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Tax Base Erosion and Profit Shifting (BEPS) and International Economic Law*

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Submitted by
Isabel Lamers
Pauline Mcharo
Kei Nakajima

To : Mr. Sergey Ripinsky and Ms. Kendra Magraw, UNCTAD

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LIST OF ABBREVIATIONS

BEPS	Base erosion and profit shifting
BITs	Bilateral investment treaties
CFC	Controlled foreign company
COMESA	Common Market for Eastern and Southern Africa
ECT	Energy Charter Treaty
EPA	Economic partnership agreement
FDI	Foreign direct investment
FET	Fair and equitable treatment
FTAs	Free Trade Agreements
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICSID	International Centre for Settlement of Investment Disputes
IIAs	International investment agreements
LCIA	London Court of International Arbitration
MFN	Most favored nation
MNEs	Multinational enterprises
NAFTA	North American Free Trade Agreement
NT	National treatment
OECD	Organization for Economic Co-operation and Development
PE	Permanent establishment
SCC	Stockholm Chamber of Commerce
SCM	Subsidies and Countervailing Measures
TRIMS	Trade-Related Investment Measures
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
VAT	Value added tax
WTO	World Trade Organization

EXECUTIVE SUMMARY

There is a growing concern with regards to the significant losses of national tax revenues because of sophisticated tax planning by multinational enterprise (MNEs) aimed at shifting profits in ways that erode the taxable base. International legal systems created to regulate directly or indirectly such conducts of MNEs have so far proven ineffective in preventing tax base erosion and profit shifting (BEPS) from occurring. The purpose of this memorandum is to show the reason why this is the case.

As BEPS is the result of the conduct of private actors, MNEs in particular, it is bilateral taxation treaties that are directly relevant to this phenomenon. However, they leave legal loopholes that make strategic tax planning possible providing opportunity for BEPS; as the traditional concept of permanent establishment can easily be manipulated, it is no longer an effective nexus providing a basis for taxation; exemption rules, originally designed to prevent double-taxation, can be exploited in a way to lead to double non-taxation; the arm's length principle, commonly underlying transfer pricing allocations, can be abused so as to separate income from the economic activity that produces it and allowing profits to be shifted to low tax environments. Consequently, other branches of international economic law, i.e. international investment as well as trade law, which are also directly or indirectly relevant to taxation, need to be explored.

International investment law, which regulates the conduct of host States, not investors, has by definition little chance to address BEPS. In addition to this, several limitations have been identified; as a lot of investment treaties exclude taxation issues from their scope of application, BEPS is placed outside the scope of investment law accordingly; to the extent that an investment treaty is applicable to taxation, it can be a regulatory measure to be scrutinized by investment arbitration, and thereby there exists a limited possibility that a measure against BEPS is alleged to constitute a violation of an investment treaty and/or contractual obligations resulting from 'tax stabilization clauses'; conversely, the usefulness of counterclaims before investment arbitration, which theoretically has a potential to tackle BEPS in the context of investment law, will be limited in the light of current jurisprudence.

In a similar vein, international trade law imposes obligations on Member States, but does not impose any obligation on private actors. It thus has by definition little chance to address BEPS; GATT has little scope to tackle BEPS as it does not deal with measures that affect taxation on income of MNEs; rather, provisions on transfer of payments could allow MNEs to use tax avoidance schemes to shift their profits from one tax jurisdiction to another lower tax rate jurisdiction.

Therefore, international soft law with its non-binding nature, which aims at the harmonization of regulation of taxation treaties as well as domestic legislation, also needs to be explored. However, in its current state, it leaves legal loopholes allowing double non-taxation to take place due to the incoherence of controlled foreign company rules as well as the excessive deductibility of interests; international cooperation on taxation matters and exchange of information between tax authorities is to date insufficient to capture the overall fiscal scheme and strategic tax planning of MNEs; current soft laws, including the OECD Model Tax Convention, cannot be compatible with modern global market.

Based upon these findings, this memorandum will suggest several proposals for amelioration of the existing system. On the whole, filling gaps in current bilateral taxation treaties would be the most effective and realistic way to address BEPS as it is these treaties that primarily and directly deal with taxation. To accelerate such improvement of taxation treaties by States, coherent international soft law standards, including standardized, best practice, rules on arm's length principle, controlled foreign company as well as exemption rules, need to be elaborated. International cooperation on tax matters between tax authorities of different States is moreover essential in uncovering the sophisticated tax planning taken by MNEs resulting in BEPS.

In addition to these suggestions, as a complementary proposal, it will be pointed out that counterclaims before investment arbitration offer room for amelioration. In line with an investment treaty, which permits countermeasures based upon non-fulfillment of domestic obligation, the system could be adjusted to enable counterclaims alleging tax avoidance by investors, and eventually to prevent BEPS from occurring to that extent.

INTRODUCTION

There is a growing concern with regards to the significant losses of national tax revenues because of sophisticated tax planning by multinational enterprise aimed at shifting profits in ways that erode the taxable base.[1] That is the reason why the OECD originated the Action Plan on tax base erosion and profit shifting (BEPS),[2] which was fully endorsed by G20 Leaders' Declaration in September 2013.[3]

In its fifteenth Action of the Plan, the need to '[a]nalyze the tax and public international law issues related to the development of a multilateral instrument' (or in the word of G20, the 'multilateral convention'[4]) to implement new measures on BEPS, was identified.[5] If no multilateral instrument so far exists, then, what does existing international law, in particular international economic law, contain in regard to BEPS?

This memorandum demonstrates that the existing international economic law does not effectively prevent BEPS from occurring, and establishes why this is the case.

According to the Tax Annex to the G20 Declaration above, BEPS 'relates chiefly to instances where the interaction of different tax rules result in tax planning that *may be used by multinational enterprises* (MNEs) to artificially shift profits out of the countries where they are earned, resulting in very low taxes or even double non-taxation.'[6] [emphasis added] In other words, the word 'BEPS' refers to tax planning (and its effects) employed by private actors, not by States. For example, the OECD refers to intra-group artificial transactions by using shell companies, intangibles, risks, capital and other high-risk transactions, etc.[7]

As a result, with a few exceptions, investment law (Chapter III) and trade law (Chapter IV), which regulate the conduct of States, have by definition little chance to address BEPS. It is rather bilateral taxation treaties that are applicable to profits of private companies, but they leave legal loopholes that make aggressive tax planning possible resulting in BEPS (Chapter II). Likewise, international soft law standards, including the OECD and G20 instruments mentioned above, provide opportunities for double non-taxation due to lacking coherence and problems in enforcement (Chapter V). To explain these, the analysis will begin by the mechanisms of BEPS (Chapter I).

[1] OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing, 2013), at 13.
[2] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing, 2013).
[3] *Saint Petersburg G20 Leaders' Declaration* (5-6 September 2013), paras. 50-52.
[4] *Tax Annex to the Saint Petersburg G20 Leaders Declaration* (September 2013), para. 4.
[5] OECD, *Action Plan, supra* note 2, at 24.
[6] *Tax Annex, supra* note 4, para. 5.
[7] OECD, *Action Plan, supra* note 2, at 13-14.

I. BACKGROUND

A. MECHANISMS OF BEPS

Globalisation has encouraged countries to 'assess continually their tax systems and public expenditures with a view to making adjustments where appropriate to improve the "fiscal climate" for investment.'[8] Reduction in taxation might initially spur investment, but a 'race to the bottom' will harm all countries in the long run.[9] Corporate tax rates are reduced to nearly zero on particular types of income, such as income from financial activities or from the provision of intangibles. In analysing the interaction of different tax systems as well as globalization, the Committee on Fiscal Affairs cautioned from the negative spill-over effects that can cause harm by: 'distorting financial and, indirectly, real investment flows; undermining the integrity and fairness of tax structures; discouraging compliance by all taxpayers; re-shaping the desired level and mix of taxes and public spending; causing undesired shifts of part of the tax burden to less mobile tax bases, such as labour, property and consumption; and increasing the administrative costs and compliance burdens on tax authorities and taxpayers.'[10] In fact, some large multinational enterprises (MNEs) can pay an effective tax corporate tax rate of as little as 5% while smaller businesses usually pay up to 30%.[11] BEPS stands for 'Base Erosion and Profit Shifting.' Tax base erosion negatively affects tax revenues, tax sovereignty and tax fairness for all tax administrations involved. Thereby, profit shifting represents one of the ways in which domestic tax bases can be eroded. Enterprises use various schemes to shift profits across borders to lower or zero tax jurisdictions to take advantage of lower tax rates in host countries.[12]

Needless to say, tax avoidance is attempted not only by MNEs, but also by private high net worth individuals. Nevertheless, as the OCED refers to BEPS in connection with the conduct of MNES, this paper will thereby focus on analyzing the international legal framework as applying to the conduct of MNEs, not individuals.

While there is clearly a question of compliance, most tax planning schemes that lead to

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[8] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publishing, 1998), para. 21.

[9] This holds especially for preferential tax regimes. Key features of harmful preferential regimes are (a) the existence of low or zero effective tax rates, (b) so-called 'ring-fencing' of the regime so that it does not affect the country offering the regime, (c) lack of transparency and effective exchange of information (to be addressed in section I.A.5).

[10] OECD, *Harmful Tax Competition*, *supra* note 8, para. 30.

[11] Patrick Love, 'BEPS: Why you're taxed more than a multinational', *OECD Insights Blog* (13 February 2013), available at: http://oecdinsights.org/2013/02/13/beps-why-youre-taxed-more-than-a-multinational/ (last visited 30 November 2013).

[12] *Ibid.*

BEPS are legal and result from an exploitation of an 'outdated' international taxation system.[13] Common principles base on experiences of national tax jurisdictions and international taxation rules are mainly directed to prevent double taxation or spur cross-border trade. International taxation is still grounded in an economic environment with a low degree of economic integration and globalization. However, modern globalized economy brings new challenges. The 'race to the bottom' is only one of the changes of modern economy. In an increasingly integrated global market, national tax laws and international standards have not kept pace with MNEs, fluid capital and the digital economy, the resulting gaps being exploited by such companies who avoid taxation in resident countries by shifting activities, risks, or assets to low or no tax jurisdictions abroad.[14] This undermines the fairness and integrity of tax systems all over the world, and especially developing countries are deprived of an important source of revenue. Wider economic risks relate to employment, innovation and productivity that can be damaged if tax profitability becomes a main investment incentive.

This paper examines, among others, how current rules allow for the allocation of taxable profits to locations other than those where the actual value-creating business activity took place. In practice, there is no single mechanism through which BEPS occurs and not all such can be examined in detail in this paper. The OECD in its 2013 report *Addressing Base Erosion and Profit Shifting* identified six key causes providing opportunities for BEPS, most of which are mentioned in this paper; and the most relevant of which will be explained in Section B):

1) Hybrids and mismatches of overlapping domestic jurisdictions and taxation treaties which generate arbitrage opportunities [*see*, for example, section V.A.1];
2) The residence-source tax balance, in the context in particular of the digital economy [*see*, for example, section II.B.1, II. C.1 and 2];
3) Intragroup financing, with companies in high-tax countries being loaded with debt [*see*, for example, section II.B.2, V.A.3];
4) Transfer pricing issues [*see*, for example, section II.2];
5) The effectiveness of anti-avoidance rules, which are often watered down because of heavy lobbying and competitive pressure [*see*, for example, section V.B.];
6) The existence of preferential regimes [*see*, for example, section V.A.4].[15]

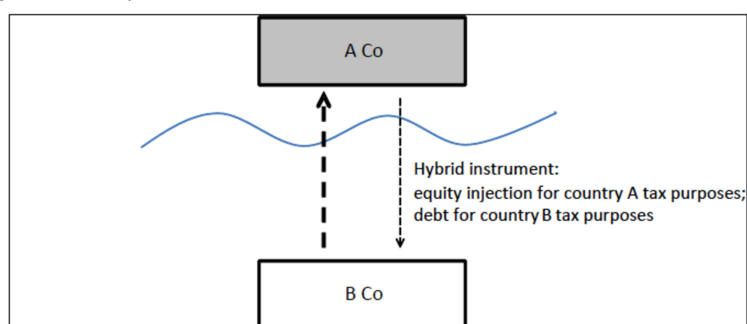
[13] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 5.
[14] OECD, Centre for Tax Policy and Administration, 'Base Erosion and Profit Shifting, About', available at: http://www.oecd.org/ctp/beps.htm (last visited 30 November 2013).
[15] Pascal Saint-Amans and Raffaele Russo, 'What the BEPS are we talking about?', *OECD Forum* (2013), available at: http://www.oecd.org/forum/what-the-beps-are-we-talking-about.htm (last visited 30 November 2013).

