taxation measure exist under this Agreement and under a tax convention, the procedural provisions of the tax convention alone shall be used, by the competent authorities identified in the tax convention, to resolve any issue related to such provisions arising under this Agreement.</p> <p>...</p>	<p>Article 23.04</p> <p>1. Except as set out in this Article, this Agreement does not apply to a taxation measure.</p> <p>2. This Agreement does not affect the rights and obligations of a Party under a tax convention. In the event of inconsistency between this Agreement and a tax convention, that convention prevails.</p> <p>3. Where a provision with respect to a taxation measure under this Agreement is similar to a provision under a tax convention, the competent authorities identified in the tax convention shall use the procedural provisions of that tax convention to resolve an issue that may arise under this Agreement.</p> <p>...</p>

<p>4. Subject to paragraph 2: (a) Article 1202 (Cross-Border Trade in Services - NT) and Article 1405 (Financial Services - NT) shall apply to taxation measures on income, capital gains or the taxable capital of corporations, and to those taxes listed in paragraph 1 of Annex 2103.4, that relate to the purchase or consumption of particular services, and (b) Articles 1102 and 1103 (Investment - NT and MFN Treatment), Articles 1202 and 1203 (Cross-Border Trade in Services - NT and MFN Treatment) and Articles 1405 and 1406 (Financial Services - NT and MFN Treatment) shall apply to all taxation measures other than those on income ...and those taxes listed in paragraph 1 of Annex 2103.4, except that nothing in those Articles shall apply (c) MFN obligation with respect to an advantage accorded by a Party pursuant to a tax convention, (d) to a non-conforming provision of any existing taxation measure, (e) to the continuation or prompt renewal of a non-conforming provision of any existing taxation measure, (f) to an amendment to a non-conforming provision of any existing taxation measure to the extent that the amendment does not decrease its conformity, at the time of the amendment, with any of those Articles, (g) to any new taxation measure</p>	<p>concerning that measure may be initiated under Article N-08 (Institutional Arrangements and Dispute Settlement Procedures – Request for an Arbitral Panel) and no claim concerning that measure may be submitted under Article G-21 (Investment – Submission of a Claim to Arbitration). No procedures or claim concerning the measure may be initiated during the period that the issue is under consideration by the competent authorities.</p> <p>4. Subject to paragraph 2: (a) Article H-02 (Cross-Border Trade in Services - NT) and Article H bis-02 (Financial Services – National Treatment) shall apply to taxation measures on income, capital gains or the taxable capital of corporations that relate to the purchase or consumption of particular services; and (b) Articles G-02 and G-03 (Investment - NT and MFN Treatment) and Articles H-02</p>	<p>Annex XIV.1 Double Taxation</p> <p>1. The Parties agree to conclude a bilateral double taxation agreement within a reasonable time after the date that this Agreement enters into force.</p> <p>2. The Parties agree that upon conclusion of a bilateral double taxation agreement, they will agree to an exchange of letters setting out the relationship between the double taxation agreement and Article XIV.3 of the Agreement.</p>	<p>5. Subject to paragraphs 2, 3, and 6:</p> <p>(a) Articles 903 (Cross-Border Trade in Services - National Treatment) and Article 1102 (Financial Services - National Treatment) apply to taxation measures on income, capital gains or on the taxable capital of corporations that relate to the purchase or consumption of particular services; and</p> <p>(b) Articles 803 and 804 (Investment - NT and MFN Treatment), 903 and 904 (Cross-Border Trade in Services - NT and MFN Treatment) and 1102 and 1103 (Financial Services - NT and MFN Treatment) apply to all taxation measures, other than those on income, capital gains or on the taxable capital of corporations.</p> <p>6. Paragraph 5 shall not:</p> <p>(a) impose any MFN obligation with respect to an advantage accorded by a Party pursuant to a tax convention; ... (c) impose on a Party any NT obligation with respect to the conditioning of a receipt, or continued receipt, of an advantage relating to the purchase or consumption of a particular service on a requirement that the service be provided in its territory;</p>	<p>5. Subject to paragraphs 2 and 3:</p> <p>(a) Article 902 (Cross-Border Trade in Services - NT) and Article 1102 (Financial Services - NT) shall apply to taxation measures on income, capital gains, or on the taxable capital of corporations that relate to the purchase or consumption of particular services, except that nothing in this subparagraph shall prevent a Party from conditioning the receipt or continued receipt of an advantage relating to the purchase or consumption of particular services on requirements to provide the service in its territory; and</p> <p>(b) Articles 803 and 804 (Investment - NT and MFN Treatment), Articles 902 and 903 (Cross-Border Trade in Services - NT and MFN Treatment), and Articles 1102 and 1103 (Financial Services - NT and MFN Treatment) shall apply to all taxation measures, other than those on income capital gains, or on the taxable capital of corporations, taxes on estates, inheritances and gifts.