B. TERMINOLOGY

1. Hybrid Mismatch Arrangement

One of the most common mechanisms for exploiting the backward nature of the international tax system is the existence of hybrid mismatch arrangement. Uncoordinated domestic rules lead to hybrid mismatch arrangements that permit unintended double *non*-taxation, *e.g.* freedom of choice of tax treatment of domestic and foreign entities, foreign tax credit and participation exemption regimes. The basic idea behind hybrids is that taxation is avoided due to the fact that the same money, transaction or entity is treated differently in different countries due to differences in national laws or bilateral treaties.[16] For example, the same transaction can be declared either as debt or equity depending on the tax rules of the countries involved for MNEs residents in two countries or more for tax purposes. For example, in Figure I.1 below, company 'A Co' in country A funds a company 'B Co' residing in B with an instrument that is an 'equity' in country A but a 'debt' in country B. Payments under this instrument are thus deductible for B Co as interest expenses under country B tax law, but are seen as exempted dividend for country A tax law.

Figure I.1 Hybrid instrument



Source: OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD Publishing 2012), at 9.

Domestic law provisions allow tax exemption and recognition of deductible payments that are also deductible in other jurisdictions, that are not includible in income payments or that are subject to controlled foreign company rules.[17] The excessive deductibility of interest and other financial expenses allow double *non*-taxation. Rules regarding deductible payments do not take into account that underlying debt can be used to reduce the income of the issuer or to finance deferred income, *e.g.* through third-party debt.

[16] Love, *supra* note 11.
[17] OECD, *Action Plan, supra* note 2, at 15.

Then accumulation and combination of domestic tax exemption rules can lead to hybrid mismatch arrangements, and, thus, effective low or zero taxation of enterprises operating in several different countries providing opportunities for BEPS.

2. Transfer Pricing

Other important tools enabling tax erosion are transfer-pricing rules. Transfer pricing rules allocate income earned to the different parts of the enterprise and, thus, attribute jurisdiction to tax among the countries in which a company does business.[18] They determine the relevant share of profits that will be subject to taxation in the respective countries. About 60% of world trade takes place *within* MNEs, for example if the headquarters of an enterprise in the US pay a subsidiary in India to manufacture parts of a product.[19] Then this payment is a transfer price. Problems arise when these internal transfers are priced differently than between independent entities. If transfer prices are artificial, profits can be shifted from high to lox tax jurisdictions.

3. Arm's Length Principle

To address this problem, the arm's length principle was introduced as the common international principle underlying transfer-pricing allocations.[20] It requires that associated entities allocate income as if it would be allocated between independent parties in the same or similar circumstances. Parties to a transaction, *i.e.* subsidiaries and parent, are on equal and independent footing, as if parties were not related. The objective is that the price and conditions of transactions between related parties remains in accordance with comparable transactions. However, this principle is often circumvented, as will be subject of analysis in section II.B.2 on the arm's length principle and II.C.3 on how it is circumvented. Coupled with the so-called 'separate entity approach,' tax authorities do not have equal access of information on where a corporation is actually taxed and where a tax exemption in one jurisdiction can be offset by taxation in another. The 'separate entity approach' refers to the fact that the separate entities of a multinational enterprise, residing in different tax jurisdictions, are treated as separate entities for tax purposes. As will be demonstrated below, current rules do not account for global value chains involving more than two countries (*see* example of a global value chain in Figure B.1 below).[21]

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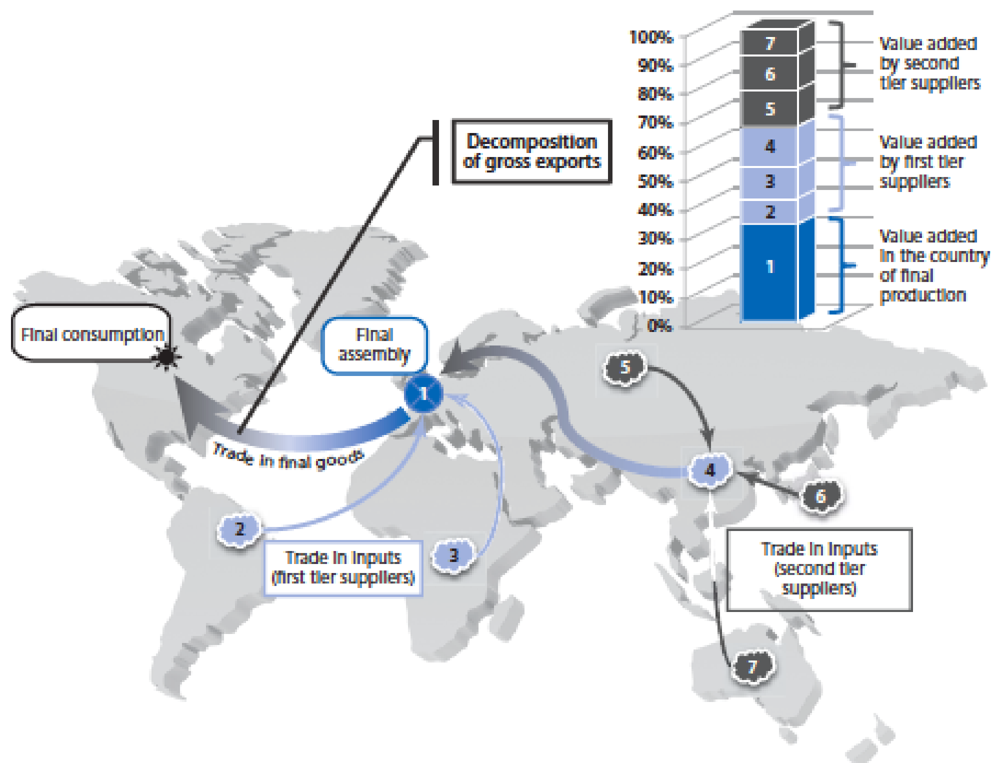
[18] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 36.
[19] Love, *supra* note 11.
[20] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 36.
[21] Global value chains are defined as the fragmentation of production stages across borders, involving emerging as well developed countries. *See* OECD, *Global Value Chains: OECD Work on Measuring Trade in Value-Added and Beyond,* STD/CSTAT/WPNA (2012) 17, Statistics Directorate (OECD Publishing, 2012).

Figure B.1. A simplified representation of a global value chain



Source: OECD, *Global Value Chains: OECD Work on Measuring Trade in Value-Added and Beyond*, STD/CSTAT/WPNA(2012)17, Statistics Directorate (OECD Publishing 2012), at 2.

In simple terms, the patterns that predominately exists in global trade includes a good produced in country 1 through the inputs of producers in countries 2 – 4 ('first tier suppliers') who again source their inputs from other economies in countries 5 - 7 ('second tier suppliers'). The final good is then exported to the markets of final consumption. As mentioned before, the 'separate entity approach' (coupled with the arm's length principle) allows many treaty rules to address taxation on an entity-by-entity basis, so that they cannot account for such fragmented production, as is the case in global value chains. BEPS occurs from the lacking overview of overall taxes paid by a multinational corporation operating across borders due to the separate entity approach and current transfer pricing rules. Meanwhile, tax administrations do not go as far as to consider the extent taxation of a MNE's foreign branches in other jurisdictions.

4. Anti-avoidance Rules

Another important issue is treaty abuse, or improper treaty use. International taxation is mostly governed through bilateral taxation treaties, which, in turn, are predominantly

based on either UN or OECD Model Tax Conventions.[22] Improper use of treaties, or treaty abuse, refers to situations where MNEs exploit the differences between countries' tax laws to secure the benefits of the tax advantages available both under domestic laws and/or under double tax conventions.[23] *Anti-abuse* clauses mostly are used to apply within treaties, whereas *anti-avoidance* rules refer to those implemented in domestic tax systems.

Tax avoidance has been generally addressed in the OECD Model Tax Convention in numerous provisions, but specific and precise provisions are needed to address the particular avoidance strategy in question. The Commentaries recommend the inclusion of specific provisions aimed at countering particular avoidance strategies in a given bilateral treaty setting. The Model Tax Convention seeks to specify a single rule for each situation, but nonetheless attempts to provide leeway for a certain margin of appreciation in the effective implementation through member countries.[24] The Commentaries exist to provide guidance in fleshing out the rules in bilateral tax treaties; and in the interpretation of tax issues by tax administrations and taxpayers the like. Thus, the avoidance in treaty abuse should be addressed through changes both in the Model Tax Convention as well as the Commentaries. Tax avoidance is explicitly dealt with in the Convention in several instances.[25] Also the Commentaries include a number of example provisions that can be used to address treaty abuse.[26] However, the OECD Action Plan nonetheless advocates the development of precise model treaty provisions and recommendations to counter double non-taxation through treaty abuse.[27] The OECD 2013 Report mentions the most relevant forms of anti-avoidance rules that can

[22] OECD, *Articles of the Model Convention with respect to Taxes on Income and Capital* (OECD Publishing, 2003), Introduction I- 3, para. 13, available at: http://www.oecd.org/tax/treaties/1914467.pdf. For example, following a decision by the Swiss Federal Council in 2009, the Swiss Double Taxation Agreements are to be based on the OECD Model Tax Convention on Income and on Capital. *See* KPMG, 'Switzerland's double tax treaties', available at: http://www.kpmg.com/ch/en/topics/saving-tax/pages/dba.aspx (last visited 30 November 2013).

[23] OECD, *Commentaries on the Articles of the Model Convention,* available at: http://www.oecd.org/berlin/publikationen/43324465.pdf; Commentary on Article 1, at 59, para. 7.1.

[24] OECD, *Action Plan, supra* note 2, Introduction, I -8.

[25] Tax avoidance is addressed, for example, by the introduction of the concept of "beneficial owner" (Arts. 10, 11 and 12) or special provisions, such as para. 2 of Article 17 addressing artiste-companies.

[26] For example, the Commentary on Article 10 (Dividends), para. 17, provides: The reduction envisaged in subparagraph a) of paragraph 2 should not be granted in cases of abuse of this provision, for example, where a company with a holding of less than 25 per cent has, shortly before the dividends become payable, increased its holding primarily for the purpose of securing the benefits of the abovementioned provision, or otherwise, where the qualifying holding was arranged primarily in order to obtain the reduction. To counteract such manoeuvres Contracting States may find it appropriate to add to subparagraph a) a provision along the following lines: provided that this holding was not acquired primarily for the purpose of taking advantage of this provision. OECD, *Commentaries*, s*upra* note 23, Commentary on Article 10, at 190, para. 17.

[27] OECD, *Action Plan, supra* note 2, at 19.

be adopted in domestic tax systems as well as in bilateral treaties. These include

- General anti-avoidance rules, which deny undue tax benefit;
- CFC rules;
- Thin capitalization and other rules limiting interest deductions;
- Anti-hybrid rules that prevent mismatches through the interaction of overlapping tax jurisdictions; and
- Anti-base erosion rules that impose high withholding taxes on certain payments.[28]

Anti-avoidance strategies are supposed to ensure fairness and effectiveness of taxation systems in domestic tax systems as well as in bilateral tax treaties.[29] However, there are no best practices in the design of legislation to strengthen anti-avoidance rules on a domestic level and in bilateral tax treaties, *e.g.* through the introduction or strengthening of controlled foreign company (CFC) rules.[30]

5. The Concept of Permanent Establishment (PE)

Finally, the term of permanent establishment (PE) presents a point of discussion related to addressing BEPS. According to Article 5(1), OECD Model Convention, PE refers to a 'fixed place of business through which the business of an enterprise is wholly or partly carried on.' The concept of permanent establishment provides the basic rule to determine whether taxing rights exist with respect to a certain business profits of a non-resident taxpayer. As will be discussed below, this concept is no longer sufficient in ensuring an adequate balance between the taxing rights of the source and resident state.

C. The Course of the Argument

As has been shown, BEPS is the result of the conducts of multinational enterprises. Accordingly, it is bilateral taxation treaties, which are directly applicable to income and profits of private actors, that are in the most suitable position to address BEPS. However, it is revealed that they leave legal loopholes that make strategic tax planning possible resulting in BEPS (Chapter II). As a result, one must explore the other branches of international economic law.

As regards investment treaty law (Chapter III) and international trade law (Chapter IV), however, they regulate the conduct of States, not that of private actors. Accordingly, it is concluded that they have little chance to address BEPS. Therefore, one has to explore international economic law with non-binding nature.

[28] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 38.
[29] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 38.
[30] OECD, *Action Plan, supra* note 2, at 16.

In this regard, international soft law standards, including the OECD and G20 instruments mentioned above, provide opportunities for double non-taxation due to lacking coherence and problems in enforcement (Chapter V).

Consequently, this memorandum concludes that existing international economic law does not effectively prevent BEPS from occurring.

II. TAXATION TREATIES LEAVE GAPS FOR BEPS

The underlying principles of treaty provisions governing taxation of business profits are mostly uniform,[31] as the majority of bilateral tax treaties in force follow the OECD or UN Model Tax Convention, including their Commentaries, and OECD Transfer Pricing Guidelines.[32] Of course, the States have discretion in the implementation of bilateral treaties and the final outcome of such treaties is also subject to bilateral taxation negotiations. However, the multitude of bilateral taxation treaties and their variations as compared to both model conventions cannot be sufficiently addressed in the realm of this brief paper. The focus of this section will thus be the OECD Model Tax Convention. After considering the function of taxation treaties (A), selected provisions directed at preventing tax avoidance shall be addressed (B). These are (1) exemption rules and (2) the arm's length principle. Subsequently, how these and other taxation treaty provisions are applied to provide opportunities for tax base erosion will be discussed (C).