</p> <p>(c) Subparagraphs (a) and (b) shall not: (i) impose any MFN obligation with respect to an advantage accorded by a Party pursuant to any tax</p>	<p>5. Subject to paragraphs 2, 3 and 6:</p> <p>(a) Article 10.03 (Cross-Border Trade in Services - NT) and Article 12.03 (Financial Services - NT) apply to a taxation measure on income, capital gains, or on the taxable capital of corporations that relate to the purchase or consumption of particular services; and</p> <p>(b) Articles 9.04 and 9.05 (Investment - NT and MFN Treatment), Articles 10.03 and 10.04 (Cross-Border Trade in Services - NT and MFN Treatment) and Articles 12.03 and 12.04 (Financial Services - NT and MFN Treatment) apply to a taxation measure, other than one on income, capital gains or on the taxable capital of corporations.</p> <p>6. Paragraph 5 does not: (a) impose a MFN obligation with respect to an advantage accorded by a Party pursuant to a tax convention;</p>
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<p>aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the Parties or arbitrarily nullify or impair benefits accorded under those Articles, in the sense of Annex 2004, or (h) to the measures listed in paragraph 2 of Annex 2103.4.</p> <p>5. Subject to paragraph 2 and without prejudice to the rights</p>	<p>and H-03 (Cross-Border Trade in Services – NT and MFN Treatment) and Articles H bis-02 and H bis-03 (Financial Services –NT and MFN) shall apply to all taxation measures, other than those on income ... except that nothing in those Articles shall apply:</p> <p>(c) any MFN obligation with respect to an advantage accorded by a Party pursuant to a tax convention;</p> <p>(d) to a non-conforming provision of any existing taxation measure;</p> <p>(e) to the continuation or prompt renewal of a non-conforming provision of any existing taxation measure;</p> <p>(f) to an amendment to a non-conforming provision of any existing taxation measure to the extent that the amendment does not decrease its conformity, at the time of the amendment, with any of those Articles; or</p> <p>(g) to any new taxation measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the Parties or arbitrarily nullify or impair benefits accorded under those Articles, in the sense of Annex N-04.</p> <p>5. Subject to paragraph 2 and without prejudice to the rights and obligations of the Parties</p>		<p>(d) apply to a non-conforming provision of any existing taxation measure;</p> <p>(e) apply to the continuation or prompt renewal of a non-conforming provision of any existing taxation measure;</p> <p>(f) apply to an amendment to a non-conforming provision of any existing taxation measure to the extent that the amendment does not decrease its conformity, at the time of the amendment, with any of the Articles referred to in paragraph 5; or</p> <p>(g) apply to any new taxation measure that is aimed at ensuring the equitable and effective imposition or collection of taxes (including, for greater certainty, any measure that is taken by a Party in order to ensure compliance with the Party's taxation system or to prevent the avoidance or evasion of taxes) and that does not arbitrarily discriminate between persons, goods or services of the Parties.</p> <p>7. Subject to paragraphs 2 and 3, and without prejudice to the rights and obligations of the Parties under paragraph 4, Article 807 (Investment - Performance Requirements) shall apply to taxation measures.</p>	<p>convention,</p> <p>(ii) apply to a non-conforming provision of any existing taxation measure,</p> <p>(iii) apply to the continuation or prompt renewal of a non-conforming provision of any existing taxation measure,</p> <p>(iv) apply to an amendment to a non-conforming provision of any existing taxation measure to the extent that the amendment does not decrease its conformity, at the time of the amendment, with any of those Articles,</p> <p>(v) apply to any new taxation measure that is aimed at ensuring the equitable and effective imposition or collection of taxes (including, for greater certainty, any measure that is taken by a Party in order to ensure compliance with the Party's taxation system or to prevent the avoidance or evasion of taxes) and that does not arbitrarily discriminate between persons, goods or services of the Parties ...</p> <p>6. Subject to paragraphs 2 and 3, and without prejudice to the</p>	<p>...</p> <p>(c) impose on a Party an obligation making the receipt, or continued receipt, of an advantage relating to the purchase or consumption of a particular service conditional on a requirement that the service be provided in its territory;</p> <p>(d) apply to a non-conforming provision of an existing taxation measure;</p> <p>(e) apply to the continuation or prompt renewal of a non-conforming provision of an existing taxation measure;</p> <p>(f) apply to an amendment to a non-conforming provision of an existing taxation measure provided that the amendment does not decrease its conformity, as it existed immediately before the amendment, with the Articles referred to in paragraph 5; or</p> <p>(g) apply to a new taxation measure that is aimed at ensuring the equitable and effective imposition or collection of taxes (including, for greater certainty, a measure that is taken by a Party in order to ensure compliance with the Party's taxation system or to prevent the avoidance or evasion of taxes) and that does not arbitrarily discriminate between persons, goods or services of the Parties.</p> <p>7. Subject to paragraphs 2 and 3, and without prejudice to the</p>