A. FUNCTION: TAXATION TREATIES SET OUT TO PREVENT DOUBLE TAXATION

Most bilateral double taxation treaties are based on either UN or OECD Model Tax Conventions.[33] These Model Conventions have been designed to facilitate trade by preventing excessive or double taxation of multinational corporate actors. Double taxation refers to the event where two countries raise taxes on the same good, merchandise, income, transfer or item. This situation arises where enterprises, or individuals, reside in multiple countries, work with global value chains or when they receive income or loans from another country.[34] Current bilateral double taxation treaties thus aim to dismantle obstacles in cross-border economic or financial transactions. These treaties also address the possibility of treaty members to request

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[31] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 34.

[32] OECD, *Model Tax Convention*, *supra* note 22, Introduction I- 3, para. 13. There are obviously differences between the OECD and UN Model Tax Conventions, for example regarding the balance of source country and residence country taxation. However, an analysis of these differences would exceed the purpose of this study. For more information on this issue, *see* Michael Lennard, 'The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments', *Asia-Pacific Tax Bulletin* (January/February 2009), at 4-11, available at: http://www.taxjustice.net/cms/upload/pdf/Lennard_0902_UN_Vs_OECD.pdf.

[33] OECD, *Model Tax Convention, supra* note 22, Introduction I- 3, para. 13. For example, following a decision by the Swiss Federal Council in 2009, the Swiss Double Taxation Agreements are to be based on the OECD Model Tax Convention on Income and on Capital. *See* KPMG, 'Switzerland's double tax treaties', *supra* note 22.

[34] State Secretariat for International Financial Matters SIF, 'Double Taxation Agreements', Schweizer Eidgenossenschaft, available at: http://www.sif.admin.ch/themen/00502/00740/?lang=en (last visited 30 November 2013).

administrative assistance in tax matters, *e.g.* invite the exchange of information. Article 26 of the OECD Model Tax Convention governs the international cooperation of tax matters.[35]

B. Provisions Addressing Tax Avoidance: Anti-Abuse Rules And Arm's Length Principle

As double taxation treaties were initially set out to address double taxation, they usually contain few rules regarding tax avoidance. These are anti-abuse rules and the arm's length principle.

1. Exemption Rules

Taxes paid in another Contracting State can be deducted from the taxes paid in the other State. Exemption rules were designed to eliminate double taxation.[36] The exemption method means that income or capital taxable in the State of source is exempted in the State of residence.[37]

Article 23(A) of the OECD Model Tax Convention specifies:

> 1. Where a resident of a Contracting State derives income or owns capital which [...] may be taxed in the other Contracting State, the first-mentioned State shall [...] exempt such income or capital from tax.

Such exemption rules can provide a major opportunity for tax base erosion, for example if applied in combination with a low (or zero) tax jurisdiction or if applied in coordination with other principles avoiding double taxation, such as the deductibility of interest.

2. Arm's Length Principle

As already elaborated, transfer pricing rules allocate income earned and attribute jurisdiction to tax among the countries in which a company does business. The arm's length principle is the common international principle of transfer pricing allocations that

[35] The use of Article 26 for cooperation in international tax matters will be discussed further in section V. on soft law.
[36] Two methods are used to eliminate double taxation: the exemption method, explained above, and the credit method, in which the income or capital taxable to the source State is subject to tax of the residence State, but the tax levied in the source State is credited against the tax levied by the residence State. OECD, *Model Tax Convention*, *supra* note 22, Introduction, I-8.
[37] However, it may be taken into consideration in ascertaining the rate of tax applicable to the remaining income.

is directed to address tax avoidance through global value chains.[38] It requires that associated entities allocate income as if it would be allocated between independent parties in the same or similar circumstances. It is coupled with the 'separate entity approach' which treats subsidiaries of a multination enterprise as separate entities for tax purposes.[39]

The arm's length principle is embodied in Articles 7 and 9 of the OECD Model Tax Convention, in domestic legislation of many countries as well as in the WTO Agreement on Custom's Valuation. Article 7 of the OECD Model Tax Convention specifies:

> 2. For the purposes of this Article and Article [23A] [23B], the profits that are attributable in each Contracting State […] are the profits it might be expected to make […], if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions […].

Article 9 of the OECD Model Tax Convention holds likewise:

> 2. Where a Contracting State includes in the profits of an enterprise of that State […] profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the [former] enterprise […] if the conditions made between the two enterprises had been those which would have been made *between independent enterprises*, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. [emphasis added]

Parties to a transaction, *i.e.* subsidiaries and parent, are on equal and independent footing, as if parties were not related. The objective is that the price and conditions of transactions between related parties remains in accordance with comparable transactions.[40] Although these rules function well in most instances, they have been misapplied or distorted in other instances so as to separate income from the economic activity that produces it as will be further explained in section II.C.3 below.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations provide guidance on the application of these articles. The emphasis of the Guidelines on legal structures of transaction settings, *e.g.* contractual risk allocation,

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[38] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 36.
[39] Arnaud de Graaf, 'International Tax Policy Needed to Counterbalance the "Excessive" Behaviour of Multinationals', 22(2) EC Tax Review 107 (2013).
[40] *Ibid.*

is perceived as contributing to BEPS.[41]

C. BEPS IS POSSIBLE AS RULES ARE CIRCUMVENTED AND LEGAL LOOPHOLES ARE OPERATED IN CORPORATE TAX-PLANNING SCHEMES

Legal loopholes in taxation treaties provide opportunities for BEPS. Since the majority of bilateral taxation treaties base on the OECD Model Tax Convention, this section shall focus on analyzing the legal difficulties therein. This section discusses gaps identified by the OECD in treaty provisions that allow tax planning and profit shifting and that require such amendment. The principles discussed are the concept of permanent establishment (1), the arm's length principle (2) and exemption rules (3). The OECD attempts to deal with treaty abuses through the amendment of the model conventions and their commentaries,[42] which in turn will influence bilateral taxation treaties. This is the focus of recent OECD Action Plan and reports.[43]

1. BEPS is Possible through Legal Loopholes in Allocating the Jurisdiction to Tax in Taxation Treaties

The jurisdiction to tax is traditionally granted to the State of residence.[44] If business is carried out through a permanent establishment situated in said State, the profits and taxation thereof are attributable to the permanent establishment.[45] BEPS is rendered possible with the artificial circumvention of PE status.

According to Article 5(1), OECD Model Convention, PE refers to a 'fixed place of business through which the business of an enterprise is wholly or partly carried on.' As discussed above, the concept of permanent establishment provides the basic rule to determine whether taxing rights exist with respect to a certain business profits of a non-resident taxpayer. The concept of PE is perceived as no longer appropriate to ensure a proper balance of taxing rights between the Source State and the Residence State. Especially, with the development of the digital economy, a resident enterprise can conduct business in another State without maintaining the nexus with State of source.[46] PE status is further avoided with the following two exceptions. First, commissionaire

[41] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 43.
[42] ECOSOC, *Report of the Secretary-General on the 'Eleventh meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters'* (E/2004/51), para. 23.
[43] For further information, *see* OECD homepage; OECD, *Action Plan, supra* note 2; OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1.
[44] OECD, *Model Tax Convention*, *supra* note 22, Article 7(1): 'Profits of an enterprise of a Contracting State shall be taxable only in that State […].'
[45] OECD, *Model Tax Convention*, *supra* note 22, Article 7(1).
[46] *See,* among others, Jean Schaffner, *How Fixed is a Permanent Establishment* (Kluwer Law International, 2013).

arrangements shift profits without a substantive change in the functions performed.[47] Second, MNEs artificially fragment their operations to qualify for the exceptions of PE status. These exceptions are stated in Article 5(5) on the dependent agent test and Article 5(4) and the preparatory and auxiliary activities provision. They are transferred into bilateral tax treaties that rely on the former.

Article 5(5) of the OECD Model Tax Convention elaborates the dependent agent test. An agent acting on behalf of the enterprise shall still be considered as PE as long as it is not of an independent status to which Article 5(6) applies.[48] Following Article 5(6), an enterprise shall not be deemed to have a PE 'merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status.' This thus allows the circumvention of PE status through commissionaire arrangements.

Article 5(4) of the OECD Model Tax Convention specifies with preparatory and auxiliary activities. Accordingly, a PE does not include a fixed place of business whose activities only include such of preparatory or auxiliary character.[49] This includes the use of facilities for storing, displaying or delivering goods or merchandise (Article 5(4)(a)), the use of stock for the purpose of storage, display or delivery (Article 5(4)(b)), or the goods or merchandise are merely processed on behalf of the primary enterprise (Article 5(4)(c)) to name a few examples of ancillary activity.[50] Global value chains include the artificial fragmentation of a company's operation in multiple group entities. This artificial fragmentation can allow subsidiaries to qualify for the exception from PE status for preparatory or auxiliary status.

An amendment to the definition of PE status as stipulated in Article 5 could help prevent BEPS and clarify the jurisdiction to tax in situation of global value chains with overlapping jurisdictions.

2. BEPS is Possible through the Strategic Management of Exemption Rules

As mentioned, certain payments can be deducted from the taxes paid in the other State.

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[47] PwC, 'OECD's Action Plan published on Base Erosion and Profit Shifting', *Tax Policy Bulletin* (19 July 2013), at 3, available at: http://www.pwc.com/en_GX/gx/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-beps-action-plan.pdf.

[48] OECD, *Model Tax Convention*, *supra* note 22, Article 5(5).

[49] Article 5(4)(f) specifies that the term PE shall not include: 'the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.'

[50] OECD, *Commentaries*, *supra* note 23, Commentary on Article 5, at 101, para. 22.

The combination of certain exemption rules and allocational rules on taxation can lead to double *non*-taxation, and provide opportunities for BEPS.

The overlapping of exemption rules and allocational rules on which State has the jurisdiction to tax can provide opportunities for tax planning arrangements, and eventually BEPS. For example, a resident company establishes a subsidiary branch in a low tax jurisdiction through which services are provided to companies resident in high tax jurisdictions. Then, the exemption system operating in the country of residence regarding foreign branches (or somehow regarding the profits of this foreign branch), coupled with the deduction of payments granted at the level of the companies in high tax jurisdiction) effectively leads to double *non-taxation*. The 2013 OECD Report, *Addressing Base Erosion and Profit Shifting,* provides a detailed explanation of possible tax planning schemes incorporating a number of different strategies, including the manipulation of exemption rules.

3. BEPS is Possible through Circumvention of the Arm's Length Principle

The problems in the current system can be found in the design of transfer pricing rules. Transfer pricing outcomes are not in line with value creation due to problems in the enforcement of the arm's length principle.[51] The principle is circumvented through re-allocation of risks and intangibles. Future efforts need to refine the standards for allocation of risk and intangibles and to re-align value creation with the associated function/asset/risk. Furthermore, international cooperation and disclosure could assist in the discovery of global value chains and risk re-allocation, as opposed to an entity-by-entity assessment.

Existing transfer pricing and their interpretation rules fail to prevent BEPS by recognizing the transferal of risks and intangibles among group members or third parties.[52] An underlying assumption of the arm's length principle is that the more extensive the function, asset or risk of one party to a transaction, the more is its expected remuneration.[53] This creates an incentive to shift said functions or intangibles to where the remunerations are taxed more favorably. For example, the overall tax burden of an enterprise can be reduced by allocating risks and hard-to-value intangibles to its branches in low tax jurisdictions. The possibility of delinking an asset or risk from the activity that created it, is perceived as contributing to tax avoidance. Two major problems give rise to this setting: First, the characterisation of intangibles and of transactions; second, the circumstances under which a particular allocation of risk should be accepted. Concerning the former set of problems, a broad definition of

[51] OECD, *Action Plan, supra* note 2, at 19.
[52] OECD, *Action Plan, supra* note 2, at 20.
[53] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 42.

intangibles and a clear characterisation of types of transactions would close legal loopholes. For example, re-characterization of transactions can prevent the application of the arm's length principle. Concerning the latter set of problems, the re-alignment of profits to value creation is necessary to assess the risk allocation. As stated by a recent OECD report, 'the evaluation of risk often involves discussions regarding whether […] a low-tax transferee of intangibles should be treated as having borne […] significant risks related to the development and use of the intangibles in commercial operations.'[54] Transfer pricing rules are applied on an entity-by-entity basis, thus neglecting the transferal of risks within among group members and third parties, *e.g.* in global value chains (*cf.* section B above).[55] Then, inappropriate returns might accrue merely for the contractual assumption of risks due to an emphasis on legal structures; instead of the underlying practice of MNEs. Most likely, a case-by-case decision is needed to determine the how risks are actually distributed and which amount of economic substance is required to accept a certain re-allocation of risks and under which circumstances such arrangements result in base erosion.

Finally, the separate entity approach and arm's length principle should be refined where unintended double *non*-taxation is produced, in particular relating to the transfer of intangible assets to low tax jurisdictions. On 30 April 2013, the OECD released a new *Draft Handbook on Transfer Pricing Risk Assessment*, which includes special consideration on transactions with affiliated branches in low tax jurisdictions.[56] A main point of criticism is the too strong emphasis on legal structures in the OECD Guidelines as opposed to a pragmatic focus on the underlying economic reality.

D. CONCLUSION

Above discussion highlighted the difficulty of designing control mechanisms that prevent unintended double *non*-taxation without unduly and inefficiently restricting the commercial freedom of market participants. Bilateral taxation treaties were intended to alleviate tax burdens on cross-border trade, but now are exploited in such a ways to avoid taxation.

Only a few problems in bilateral taxation treaties could be examined here, in particular the focus of discussion lay on the OECD Model Tax Convention. The following conclusion can be drawn. First, the allocation of tax jurisdiction through the PE status is flawed as PE status can easily be circumvented. An amendment to definition of PE

[54] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 42.
[55] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 42.
[56] OECD, *Draft Handbook on Transfer Pricing Risk Assessment* (OECD Publishing, 2013), available at: http://www.oecd.org/ctp/transfer-pricing/draft-handbook-on-tp-risk-assessment.htm (last visited 30 November 2013).

status in Article 5 of the Model Tax Convention as well as clarifying more generally how to allocate the jurisdiction to tax in a situation of global value chains could prevent overlapping jurisdictions and unintended double non-taxation. Second, the overlapping of exemption rules provides opportunities for tax avoidance. These rules should be refined. Another suggestion might be the introduction of only conditional tax exemption rules or the adoption of so-called ‘switch over clauses’ as in some EU countries.[57] Third, and related to prior point is the problem of isolated allocation of risks and functions due to the combination of the separate entity approach and arm’s length principle. Future efforts need to refine the standards for allocation of risk and intangibles and to re-align value creation with the associated function/asset/risk. Furthermore, international cooperation and complete disclosure of taxes paid could assist in the discovery of global value chains and risk re-allocation, as opposed to an entity-by-entity assessment.

[57] Further research on such clauses would be necessary. *See* C-298/05 Columbus Container Service BVBA v. FA Bielefeld-Innenstadt.

III. INTERNATIONAL INVESTMENT LAW AND BEPS

On the one hand, BEPS is the result of the conduct of private actors, and in particular, of multinational enterprises to avoid tax burdens. On the other hand, as modern bilateral investment treaties (BITs) came into being to protect foreign investment,[58] international investment agreements (IIAs) impose obligations on host states *vis-à-vis* foreign investors, but do not impose any disciplines on investors.[59] Accordingly, by definition, it is difficult to assume that BEPS could be addressed through investment treaties. In fact, this research found no provision in IIAs expressly limiting or prohibiting tax erosion by investors.

Rather, since IIAs impose obligations on host states, they might have an effect on limiting States' ability to take measures to address BEPS. Section A will demonstrate that tax related arrangements in IIAs may restrict the conduct of States in addressing BEPS, though it is very limited extent. Section B will demonstrate that investment arbitration theoretically has a potential to restrict States' fight against BEPS, though the probability is very low. Additionally, counterclaims before investment arbitration could be potentially a tool to address BEPS in the context of investment law; but the chances of success will be low in the light of current jurisprudence.

A. INTERNATIONAL INVESTMENT AGREEMENTS AND TAXATION ISSUES

Section A will examine the coverage of taxation by international investment agreements and its implication for BEPS. Firstly, the exclusion of taxation issues from the coverage of an investment treaty signifies that host States' sovereign power to taxation is untouched (1.). Secondly, despite the explicit reference to taxation, provisions on capital transfer guarantee have little influence on BEPS (2.). Thirdly, so-called 'tax stabilization clause' in investment contracts has the potential to limit the competence of host states in relation to investors (3.).

1. Exclusion of Taxation Issues from IIAs

Taxation[60] is 'an essential prerogative of State sovereignty.'[61] In *ConocoPhillips v.*

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[58] Marc Jacob, 'Investments, Bilateral Treaties', in *Max Planck Encyclopedia of Public International Law* (last updated, May 2011), para. 10.

[59] Jeswald W. Salacuse, *The Three Laws of International Investment: National, Contractual, and International Frameworks for Foreign Capital* (Oxford University Press, 2013), at 383-384; Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law', 17 Lewis & Clark Law Review 463 (2013).

[60] Regarding 'tax' or 'taxation' in the context of investment law, on the one hand, some investment treaties provide definition clauses on them. For example, Article 21(7) of the Energy Charter Treaty

Venezuela, the Tribunal stated that 'the power to tax is in principle within the customary regulatory or sovereign powers of the State,' and '[t]hat proposition is reflected in many [investment] treaties by the exclusion from their coverage of matters of taxation […].'[62] In other words, the exclusion of taxation issues from the coverage of an investment treaty, as will be examined below, signifies that host States' sovereign power to taxation under customary international law is untouched. From this point of view, various arrangements in IIAs in relations to tax exclusion do not constitute limitation for States to address BEPS.

Conversely, as far as taxation is covered by investment treaties, international investment law has relevance for BEPS in the sense that host States' conduct to address tax erosion by investors can be restricted by substantive obligations derived from IIAs. Therefore, it is necessary to identify various approaches of the exclusion of taxation from the coverage of IIAs, before analyzing on the effects of the coverage. They can be categorized into several types: general exclusion (i.), limited exclusion (ii.)(iii.)(iv.), tax veto to expropriation case (v.), and priority of taxation treaties over IIAs (vi.). But one must bear in mind that the types of exclusion and/or exceptions can be complexly

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defines the term "Taxation Measure" as including 'any provision relating to taxes of the domestic law of the Contracting Party or of a political subdivision thereof or a local authority therein' and 'any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound.' On the other hand, it has been pointed out that investment treaties themselves usually do not provide for a definition of taxation (Thomas Wälde and Abba Kolo, 'Coverage of Taxation under Modern Investment Treaties', in Peter Muchilinski, Federico Ortino and Christoph Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008), at 318). In that case, a definition is given by determination of an arbitral tribunal when a dispute arises. For example, in *EnCana v. Ecuador,* the Tribunal found that the applicable Canada/Ecuador BIT has no definition on 'taxation measures,' and indicated several factors to determine the scope of 'taxation measures' at issues; First, 'it is in the nature of a tax that it is imposed by law'; Secondly, the term 'taxation' includes not only direct taxation but also indirect taxes such as VAT. But one has to bear in mind that some BITs exclude direct taxes from its scope of the application, as will be examined later; Thirdly, the broad term 'measure' includes not only the actual provisions of the taxation law, but also 'all those aspects of the tax regime which go to determine how much tax is payable or refundable', such as deductions, allowances or rebates; Fourthly, '[a] taxation law is one which imposes a liability on classes of persons to pay money to the State for public purposes.' *EnCana Corporation v. Ecuador,* LCIA Case No. UN 3481, Award, 3 February 2006, paras. 141-142. The first and the fourth propositions are referred in *Duke Energy v. Ecuador,* ICSID Case No. ARB/04/19, Award, 18 August 2008, para. 174; *Burlington Resources v. Ecuador,* ICSID Case No. ARB/08/5, Decision on Jurisdiction, 2 June 2010, para. 164.

[61] *Burlington Resources v. Ecuador,* ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012, para. 391. Taxes are a main source of national budget, and modern welfare states pursue a variety of social policies on the basis of tax revenues, such as redistribution of wealth, support for domestic industry, etc. It has been pointed out that States are therefore unwilling to subject taxation to investment treaties, and they perceive subjecting their taxing powers to an arbitral tribunal as undermining their fiscal sovereignty. Wälde and Kolo, *supra* note 60, at 322-323.

[62] *ConocoPhillips v. Venezuela,* ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits, 3 September 2013, paras. 312-313.

combined in one investment treaty (vii.). Since the provisions of BITs vary from one to another, it would hardly be possible to sketch a complete picture showing everything on the exclusion of taxation from BITs. Nevertheless, some general trends and types of exclusion can be identified, as will be examined below.

i. General exclusion

In the first place, some investment agreements exclude tax matters from its scope of application without any reservation. For example, Article 5(2) of the Argentina/New Zealand BIT (1999) provides as follows:

> The provisions of this Agreement *shall not apply to matters of taxation* in the area of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties.[63] [emphasis added]

The policy behind this exclusion is to leave taxation issues to taxation treaties. For example, the Colombia Model BIT (2004), which has the same type of exclusion, provides an accompanying explanation: ‘It is policy of Colombia to treat tax matters in double taxation treaties.’

ii. Limited exclusion in relation to NT and MFN standards

Many BITs exclude the application of the National Treatment (NT) and Most Favored Nation (MFN) standards to taxation issues. For example, Article 4 of France Model BIT (2006) provides that ‘[t]he provisions of this article [*i.e.* NT and MFN] *do not apply to tax matters*.’ [emphasis added] This is due to the inherent bilateral nature of treatment conferred by tax avoidance treaties.[64] Based on its scope of exclusion, they can be categorized into several types of approaches.

Firstly, some BITs exclude the application of NT and MFN to the treatment on taxation resulting from double taxation agreements. For example, Article 3(4) of Germany Model BIT (2008) stipulates:

[63] Same provisions can be found in investment agreements concluded by New Zealand; Article 8(2) of the New Zealand/Hong Kong Investment Agreement (1995); Article 8(2) of New Zealand/Chile BIT (1999). Article 5(2) of New Zealand/China BIT (1994) expressly states the ‘matters of taxation’ shall be governed by the double taxation treaty concluded by the same parties in 1986.

[64] UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (United Nations Publications, 2007), at 42.

> The treatment granted under this Article shall not relate to advantages which either Contracting State accords to investors of third States *by virtue of an agreement for the avoidance of double taxation in the field of taxes on income and assets or other agreements regarding matters of taxation*.[65] [emphasis added]

Secondly, in addition to taxation agreements, some BITs exclude the application of NT and MFN to the treatment on taxation resulting from international 'arrangements' relating to taxation 'wholly or mainly.' For example, Article 3(3) of Honduras/Korea BIT (2000) stipulates as follows:

> 3. The provisions of paragraphs 1 and 2 of this Article [*i.e.* NT and MFN] shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege *resulting from any international agreement or arrangement relating wholly or mainly to taxation* […].[66] [emphasis added]

Thirdly, some BITs exclude the application of NT and MFN from treatments resulting from 'any matter' related to taxation. For example, Article 3(3) of Austria/India BIT (1999) states as follows:

> (3) The provisions of paragraph (I) [*i.e.* NT and MFN] shall not be construed as to oblige one Contracting Party to extend to the investors of the other Contracting Party and their investments the present or future benefit of any treatment, preference or privilege resulting from […] *any matter, including international agreements, pertaining wholly or mainly to taxation*.[67] [emphasis added]

Lastly, most simple and broad exclusion can be found in several BITs concluded by

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[65] Similar provisions can be found in Article 3(4) of Germany/Poland BIT (1989); Article 3(4) of Germany/Philippines BIT; Article 3(3) of Germany/USSR BIT (1989); Article 3(4) of China/Germany BIT (2003); Article 4(4) of France/Hungary BIT (1987); Article 4(3) of France/Poland BIT (1989); Article 4 of Czech/France BIT (1990); Article 4(3) of Germany/India BIT (1995); Article 3(4)(b) of Austria/Mexico BIT (1998); Article 3(3) of Bahrain/China BIT (1999); Article 3(2)(b) of Austria/Slovenia BIT (2002).

[66] Similar provision can be found BITs concluded by Republic of Korea. Article 7(c) of Korea/UK BIT (1976); Article 4(c) of Korea/Malaysia BIT (1988); Article 8(c) of Korea/Pakistan BIT (1988); Article 3(3)(b) of Czech/Korea BIT (1992); Article 4(b) of Korea/Peru BIT (1993); Article 3(3) of Korea/Portugal BIT (1995); Article 3(3)(b) of Greece/Korea BIT (1995); Article 7(b) of Korea/Sweden BIT (1995); Article 7(b) of Korea/Ukraine BIT (1996); Article 3(3) of Korea/UAE BIT (2002). In addition to Korean BITs, Article 3(3)(b) of Austria/Malaysia BIT (1985); Article 4(3)(b) of India/UK BIT (1994).

[67] Similarly, Article 4(3)(b) of Belgium/India BIT (1997) excludes benefits resulted from '*de toute matière* concernant principalement ou exclusivement l'imposition.'