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<p>and obligations of the Parties under paragraph 3, Article 1106(3), (4) and (5) (Performance Requirements) shall apply to taxation measures.</p>	<p>under paragraph 3, Article G-06(3), (4) and (5) (Performance Requirements) shall apply to taxation measures.</p>			<p>rights and obligations of the Parties under paragraph 4, Article 807 (Investment - Performance Requirements) shall apply to taxation measures.</p>	<p>rights and obligations of the Parties under paragraph 4, Article 9.07 (Investment - Performance Requirements) applies to a taxation measure.</p>
<p><u>Dispute resolution</u></p>	<p><u>Dispute resolution</u></p>		<p><u>Dispute resolution</u></p>	<p><u>Dispute resolution</u></p>	<p><u>Dispute resolution</u></p>
<p>6. Article 1110 (Expropriation and Compensation) shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim under Article 1116 (Claim by an Investor of a Party on its Own Behalf) or 1117 (Claim by an Investor of a Party on Behalf of an Enterprise), where it has been determined pursuant to this paragraph that the measure is not an expropriation. The investor shall refer the issue of whether the measure is not an expropriation for a determination to the appropriate competent authorities set out in Annex 2103.6 at the time that it gives notice under Article 1119 (Notice of Intent to Submit a Claim to Arbitration). If the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation within a period of six months of such referral, the investor may submit its claim to arbitration under Article 1120 (Submission of a Claim to Arbitration).</p>	<p>6. Article G-10 (Expropriation and Compensation) shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim under Article G-17 (Claim by an Investor of a Party on Its Own Behalf) or G-18 (Claim by an Investor of a Party on Behalf of an Enterprise), where it has been determined pursuant to this paragraph that the measure is not an expropriation. The investor shall refer the issue of whether the measure is not an expropriation for a determination to the appropriate competent authorities set out in Annex O-03.6 at the time that it gives notice under Article G-20 (Notice of Intent to Submit a Claim to Arbitration). If the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation within a period of six months of such referral, the investor may submit its claim to arbitration under Article G-21 (Submission of a Claim to</p>		<p>8. Notwithstanding paragraphs 2 and 3, Article 812 (Investment - Expropriation) shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim under Article 819 (Investment - Claim by an Investor of a Party on Its Own Behalf) or 820 (Investment - Claim by an Investor of a Party on Behalf of an Enterprise), where it has been determined pursuant to this paragraph that a taxation measure is not an expropriation. The investor shall refer the issue of whether a measure is not an expropriation for a determination to the designated authorities of the Parties at the time that it gives notice under subparagraph 1(c) of Article 823 (Investment - Conditions Precedent to Submission of a Claim to Arbitration). If, within a period of six months from the date of such referral, the designated authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an</p>	<p>7. Articles 811 and 822 (Investment - Expropriation and Submission of a Claim to Arbitration) shall apply to a taxation measure alleged to be an expropriation. However, (a) no investor may invoke Article 811 (Investment - Expropriation) as the basis for a claim where it has been determined pursuant to this paragraph that the measure is not an expropriation; (b) an investor that seeks to invoke Article 811 (Investment - Expropriation) with respect to a taxation measure must first refer to the designated authorities of the Parties at the time that it gives its notice of intent under subparagraph 1(c) of Article 822 (Investment - Submission of a Claim to Arbitration) the issue of whether that taxation measure is not an expropriation; and (c) the designated authorities of the Parties shall agree to consider the issue. If the designated authorities fail to agree that the measure is not an expropriation within a period of six months of such referral, the investor may submit its claim to arbitration</p>	<p>8. Notwithstanding paragraphs 2 and 3, Article 9.11 (Investment - Expropriation) applies to a taxation measure, but an investor may invoke that Article as the basis for a claim under Articles 9.20 (Investment - Claim by an Investor of a Party on Its Own Behalf) or 9.21 (Investment - Claim by an Investor of a Party on Behalf of an Enterprise), where the designated authorities of the Parties have determined under this paragraph that a taxation measure is not an expropriation. The investor shall refer the issue of whether a measure is not an expropriation for a determination to the designated authorities of the Parties at the time that it gives notice under subparagraph 2(c) of Article 9.22 (Investment - Conditions Precedent to Submission of a Claim to Arbitration). If, within a period of six months from the date of this referral, the designated authorities do not agree to consider the issue or, having agreed to consider</p>