France. For example, Article 4(2) of France/Mexico BIT (1998) stipulates that '[t]he provisions of this article (*i.e.* MFN and NT) do not apply to *tax matters*.' In French, '[l]es dispositions de cet article ne s'appliquent pas *aux questions fiscales*.'[68] [emphasis added]

iii. Limited exclusion in relation to fair and equitable treatment

Some investment treaties exclude the application of the obligation of fair and equitable treatment (FET) on taxation measures. A major example is NAFTA, Article 2103(1) of which stipulates that '[e]xcept as set out in this Article, nothing in this Agreement shall apply to taxation measures.' On the one hand, 'Articles 1102 and 1103 [*i.e.* NT and MFN] […] shall apply to all taxation measures,' and 'Article 1106(3), (4) and (5) [*i.e.* Performance Requirements] shall apply to taxation measures.' On the other hand, since there is no explicit reference to FET, arbitral tribunals have repeatedly interpreted that 'Article 1105 [*i.e.* FET] is not available in tax cases,'[69] and 'the tax measures are excluded from consideration in the context of Article 1105.'[70]

In this regard, the Article 2103 is so complex that a separate analysis on expropriation (see v. below) and other substantive obligations will follow (see vii. below).

iv. Limited exclusion based on the distinction between direct and indirect taxes

Some investment treaties restrict its application to limited types of taxes. In other words, by providing a distinction between direct and indirect taxes, they limit their scope of some substantive obligations to indirect taxes.[71] For example, Article 2103(4)(b) of NAFTA stipulates as follows:

> Articles 1102 and 1103 (Investment - National Treatment and Most-Favored Nation Treatment) […] shall apply to all taxation measures, *other than those on income, capital gains or on the taxable capital of corporations, taxes on estates,*

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[68] Article 4 of France/Ukraine BIT (1994); Article 4 of France/South Africa BIT (1995); Article 3 of France/Lebanon BIT (1996); Article 4 of Ecuador/France BIT (1996); Article 4 of France/Georgia BIT (1997); Article 5(4) of France/India BIT (1997); Article 4 of France/Moldova BIT (1997); Article 3 of France/Saudi Arabia BIT (2002). Article 4(3) of India/Switzerland BIT (1997) provides that 'Neither Contracting Party *shall be obliged to apply in matters of taxation* the provisions of paragraph (I) of this Article [*i.e.* NT and MFN].' (emphasis added)

[69] *Marvin Roy Feldman Karpa v. United Mexican States,* ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, para. 141.

[70] *Cargill, Incorporated v. United Mexican States,* ICSID Case No. ARB(AF)/05/2, Award, 18 September 2009, para. 297; See also, *United Percel Service of America Inc. v. Canada,* UNCITRAL, Award on Jurisdiction, 22 November 2002, para. 117.

[71] Wälde and Kolo, *supra* note 60, at 320.

> *inheritances, gifts and generation-skipping transfers* […][72] [emphasis added]

v. Tax veto to expropriation case

Some IIAs grant the tax authorities the competence to 'veto'[73] a complaint by an investor alleging expropriation arising from a taxation measure by the host state. For example, Article 2103(6) of NAFTA stipulates that an investor can submit a claim relating to expropriatory taxation to arbitration only if 'the competent authorities […] fail to agree that the measure is not an expropriation.'[74] The agreement of competent tax authorities on non-expropriatory character of a measure thus precludes the investor from initiating investment arbitration.[75]

For example, in *Gottlieb v. Canada,* although the claimant notified the intent to initiate arbitration under NAFTA, the US and Canada tax authorities agreed that the measures at issue were 'not expropriations' and thereby Canada informed the claimant that it 'cannot be the object of any claim under Article 1110 [*i.e.* expropriation].'[76]

vi. Priority of taxation treaties over IIAs

Some BITs insert no express provision on exclusion of taxation from its coverage, but provide priority of taxation treaties over the investment treaty, which can be qualified as 'explicit conflict clauses.'[77] For example, Article 20 of Japan/Iraq BIT (2012) stipulates:

> Nothing in this Agreement shall affect the rights and obligations of either Contracting Party under *any tax convention*. In the event of any inconsistency between this Agreement and any such convention, *that convention shall prevail*

[72] Similar but more complicated provision can be found in Article 21(2), (3) and (4) of the ECT.
[73] William W. Park, 'Arbitration and the Fisc: NAFTA's Tax Veto', 2 Chicago Journal of International Law 231 (2001).
[74] Similar type of provision can be found in Article 21(2) of US Model BIT (2012); Article 12(4) of Canada/Ecuador BIT (1996); and regarding the Article 21(5) of the ECT, *Plama Consortium Limited v. Bulgaria,* ICSID Case No. ARB/03/24, Award, 27 August 2008, para. 266.
[75] Wälde and Kolo, *supra* note 60, at 353. In addition to the 'veto' to initiate arbitral proceeding, a decision of competent tax authority may have an effect on the merit phase of arbitration. For example, Article 21(5)(b)(iii) of the ECT provides that 'Bodies called upon to settle disputes […] *may take into account any conclusions arrived at by the Competent Tax Authorities* regarding whether the tax is an expropriation.' [emphasis added] In this way, the determination of tax authorities may affect both jurisdictional as well as merit phases of investment arbitration.
[76] Letter to Gottlieb Investment Group from Ms. Meg Kinnear (29 April 2008), available at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gottlieb.aspx?lang=eng.
[77] Joost Pauwelyn, *Conflict of Norms in Public International Law* (Cambridge University Press, 2003), at 328.

to the extent of the inconsistency. [emphasis added]

This type of BITs[78] still applies to taxation, but to the extent that is covered by taxation treaties, the latter shall prevail.

vii. Complex combination of exceptions within exclusion

One must bear in mind that the types of exclusion described above do not preclude each other. Rather, some IIAs combine several exceptions within the exclusion, resulting in a complex structure, which requires careful scrutiny to identify the scope of application. For example, Article 12 of Canada/Ecuador BIT (1996) stipulates that '[e]xcept as set out in this Article, nothing in this Agreement shall apply to taxation measures,' but at the same time provides a priority clause (paragraph 2) and a tax veto (paragraph 4), as explained above.[79]

Additionally, since the provisions of BITs vary one from another, it would hardly be possible to sketch a complete picture showing everything on the exclusion of taxation from BITs. For example, Article 2103 of NAFTA [taxation exclusion], as examined above, can be interpreted so as to exclude not only FET obligation, but also other substantive obligations, such as provided in Article 1107 (Boards of director requirement) and Article 1109 (Transfer guarantees). To show some general trends, this section limits its scope of analysis to major types of exclusion clauses.

viii. Consequences of exclusion of taxation from IIAs

As examined above, several IIAs exclude taxation issues from their scope of regulation, though the extent of exclusion may vary from one treaty to another.

These exclusions of taxation from the coverage of IIAs signify that host States' sovereign power to taxation under customary international law remains untouched. In other words, various arrangements in IIAs in relations to tax exclusion do not constitute *per se* limitation for States to address BEPS. At this point, States generally treat taxation issues in taxation treaties,[80] and it is rather the deficiencies in taxation treaties that have brought BEPS (as explained in Chapter II).

[78] *E.g.* Article 16(1) of Canada Model BIT (2004); Article 7(3) of Germany Model BIT (2008).
[79] Regarding the complex 'Matryoshka' of taxation provision in the Energy Charter Treaty (ECT), William W. Park, 'Tax Arbitration and Investment Protection', in Graham Coop and Clarisse Ribeiro (eds.), *Investment Arbitration and the Energy Charter Treaty* (Juris Publishing, 2008), at 116-118.
[80] Taxation is usually dealt with by national authorities other than those negotiating investment agreements, and a previous UNCTAD report pointed out that '[c]ountries […] want to prevent any conflict of competence among their different government agencies.' UNCTAD, *Bilateral Investment Treaties 1995–2006, supra* note 64, at 81.

Conversely, as far as investment treaties cover taxation,[81] international investment law can have relevance for BEPS, since host States' power to address tax avoidance by investors can be restricted by substantive obligations provided in investment treaties. To identify the possibility, one has to go into the analysis of the case law of investment arbitration (Section B of this Chapter). Before that, a substantive obligation on capital transfer guarantee, which expressly refers to taxation, will be examined.

2. Reference to Taxation in the Provision on Capital Transfer Guarantee

On the one hand, repatriation of capital, earnings and revenues form an essential part of foreign investment. On the other hand, host states have an interest in profits being reinvested in the local economy; and they often see repatriation as detrimental to their economy. It has been pointed out that so-called capital transfer guarantee provision balances this conflict of interests.[82]

Despite the explicit reference to taxation, capital transfer guarantee has little influence on BEPS. Supposing that taxation is an essential prerogative of state sovereignty, it is reasonable to interpret this provision as nothing but a confirmation of taxation power of host states and of investor's duty to comply with tax legislations in national level (i.). So even if a BIT has no explicit reference to them, the provision shall be construed as leaving the host state's power to taxation untouched (ii.).

i. Reference to income tax and/or national tax obligations

Some investment agreements provide capital transfer guarantee with explicitly reserving the competence to impose income tax on the profits of investors. For example, Article 4(3) of Ukraine/US BIT (1996) stipulates as follows:

> Notwithstanding the provisions of paragraphs 1 and 2 [*i.e.* capital transfer guarantee], either Party may maintain laws and regulations […] *imposing income taxes by such means as a withholding tax* applicable to dividends or

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[81] Even if a BIT does not cover taxation *per se*, it may be taken into account in considering the cumulative effect of State conducts. in *RosInvest v. Russia,* the Tribunal stated that 'even if taxation as such is excluded from qualifying as a breach by Article 11(3) of the Denmark-Russia BIT and thus also for the IPPA under its MFN clause, this does not exclude to take taxation measures into account, besides other measures of Respondent, in considering the cumulative effect of a general pattern of treatment in the examination whether that qualifies as "*measures having effect equivalent to nationalisation or expropriation*" and as "*discriminatory*."' *RosInvestCo UK Ltd. v. Russia,* SCC Case 079/2005, Final Award, 12 September 2010, para. 618.

[82] Wälde and Kolo, *supra* note 60, at 331-333.

> other transfers.[83] [emphasis added]

In a similar vein, some investment treaties prescribe the payment of taxes as a precondition to enjoy the benefit of capital transfer guarantee. For example, Article 6 of Malaysia/Saudi Arabia BIT (2000) provides as follows:

> Each Contracting Party shall guarantee to investors of the other Contracting Party, *after all taxes and obligations have been met,* the free transfer of payments in any freely usable currency in connection with investments and investment returns they hold […].[84] [emphasis added]

Here, one can find the idea of balancing interests of investors and host states: investors can enjoy capital transfer guarantee as far as they comply with tax obligations derived from the national legislations of host states. Nevertheless, since States have sovereign rights to impose tax on profits within their jurisdiction, these provisions do not substantially add anything to taxation power of host states under general international law.

ii. The case of no explicit reference to taxation

However, several investment treaties have no explicit reference to taxation by host states as mentioned above. For example, Article 5 of Kazakhstan/Netherlands BIT (2007) stipulates that 'The Contracting Parties shall guarantee that payments relating to an investment may be transferred' without any reference to taxation by the host State.[85]

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[83] Similar clause can be found in Article 4 of Ecuador/US BIT (1993); Article 4 of Romania/US BIT (1994). Nevertheless, US Model BITs (both 2004 and 2012) do not follow this line. Instead, the Articles 7 provide that 'a Party may prevent a transfer through the equitable, non-discriminatory, and good faith application of its laws' without special reference to taxation.

[84] Similarly, Article 7(1) of Kazakhstan/India BIT (1996) guarantees the capital transfer for an investor provided that he/she fulfills 'tax obligations.' The wordings of Article 6(1) of Italy Model BIT (2003) are 'after the fiscal obligations have been met.' Similar wordings can be found in Italian BITs including: Article 6(1) of Bangladesh/Italy BIT (1990); Article 6(1) of Italy/Mongolia BIT (1993); Article 6(1) of Italy/Tanzania BIT (2001). Article 6(1) of China/Kuwait BIT (1985) provides that repatriation of investment shall be guaranteed 'in accordance with its laws and regulations' of host states. Similar provision can be found in: Article 8 of Italy/Philippines BIT (1988); Article 6(1) of Italy/Korea BIT (1989); Article 7 of China/Indonesia BIT (1994). Some Malaysian BITs adds 'national policies' to this: Article 6(1) of Kazakhstan/Malaysia BIT (1996); Article 6(1) of Egypt/Malaysia BIT (1997). Similarly, Article 7 of France/Kenya BIT (2007) provides that 'L'application du présent article *est soumise au respect des lois, règlements et conventions en matière fiscale* de chaque Etat contractant.' (emphasis added) In the case of ASEAN-China Investment Agreements (2009), the Article 10(3)(c) provides that 'a Party may prevent or delay a transfer through the equitable, non-discriminatory and good faith application of its laws and regulations relating to' '*non-fulfilment of tax obligations*.' (emphasis added)

[85] Similar provision can be found in Article 5 of Bosnia Herzegovina/Germany BIT (2001); Article 4 of Switzerland/Uruguay BIT (1988); Article 4 of Switzerland/Uzbekistan BIT (1993); Article 5 of

What does such provision mean in relation to taxation?

If one reminds again that taxation is an essential prerogative of sovereignty, the restriction 'should be read into investment treaties only with prudence.'[86] For example, the use of the words 'may be transferred' can be construed as leaving the discretion for the host state to impose taxation when necessary.[87] In other words, irrespective of the inexistence of explicit reference, it is logical to suppose that the sovereign power of taxation, including power to address BEPS, will remain.

In sum, explicit reference to taxation does not constitute any additional basis to address BEPS. Conversely, the inexistence of reference to taxation does not necessarily limit the sovereign power to taxation. Accordingly, regardless of whether a BIT contains such a provision or not, host States can require investors to comply with their national tax obligations before the repatriation of profits.

Nevertheless, States can limit their taxation power by themselves through direct contracts with investors, as will be examined next.

3. Contractual Limitation: Effect of 'Tax Stabilization Clause'

Foreign direct investment is governed not only by investment treaties, but also by contracts between an investor and the host state (and/or its subsidiaries[88]). Practice shows that investors often conclude a contract with the host state providing a stabilization clause by which the law of the host state, including the law of taxation, is 'frozen' for an extended period of time.[89] For example, a legal stability agreement concluded between Peru and an investor (Duke Energy International) provides that Peru guarantees legal stability for Duke Energy International under the following terms:

> Stability of the tax regime with respect to the Income Tax, […] *in effect at the time this Agreement was executed*, according to which dividends and any other form of distribution of profits, *are not taxed* […].[90] [emphasis added]

Switzerland/Venezuela BIT (1993); Article 5 of Switzerland/Zimbabwe BIT (1996). Both Article 6 of German Model BIT (2008) and Article 6 of French Model BIT (2006) guarantee free transfer but have no explicit reference to taxation issues.

[86] Wälde and Kolo, *supra* note 60, at 336.

[87] Wälde and Kolo, *supra* note 60, at 336.

[88] Salacuse, *supra* note 59.

[89] Christian Tietje and Karoline Kampermann, 'Taxation and Investment: Constitutional Law Limitations on the Tax Legislation in Context', in Stephan W. Schill (ed.), *International Investment Law and Comparative Public Law* (Oxford University Press, 2010), at 586.

[90] *Duke Energy International Peru Investments No. 1, Ltd. v. Republic of Peru,* ICSID Case No. ARB/03/28, Award, 25 July 2008, para. 186.

This provision may prevent Peru from raising taxes, and from possibly taking measures addressing BEPS by investors, in case this would lead to higher burden on Duke Energy International.[91]

Although it is debatable whether such a contractual stabilization clause can achieve the legal effect of fettering the legislative sovereignty of a state regarding taxation for a long period of time,[92] the breach of the clause at least could lead to compensation in international arbitration (i.). In addition, the existence of such a clause can be a basis of legitimate expectation of investors (ii.). Outside the arbitration process, the existence of the clause may be an obstacle for the renegotiation between investors and host states on taxation (iii.).

i. The breach of the clause can lead to compensation

The arbitral award of *Revere Copper v. OPIC* is one of the examples illustrating that the introduction of a new tax may be a breach of a prior tax stabilization clause, which can amount to an expropriation.[93] This is not investor-state arbitration, but arbitration by an investor against an investment insurance company. In this case, the investor and the host State, Jamaica concluded a state contract including a tax stabilization clause which provides '[n]o further taxes [...] burdens, levies [...] will be imposed on bauxite, bauxite reserves, or bauxite operations.'[94] Notwithstanding with this, Jamaica enacted later new laws which increased tax rates applicable to investor, finally resulting in the cease of operation by investor.

Revere's investment had been insured with OPIC (Respondent), and the insurance contract provided for compensation for loss resulting from 'expropriatory action.'[95] As a result, the question whether Jamaica's conduct constituted 'expropriatory action' had risen, and settled by arbitration. The arbitral tribunal finally concluded that the enactment of tax legislations by host State (Jamaica) which increases tax rates applicable to investors amounted to 'expropriatory action' and thereby the compensation

[91] Supposing a question *ex hypothesi*, a State already has legislation addressing BEPS at the time of the conclusion of the contract, and subsequently finds tax erosion by investor. To regulate the latter, can the State argue that it is not changing the tax regime, but just enforcing it? There is no precedent directly relevant to this situation and, eventually, the answer will depend on the wording and purpose of each tax stabilization clause. One can interpret that it is existing legislation and its legal effects that cannot be modified, so an enforcement measure based upon the legislation does not be prevented. However, one cannot deny *a priori* a case that the purpose of stabilization clause is so broad enough to prevent an enforcement measure based upon existing laws too.
[92] Tietje and Kampermann, *supra* note 89, at 587.
[93] *Revere Copper and Brass Inc. v. Overseas Private Investment Corp (OPIC),* Award (24 August 1978), *I.L.R.,* vol. 56 (1980), at 258.
[94] *Revere Copper* (1978), at 273.
[95] *Revere Copper* (1978), at 261.

is due:

> We find that the commitments made by the Government were internationally binding, although they may not […] have prevented the legislature, acting under its Constitutional powers, from enacting legislation contrary to their provisions. Action contrary to them, however, constituted a breach.[96]

If this is the case,[97] one can assume that the breach of a tax stabilization clause could constitute not only expropriation, but also the violation of other substantive obligations of IIAs, such as fair and equitable treatment and the umbrella clause, according to the particular circumstances of cases.

ii. Stabilization clause as a basis of legitimate expectation

Irrespective of the legal effect of the clause *per se*, the existence of the stabilization clause may be taken into account in the consideration of investors' legitimate expectations, and thereby the violation of FET provisions. In *Sergei Paushok v. Mongolia,* the Tribunal concluded that '[c]laimants have not succeeded in establishing that they had legitimate expectations that they would not be exposed to significant tax increases in the future' on the basis of the fact that the claimants failed to agree on tax stabilization agreements with the Respondent.[98] The converse is that the existence of a tax stabilization clause can be a basis for investors' legitimate expectation, which results in the violation of FET obligation by host States.

iii. The existence of the clause can be an obstacle for renegotiation

It has been reported that investors actually refuse to renegotiate with host states on taxation issues by invoking tax stabilization clauses. For example, Africa Progress Panel, advocating equitable and sustainable development for Africa, reported that "[w]hen Zambia sought to renegotiate its royalty rate on copper exports, major investors opposed the measure despite a fourfold increase in the price of copper between 2000 and 2011, and the very low effective tax rates that transnational companies were paying."[99]

Regardless of the doctrinal debate on the legal effect of the clause as indicated above,

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[96] *Revere Copper* (1978), at 286.

[97] There is a criticism against the reasoning of the award. *See,* Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press, 2009), at 207-213.

[98] *Sergei Puashok v. Mongolia,* UNCITRAL, Award on Jurisdiction and Admissibility, 28 April 2011, paras. 97-100, 302; similarly, *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic,* UNCITRAL, Final Award, 23 April 2012, para. 236.

[99] Africa Progress Panel, *Equity in Extractives: Stewarding Africa's Natural Resources for All* (Africa Progress Reports, 2013), at 64.

this example shows that such tax stabilization clause has an effect *de facto* limiting host states' capacity to taxation, and thereby to take anti-BEPS measures.

B. INVESTMENT ARBITRATION RELATING TO TAXATION ISSUES

In investment arbitration, most taxation issues have arisen as regulatory measures taken by host states. Even criminal investigation on tax evasion can be a subject of matter of arbitration proceedings (1.). Nevertheless, this does not mean that there is no place to argue tax avoidance by investors before investment arbitration. In a few cases, host states attempted to reproach tax evasion by investors via counterclaims (2.).

1. Taxation as Regulatory Measures Taken by Host States

Despite the existence of IIAs excluding taxation from its scope of application, some investment treaties still cover taxation. In such a case, host states' sovereign power to taxation and thereby possibly to address BEPS can be subjected to the scrutiny of investment arbitration. Practice shows that most taxation related investment arbitrations have little or no relevance to BEPS (i.), whereas several cases involved investigation by taxation authority of host states against alleged tax evasion by investors (ii.).

i. Generalities

Classical large-scale nationalization is no longer common practice in foreign direct investment. Instead, more sophisticated and less conspicuous ways of 'squeezing' foreign investment have been brought before investment arbitrations. Introducing new tax such as 'windfall profits tax' is an example.[100] In this way, taxation measures have been alleged to constitute 'indirect expropriation' or violation of investment treaty obligations, such as fair and equitable treatment.[101] Overall picture on investment arbitration relating to taxation generally will be showed in the Annex B of this Memo.

ii. Investigation on tax evasion as an abuse of power by host states

In general, States have a broad discretion on taxation issues (a.). In several cases, however, it has been submitted that criminal or administrative investigation by the authority of host states against alleged tax evasion by investors constitute abuse of power and thereby violate substantive obligations of investment treaties (b.). Nevertheless, it is concluded that investment arbitration will not be a serious obstacle to fight against BEPS.

[100] Wälde and Kolo, *supra* note 60, at 308-309.
[101] *Marvin Feldman v. Mexico,* ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, para. 101.

a). Broad discretion of tax authorities and presumption of bona fide

On the one hand, since taxation is 'an essential prerogative of State sovereignty' as mentioned above, host States have a broad discretion in the operation of taxation law. In *Sergei Paushok v. Mongolia,* the Tribunal recognized a 'considerable discretion granted to tax authorities in the interpretation of [taxation laws] in their pursuit of tax avoidance by taxpayers.'[102] In *RosInvest v. Russia,* the Tribunal stated that 'tax authorities may change their positions regarding the interpretation and application of the tax law and that they have a certain discretion in this respect.'[103] As a result, the Tribunal in *Renta 4 v. Russia* recognized the presumption of *bona fide* in following terms: 'the presumption must be that [tax] measures are bona fide, *unless there is convincing evidence that,* upon a true characterisation, they constitute a taking.'[104] [emphasis added]

On the other hand, taxation, even if it is a manifestation of sovereignty, is regulated by public international law. In *Burlington v. Ecuador,* the Tribunal stated '[c]ustomary international law imposes two limitations on the power to tax. Taxes may not be *discriminatory* and they may not be *confiscatory*.'[105] [emphasis added] As examined next, there are some instances that host States' conducts addressing tax evasion by investors are found to constitute violations of investment treaties. Nevertheless, since most tribunals' conclusions are case-specific, it is difficult to extract a general implication for States' fight against BEPS.

b). Arbitral awards relating alleged tax evasion by investors

There have been at least three cases where alleged tax evasion by investors was invoked and tribunals decided on them, although it is difficult to find any general tendency.

First, in *Sergei Paushok v. Mongolia,* Claimants alleged violation of the Mongolia/Russia BIT,[106] resulting from the tax assessment by the tax authorities of

[102] *Sergei Puashok v. Mongolia,* UNCITRAL, Award on Jurisdiction and Admissibility, 28 April 2011, para. 617.
[103] *RosInvestCo UK Ltd. v. Russia,* SCC Case 079/2005, Final Award, 12 September 2010, para. 496.
[104] *Renta 4 S.V.S.A. v. Russia,* SCC No. 24/2007, Award, 20 July 2012, para. 181.
[105] *Burlington Resources v. Ecuador,* ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012, para. 393. As the authority of the sentence, the Tribunal cited A.R. Albrecht, 'The Taxation on Aliens under International Law', 29 British Year Book of International Law 169 (1952).
[106] The text is available in Russian only, except provisions as translated in the Award. But as the respondent did not raise any objection to the jurisdiction of the tribunal in relation to the matter of taxation, issues relating to the scope of the exclusion as examined above did not come up. *Sergei Paushok v. Mongolia,* UNCITRAL, Award on Jurisdiction and Admissibility, 28 April 2011, paras. 183-234.

Respondent, and the latter invoked tax evasion by Claimants as a justification, though the criminal prosecution has never occurred. The Tribunal stated that the question is 'whether the Mongolian tax authorities made proper use of [national tax legislations] or breached the Treaty,' and concluded no violation of the Treaty in this regards, although found that some conditions set by the legislation were not satisfied:[107]

> In the present case, the Tribunal is not convinced that conditions 1) and 2) of I.A.S. 18 [*i.e.* International Accounting Standards 18] were satisfied. In particular, it does not appear correct to conclude that the enterprise had transferred to the buyer the significant risks and rewards of ownership of the goods.[108]

In the words of the Tribunal, however, 'these are matters of interpretation' and the Tribunal stated that it 'has received no indication that the taxation authorities would have breached any of the conditions.'[109] In sum, although the Tribunal referred to the 'considerable discretion granted to tax authorities,' the basis of the decision was case-specific and thereby one cannot deduce a general implication in relation to BEPS.

Secondly, in *RosInvest v. Russia*, Claimant asserted that Respondent misused its police powers in the tax assessments whereas Respondent countered that the tax assessments were a legitimate consequence of Yukos' [*i.e.* Russian Oil Company; Claimant's subsidiary in Russia] flagrant breaches of tax laws, or in the words of Respondent, 'aggressive tax evasion practice.'[110] The Tribunal eventually found that 'the tax assessments on Yukos must be seen as a treatment which can hardly be accepted as a bona fide treatment' because 'changes [of positions regarding the interpretation and application of the tax law] and the use of discretion occur in so many respects and regarding a particular tax payer as compared with the treatment accorded to comparable other tax payers.'[111] However, the Tribunal did not find the violation of the BIT by the Respondent's tax assessment *per se*, as there exists a tax exclusion provision in the applicable Denmark/Russia BIT (1993) which provides in its Article 11(3) that '[t]he provisions of this Agreement shall not apply to taxation.'