	Arbitration).		<p>expropriation, the investor may submit its claim to arbitration under Article 824 (Investment - Submission of a Claim to Arbitration).</p> <p>9. In order to give effect to paragraphs 1 to 3:</p> <p>(a) Where in a dispute between Parties, an issue arises as to whether a measure of a Party is a taxation measure, either Party may refer the issue to the designated authorities of the Parties ... Where the designated authorities have not decided the issue within six months of the referral, the Tribunal shall decide the issue in place of the designated authorities.</p> <p>(b) Where in connection with a claim by an investor of a Party, an issue arises as to whether a measure is a taxation measure, the Party that has received notice of intention to submit a claim or against which an investor of a Party has submitted a claim may refer the issue to the designated authorities of the Parties ... Where the designated authorities have not decided the issue within six months of the referral, the Tribunal shall decide the issue in place of the designated</p>	<p>under Article 822 (Submission of a Claim to Arbitration).</p> <p>8. In order to give effect to paragraphs 1 to 3:</p> <p>(a) Where in a dispute between Parties, an issue arises as to whether a measure of a Party is a taxation measure, either Party may refer the issue to the designated authorities of the Parties ... Where the designated authorities have been referred the issue and have not decided the issue within six months of the referral, the panel shall decide the issue;</p> <p>(b) Where in connection with a claim by an investor of a Party, an issue arises as to whether a measure is a taxation measure, the Party that has received notice of intention to submit a claim or against which an investor of a Party has submitted a claim may refer the issue to the designated authorities of the Parties ... Where the designated authorities have been referred the issue and have not decided the issue within six months of the referral, the Tribunal shall</p>	<p>it, fail to agree that the measure is not an expropriation, the investor may submit its claim to arbitration under Article 9.23 (Investment - Submission of a Claim to Arbitration).</p> <p>...</p> <p>10. In order to give effect to paragraphs 1 to 3:</p> <p>(a) If an issue arises as to whether a measure of a Party is a taxation measure in a dispute between the Parties, either Party may refer the issue to the designated authorities of the Parties ... If a Party has referred the issue to the designated authorities and they have not decided the issue within six months of the referral, the panel shall decide the issue;</p> <p>(b) If an issue arises as to whether a measure is a taxation measure in connection with a claim by an investor of a Party, the Party that has received notice of intention to submit a claim or against which an investor of a Party has submitted a claim may refer the issue to the designated authorities of the Parties ... If a Party has referred the issue to the designated authorities and they have not decided the issue within six months of the referral, the Tribunal shall</p>
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			<p>authorities.</p> <p>(c) Where in a dispute between Parties, an issue arises as to whether a tax convention prevails over this Agreement, a Party to the dispute may refer the issue to the designated authorities of the Parties. ...</p> <p>(d) Where prior to the submission of a claim by an investor of a Party, an issue arises as to whether a tax convention prevails over this Agreement, the Party that has received notice of intention to submit a claim may refer the issue to the designated authorities of the Parties.</p>	<p>decide the issue;</p> <p>(c) Where in a dispute between Parties, an issue arises as to whether a tax convention prevails over this Agreement, a Party to the dispute may refer the issue to the designated authorities of the Parties ... Where the designated authorities have been referred the issue and have not decided the issue within six months of the referral, the panel shall decide the issue; and</p> <p>(d) Where prior to the submission of a claim by an investor of a Party, an issue arises as to whether a tax convention prevails over this Agreement, the Party that has received notice of intention to submit a claim may refer the issue to the designated authorities of the Parties ... Where the designated authorities have been referred the issue and have not decided the issue within six months of the referral, the Tribunal shall decide the issue.</p>	<p>decide the issue;</p> <p>(c) If an issue arises as to whether a tax convention prevails over this Agreement in a dispute between the Parties, a Party to the dispute may refer the issue to the designated authorities of the Parties ... If a Party has referred the issue to the designated authorities and they have not decided the issue within six months of the referral, the panel shall decide the issue;</p> <p>(d) If an issue arises as to whether a tax convention prevails over this Agreement prior to the submission of a claim by an investor of a Party, the Party that has received notice of intention to submit a claim may refer the issue to the designated authorities of the Parties. ... If a Party has referred the issue to the designated authorities and they have not decided the issue within six months of the referral, the panel shall decide the issue.</p>
<p>Tax treaties:</p> <p>In force: Canada - US, Canada - Mexico</p>	<p>Tax treaty:</p> <p>In force</p>	<p>Tax treaty:</p> <p>Under negotiation</p>	<p>Tax treaty:</p> <p>In force</p>	<p>Tax treaty:</p> <p>In force</p>	<p>Tax treaty:</p> <p>not signed, not being negotiated</p>