Instead, the Tribunal considered 'these doubts' as an element to conclude Respondent's measures were an unlawful expropriation 'seen in their cumulative effect towards Yukos':[112]

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[107] *Sergei Paushok* (2011), paras. 610-621.
[108] *Sergei Paushok* (2011), para. 618.
[109] *Sergei Paushok* (2011), para. 619.
[110] *RosInvestCo UK Ltd. v. Russia,* SCC Case 079/2005, Final Award, 12 September 2010, paras. 456, 479.
[111] *RosInvestCo* (2010), paras. 496-497.
[112] *RosInvestCo* (2010), paras. 497, 498, 633.

> [E]ven if taxation as such is excluded from qualifying as a breach by Article 11(3) of the Denmark-Russia BIT […], this does not exclude to take taxation measures *into* account, besides other measures of Respondent, in considering the cumulative effect of a general pattern of treatment in the examination whether that qualifies as *"measures having effect equivilant to nationalisation or expropriation"* and as *"discriminatory."*[113]

On the one hand, it is remarkable that by introducing the theory of 'cumulative effect' the Tribunal paved the way to consider taxation despite the existence of tax exclusion clause. But on the other hand, under this theory, taxation is embedded into an overall consideration taken by the Tribunal, it is thereby difficult to identify potential implication on BEPS.

Lastly, in *Renta 4 v. Russia*, which shares the same factual background with *RosInvestCo v. Russia,* Claimants contend that the freeze on Yukos' [*i.e.* the Claimant was a shareholder] asset and the subsequent prevention on Yukos from discharging tax liabilities constitute expropriation, whereas Respondent countered that these conducts were reasonable response to Yukos' 'tax evasion.'[114] The Tribunal finally found that constituted an expropriation, but with emphasis on the '*case-by-case, fact-based inquiry*.'[115] In this regard, the Tribunal referred to the *RosInvest* Award as the finding on the illegal expropriation 'comports a finding of [legal] expropriation - *qui peut le plus peut le moins* - and the conclusion of the present award.'[116] In any event, it would be difficult to deduce general implication in relation to BEPS.

From these limited and case-specific awards, it is difficult to extract a general implication for States' fight against BEPS. As investment arbitrations deal with taxation to a certain extent, one cannot *a priori* exclude the possibility that a fight against BEPS by a host State is found as the violation of BITs. And the theory of 'cumulative effect' advanced by the *RosInvest* Award will remain to be seen. However, it would be hard to identify if a *bona fide* anti-BEPS action is discriminatory and confiscatory. In this perspective, it can be concluded that investment arbitration will not be a serious obstacle to address BEPS.

2. Tax Avoidance by Investors and Counterclaims in Investment Arbitration

Although the majority of taxation issues before investment arbitration have been

[113] *RosInvestCo* (2010), para. 618.
[114] *Renta 4 S.V.S.A. v. Russia,* SCC No. 24/2007, Award, 20 July 2012, paras. 87-93.
[115] *Renta 4* (2012), paras. 181-183.
[116] *Renta 4* (2012), paras. 186.

appeared as respondents' regulatory measures, a few of them are related to investors' conducts. That is to say, respondent States have attempted to bring counterclaims alleging tax evasion or tax related misconducts by investors. Theoretically speaking, therefore, counterclaims before investment arbitration have potential to address BEPS in the context of international investment law.

Due to the fact that a counterclaim before investment arbitration must have a close connection with the primary claim submitted by investors (i.), however, tribunals tend to decline jurisdiction over tax related counterclaims submitted by host States to date (ii.).

i. Counterclaims before investment arbitration requires a close connection with the primary claim

In general, a counterclaim must satisfy several conditions to be upheld before investment arbitration.[117] One important condition regarding taxation related counterclaims is the requirement of a nexus between the primary claim submitted by investors and the counterclaim. For example, Article 46 of the ICSID Convention requires that counterclaims have arisen '*directly out of the subject-matter of the dispute*.' Additionally, Article 9(3) of the 1976 UNCITRAL Arbitration Rules, which is still used in recent arbitral practice, provides that a 'respondent may make *a counter-claim arising out of the same contract* or rely on a claim arising out of the same contract for the purpose of a set-off.' [emphasis added]

In the words of the arbitral tribunal in *Saluka Investment BV v. Czech Republic,* 'a legitimate counterclaim must have *a close connexion with the primary claim* to which it is a response.'[118] [emphasis added] As will be explained below, an important factor to determine the (in)existence of 'close connection' in relation to tax counterclaims has been the legal basis of each claim.

ii. Taxation related counterclaims have difficulties to fulfill this condition

In investment arbitration, primary claims submitted by claimants are usually based on investment treaties and/or investment contracts;[119] whereas the counterclaims

[117] *See generally,* Helene Bubrowski, 'Balancing IIA Arbitration through the Use of Counterclaims', Armand de Mestral and Céline Lévesque (eds.), *Improving International Investment Agreements* (Routledge, 2012), at 212-229.
[118] *Saluka Investments BV v. Czech Republic,* Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004, para. 61.
[119] As regards contract-based arbitration, there has been a case which upheld the jurisdiction on taxation related counterclaims. In *Benevenuti and Bonfant v. Congo*, the Respondent filed counterclaims for damages for non-payment of duties and taxes on imported goods, and the Tribunal upheld its jurisdiction, but on the basis of a circular reasoning: '[c]onsidering that the counterclaim

submitted by respondents are based upon its national laws including tax legislations. This difference of the legal basis of claims has been seen by arbitral tribunals as a decisive element to reject taxation related counterclaims based on national law of host states.

a). Rejection based upon the nature of rights and obligation

In the resubmitted case of *Amco v. Indonesia*, the respondent brought a counterclaim and alleged 'tax fraud' by the investor. In the request, 'Indonesia […] claims to recover corporate taxes that P.T. Amco has not paid to the Indonesian Government since 1973. Indonesia will submit further evidence in this arbitration providing *a systematic course of tax evasion by P.T. Amco* over many years.'[120] [emphasis added]

However, the Tribunal declined the jurisdiction to entertain the counterclaim brought by Indonesia, based upon the distinction between rights and obligations resulting from general law of Indonesia and from an investment agreement:

> [T]he Tribunal believes that it is correct to distinguish between rights and obligations that are applicable to legal or natural persons who are within the reach of a host State's jurisdiction, as a matter of general law; and rights and obligations that are applicable to an investor as a consequence of an investment agreement entered into with that host state. Legal disputes relating to the latter will fall under Article 25(1) of the Convention. *Legal disputes concerning the former in principle fall to be decided by the appropriate procedures in the relevant jurisdiction* unless the general law generates an investment dispute under the Convention.[121] [emphasis added]

According to the Tribunal, since '[t]he obligation not to engage in tax fraud is clearly a general obligation of law in Indonesia […] the claim of tax fraud [is] beyond its competence *ratione materiae*.'[122] Therefore, it is the Tribunal's supposition that tax

relates directly to the object of the dispute, that the competence of the Tribunal has not been disputed and that it is within the competence of the Centre, the Tribunal considers, therefore, that it is bound to uphold its competence.' *S.A.R.L. Benevenuti & Bonfant v. People's Republic of the Congo*, ICSID Case No. ARB/77/2, Award, 8 August 1980, para. 4.104. A previous study on counterclaims before investment arbitration also qualified this reasoning as 'a tautological statement.' Dafina Atanasova, Carlos Adrián Martínez Benoit and Josef Ostřanský, 'Counterclaims in Investor-State Dispute Settlement (ISDS) under International Investment Agreements (IIAs),' *CTEI Working Papers,* No. 2012-05 (The Graduate Institute Geneva, 2012), at 30. As the result, the award has been seldom referred by the subsequent arbitrations.

[120] *Amco Asia Corporation and others v. Republic of Indonesia,* ICSID Case No. ARB/81/1, Decision of Jurisdiction, 10 May 1988, para. 110.

[121] *Amco Asia* (1988), paras. 125.

[122] *Amco Asia* (1988), paras. 126-127.

evasion by the investor should be dealt with by national courts of Indonesia or other relevant jurisdiction, not by the investment tribunal.

b). Non-extraterritorial enforceability of public law

The logic introduced by *Amco Asia v. Indonesia* was subsequently elaborated by an award of the Iran-United States Claims Tribunal. In a number of cases before the Tribunal, Iran brought counterclaims requesting allegedly unpaid taxes by claimants. However, if the counterclaims arise not out of the contracts that were subject matter of the main claims, but out of the domestic law of Iran, the Tribunals usually deny its jurisdiction on the counterclaims.[123] The leading case, which has been cited by the following arbitral awards, is *Computer Science Corporation v. Iran*. The Tribunal denied its jurisdiction over tax related counterclaims submitted by Iran by supposing 'non-extraterritorial enforceability of public law' as the rationale:

> *Such a claim is essentially a request that this Tribunal enforce the tax laws of a sovereign state*, in that what it seeks is a binding declaration of the taxes owed by the Claimant. […] *It is a 'universally accepted rule that public law cannot be extraterritorially enforced.'* Tax laws are manifestations of *jus imperii* which may be exercised only within the borders of a state. In addition, revenue laws are typically enormously complex, so much so that their enforcement is frequently assigned to specialized courts or administrative agencies. For these reasons, *actions to enforce tax laws are universally limited to their domestic forum.*[124] [emphasis added]

This decision was not only followed by the subsequent award by the same Tribunal, but also by an ICSID Tribunal.

In *Sergei Paushok v. Mongolia,* the Respondent asserts various counterclaims including tax evasion by the investors. According to Mongolia, '[c]laimants owe Windfall Profits Taxes they caused GEM [*i.e.* a company owned by the investors] to evade in violation of law,' and '[c]laimants owe taxes, fees and levies they caused GEM to *evade by illicit intergroup transfers, including non-arm's length transfers*.'[125] [emphasis added]

However, the Tribunal denied its jurisdiction over the counterclaims in line with the

[123] Yaraslau Kryvoi, 'Counterclaims in Investor-State Arbitration', 21 Minnesota Journal of International Law 237 (2012).
[124] *Computer Sciences Corporation v. The Government of the Islamic Republic of Iran, et al.,* Award No. 221-65-1 (16 April 1986), *Iran-U.S. C.T.R.,* vol. 10, at 55-56.
[125] *Sergei Puashok v. Mongolia,* UNCITRAL, Award on Jurisdiction and Admissibility, 28 April 2011, para. 678.

Computer Science award as mentioned above:

> [T]he Counterclaims arise out of Mongolian public law and exclusively raise issues of non-compliance with Mongolian public law, including the tax laws of Mongolia. *All these issues squarely fall within the scope of the exclusive jurisdiction of Mongolian courts, are matters governed by Mongolian public law,* and cannot be considered as constituting an indivisible part of the Claimants' claims based on the BIT and international law or as creating a reasonable nexus between the Claimants' claims and the Counterclaims justifying their joint consideration by an arbitral tribunal exclusively vested with jurisdiction under the BIT.[126] [emphasis added]

The Tribunal presupposes that 'the generally accepted principle is *the non-extraterritorial enforceability of national public laws* and, specifically, *of national tax laws*.' Therefore, 'if the Arbitral Tribunal extended its jurisdiction to the Counterclaims, it would be acquiescing to a possible exorbitant extension of Mongolia's legislative jurisdiction *without any legal basis under international law to do so*.'[127] [emphasis added]

iii. Analysis and a solution

As has been shown, almost all tribunal has found no jurisdiction over tax related counterclaims submitted by host States. This is due to the fact that a counterclaim before investment arbitration must have a close connection with the primary claim submitted by investors.

In this regard, a possible solution can be found by preparing a special rule applicable to counterclaims instead of the jurisprudence. One rare example is the Common Market for Eastern and Southern Africa (COMESA) Investment Agreement (2007), which provides in Article 28(9):

> A Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defence, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement, *including the obligations to comply with all applicable domestic measures* or that it has not taken all reasonable steps to mitigate possible damages. [emphasis added]

[126] *Sergei Puashok* (2011), para. 694.
[127] *Sergei Puashok* (2011), para. 695.

This provision can be interpreted as granting the jurisdiction of investment tribunals over counterclaims by respondent states alleging non-compliance with its domestic law by investors.[128] Therefore, if international investment law should address BEPS, such a legislative solution would be worth considering in future negotiation of investment treaties.

C. Conclusion

Since international investment agreements impose obligations on host States, they theoretically could have an effect limiting the states from taking taxation measures including measures against BEPS. In fact, it has revealed that tax stabilization clause in investment contracts also may constitute an obstacle for States to address BEPS.

As regards the substantive obligations of IIAs, however, one can conclude that the possibility is relatively limited. Firstly, since some IIAs exclude taxation from their scope of application, even though the extent varies from one treaty to another. Secondly, since taxation must be discriminatory and confiscatory to constitute an expropriation and/or the violation of substantive obligations of IIAs (though such condition equally vary in each IIA), the possibility that a state attempting to address BEPS could be given such a qualification will be quite limited. Therefore, although investment law and arbitration theoretically has a potential to restrict States' fight against BEPS, it will be unlikely to do so.

Conversely, counterclaims before investment arbitration could be potentially a tool to address BEPS in the context of investment law; but in the light of current jurisprudence, the chance will be low. Nevertheless, the COMESA provision on counterclaim, which enables States to bring a counterclaim for non-compliance with domestic tax obligations, could be guidance for future investment treaties.

In conclusion, investment treaty law has little effect on BEPS so far and thus does not prevent it from occurring.

[128] Bjorklund, *supra* note 59, 467.

IV. WTO AGREEMENTS AND FTAs: A WEAK APPROACH TO BEPS

The purpose of the GATT - WTO Agreements is to promote liberalization of trade in goods and services globally, therefore, transfer of capital and profits from country to country takes place in the process of trade liberalization. On the other hand, BEPS is the result of the conduct of private actors, in particular, by multinational enterprises to avoid tax burden through shifting profits from high tax jurisdictions to low tax jurisdictions. This creates a contradiction as the countries meant to benefit from trade liberalization are not able to benefit due to conduct that results in BEPS. This part will examine several WTO agreements and their impact in tax base erosion and profit shifting. It will demonstrate that while there is no specific prohibition of tax base erosion and profit shifting in international trade law, WTO law has an effect on the extent in which a country can restrict BEPS or facilitate BEPS.

In recognition of its potentially important effects on international trade and investment flows, taxation has been under scrutiny at the WTO.[129] This recognition is reflected in the GATT and several of the multilateral agreements reached at the conclusion of the Uruguay Round. These agreements include those on Subsidies and Countervailing Measures (SCM), Agriculture, Trade-Related Investment Measures (TRIMS), Agreement on Customs Valuation and Agreement on Trade in Services (GATS). The agreements reflect the growing realisation on the part of national governments that multilateral rules need to play an increasingly important role in regulating the use of tax measures, especially where these measures affect the international movement of goods, services, capital, persons and technology.

WTO rules are addressed to States.[130] BEPS is the effect of conduct by private sector, mainly multinationals to avoid tax. The tax avoidance schemes facilitate the avoidance of taxes through intra-firm shifting of profits. WTO rules do not have a direct effect on BEPS as they are directed at Member States though they may facilitate or constrain control of BEPS.

This part is organized as follows. First, WTO rules that enable States to restrict BEPS and limit a country's efforts to prevent BEPS (A.). Secondly, the provisions of Free Trade Agreements that restrict BEPS and limit States' effort to address BEPS (B.).

A. WTO AGREEMENTS AND BEPS

1. WTO Rules that Enable States to Restrict BEPS

[129] Michael Daly, 'The WTO and Direct Taxation', *WTO Discussion Paper*, No. 9 (June 2005).
[130] Marrakesh Agreement Establishing the World Trade Organization, Article II.

i. Customs valuation (Article VII and Customs Valuation Agreement) restricts BEPS through application of 'Arm's Length Principle'

Customs valuation is the procedure applied to determine the customs value of imported goods. Customs valuation prevents tax base erosion and profit shifting through prohibition of intra-firm valuation of goods by transfer pricing. Instead it encourages the application of arm's length pricing. GATT 1947, Article VII: 2(a) provides:

> The value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values.

The GATT Article VII and the WTO Agreement on Implementation of Article VII of the GATT 1994, has laid down the general principles and rules for an international system of custom valuation. Member countries of the WTO harmonise their internal legislation on customs valuation with the WTO Agreement on Customs Valuation.

The arm's length principle is applied by many customs administrations as a principle of comparison between the value attributable to goods imported by associated enterprises and the value of similar goods imported by independent enterprises.[131] However, there is growing concern that the documented custom valuation has been used to justify the transfer prices of imported goods in international transactions between associated enterprises.[132] Documented custom valuation is the practice in which Customs officials use a shipment's declared value or declared value for customs (the value the shipper declares on the goods being shipped), along with the description of the goods, to determine duties and taxes. Transfer pricing refers to the terms and conditions surrounding transactions within multi-national enterprises. It concerns the prices charged between associated enterprises established in different countries for their inter-company transactions, *i.e.* transfer of goods and services. Since the prices are set by non-independent associates within the multi-national, it may be the prices do not reflect an independent market price.[133] For tax purposes, transfer pricing determines the amount of income that each party earns and thus, the amount of income tax that is due in both the country of export and the country of import. A problem may arise if the importing and exporting enterprises are associated and apply lower transfer prices. This leads to lower customs value and applicable duties, which will consequently reduce the taxable income in the country of export and lead to shifting of profits to tax-friendly

[131] Liu Ping and Caroline Silberztein, 'Transfer Pricing, Customs Valuation and VAT Rules: Can we Bridge the Gap', 1 World Commercial Review (2007), available at: http://www.worldcommercereview.com/publications/article_pdf/13.
[132] *Ibid.*
[133] *See* http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/index_en.htm.

countries or tax havens. The rationale is to avoid paying tax completely or pay less tax than the enterprise would pay in the country of establishment.

Abuse of transfer pricing is a major concern for tax authorities who worry that multi-national entities may set transfer prices on cross-border transactions to reduce taxable profits in their jurisdiction. There is currently a great deal of focus on the interplay of transfer pricing methods on the one hand and custom valuation methods on the other hand. Globalization is providing opportunities for economic development and growth through intensified cross-border trade, investment and services. At the same time, there is also a growing trend, in both developed and developing economies, of government regulatory bodies stepping up their control over transfer pricing compliance through transfer pricing regulations and audits, with a view to protecting their tax base while avoiding double taxation that would hamper international trade.[134] Article VII:2(a) of the GATT regulates conduct that would restrict BEPS by associated enterprises.

ii. Article XIV (d) of the General Agreement on Trade in Services (GATS) enables a country to impose measures to prevent tax avoidance and evasion

The GATS provisions encourage liberalization of trade in services by service suppliers. Trade in services accounts for around three-quarters of production and employment in industrialised countries, it is recognised that non-tariff restrictions, particularly internal regulations, can be important obstacles to the cross-border provision of services.[135] Consequently, obstacles to foreign direct investment (FDI) impede the establishment of foreign firms that provide these services; likewise, measures to encourage FDI facilitate trade in services.[136] Liberalisation of trade in services and of FDI, thus often go hand in hand and includes shifting/transfer of profits and revenue from one country to another, this could have an impact in facilitating BEPS by multinational enterprises.

This part will analyse the exception in Article XIV(d) which enables a country to impose measures to prevent tax avoidance and evasion by service suppliers. A provision that could enable a country to impose measures that restrict BEPS through prevention of tax avoidance and evasion is the exception in Article XIV(d) which provides that 'tax measures inconsistent to National Treatment are permitted so long as they are aimed at ensuring the equitable and effective imposition of direct taxes.' The footnote 6 to Article XIV(d)[137] provides that the exception measures include those that apply to non-residents or residents of a country in order to prevent the avoidance or evasion of

[134] *Ibid.*
[135] *Ibid.; Daly, supra* note 129.
[136] *Ibid.; Daly*, *supra* note 129.
[137] GATS Article XIV(d), footnote 6
(iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; …

taxes, including compliance measures. Member States have the discretion of determining whether an enterprise is engaging in tax avoidance and tax evasion and the compliance measures to be taken. In addition, Article XIV(e) further provides that measures inconsistent with MFN are permitted so long as the difference in treatment is the result of an agreement on the avoidance of double taxation.

Article XIV(d) can be applied to prevent unfair tax competition through use of anti-avoidance rules. Anti-avoidance rules are statutory rules that deny tax payers the benefit of tax arrangements that they have entered into for an impermissible tax -related purpose.[138] The scope of 'impermissible tax-related purpose' is broad and could include BEPS if a country wishes to, in its domestic legislation. Countries such as Australia, Canada, China, Ireland, Hong Kong, Germany, New Zealand and South Africa have anti-avoidance rules in place to deal with schemes that avoid tax.[139] Tax authorities and organizations such as the OECD are considering use of general anti-avoidance rules to restrict BEPS.[140] The anti-avoidance measures can be included in domestic laws or included in international instruments. Application of Article XIV(d) by a Member State has the possibility to restrict BEPS by multinational or associated enterprises.

2. WTO Rules that Limit a State's Efforts to Prevent BEPS

i. Article I and III of the GATT, 1947 has limited ability to prevent BEPS because its scope does not cover taxation of income of MNEs and the non-discriminatory principles do not prohibit conduct that results in BEPS

The cornerstone of the GATT, as well as other WTO Agreements, is non-discrimination; it has two aspects, namely most-favoured-nation (MFN) and national treatment (NT). Taxation of income of multinational enterprises is not covered by GATT Article III. Instead, the scope of Article III relates to application of direct and indirect taxes. Non-discriminatory principles relate to the application of indirect and direct taxes for trade in goods by States. The non-discriminatory principles could constrain discriminatory tax regimes that are aimed at preventing BEPS, as States could be limited from imposing different taxation regimes on enterprises that engage in BEPS through abuse of transfer of pricing mechanisms for products to avoid payment of taxes. On the other hand, if a country imposed different tax measures on multinational enterprises that complied with proper pricing of goods and payment of taxes, from those

[138] *Ibid.*
[139] PwC, 'General Anti Avoidance Rules: What Are the Key Elements to a Balanced Approach?', *Tax Controversy and Dispute Resolution Alert* (4 June 2012), available at: http://www.pwc.com/en_GX/gx/tax/newsletters/tax-controversy-dispute-resolution/assets/pwc-general-anti-avoidance-rules.pdf.
[140] OECD, *Declaration on Base Erosion and Profit Shifting* (29 May 2013), available at: http://www.oecd.org/mcm/C-MIN(2013)22-FINAL-ENG.pdf.

that did not, this would not be *per se* discriminatory if it has evidence of the abuse of transfer pricing, a rationale and a purpose, and the measures are not arbitrary or unjustifiable discrimination where the same conditions prevail. In this case the exception in Article XX(d) of the GATT could apply.

ii. Article XI of the GATS enables Member States to facilitate the free flow of profits and other forms of revenue related to supply of services

Article XI is a provision that provides that Member States shall facilitate the free flow of profits and other forms of revenue related to supply of services. Article XI provides that a WTO member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments. The purpose Article XI is to secure the value of specific commitments on market access and national treatment that would be seriously impaired if Members could restrict international transfers and payment for service transactions in scheduled sectors.[141] Private enterprises can therefore transfer profits and revenue from one country to another in relation to transactions on provision of services; so long the balance of payments of a country is not affected.[142]

B. FTAS AND BEPS

This section will analyse the provisions of Free Trade Agreements (FTAs) which have an impact on tax base erosion and profit shifting. FTAs are preferential agreements between states to promote trade and investment between two or more countries. FTA provisions are to be implemented by States in order to create a preferential and enabling business environment for private enterprises to engage in regional or transnational trade. The section analyses taxation and trade related provisions that could impact tax base erosion and profit shifting. This section will illustrate that an FTA could have provisions that have the effect of either limiting BEPS, or provisions that are neutral and leave the discretion to address BEPS to the State and on the other hand, provisions that have the effect of facilitating BEPS. The provisions mainly covered are as follows: scope of the exclusion of tax issues, transfer of payments, customs valuation and general exceptions. This part is organized as follows. First, provisions that impose obligations that restrict BEPS (1.). Secondly, neutral provisions that leave the discretion to address BEPS to the State (2.) and third, provisions that limit a country's efforts to prevent BEPS (3.).

1. FTA Provisions that Impose Obligations on States that could be Used to Restrict BEPS

[141] *US — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Panel Report, WT/DS285/R (circulated 10 November 2004), paras. 6.441–6.442.
[142] Article XI(1) provides for importance of safeguarding balance of payments.

i. Customs valuation provisions

Some FTAs have provisions on customs valuation of goods. They adopt the 'arm's length pricing' valuation that is provided in the WTO Agreement on Customs Valuation. Repeating WTO commitments in the FTAs has no additional legal effect, however, the repeated WTO commitments emphasize the key rules that the FTA parties will apply in the trading arrangement. Adoption of arm's length pricing prevents tax base erosion and profit shifting as goods valued using transfer pricing by multinational enterprises have to be valued in comparison to similar goods by independent enterprises. Some of the FTA's that have provisions on customs valuation include; Article 15 of the Japan-Singapore FTA, it provides as follows:

> The Parties *shall apply the provisions of Part 1 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 in Annex 1A to the WTO Agreement* (hereinafter referred to in this Agreement as the 'Agreement on Customs Valuation') for the purposes of determining the customs value of goods traded between the parties. [emphasis added]

The US-Australia FTA,[143] Australia-Chile FTA[144] and the India-Singapore FTA[145] also have similar provisions adopting valuations similar to the WTO Agreement on Customs Valuation. Accordingly, customs valuation provisions in FTAs that provide for 'arm's length' pricing restrict BEPS as goods at the borders are valued according to their market value. The valuation of goods is done by the customs administration that compares the documented valuation of goods by the associated enterprises with the value of similar goods in the market from different manufacturers.

ii. General exceptions provisions that enable countries to take measures to prevent tax avoidance

As seen in the previous Chapter III, there are different types of exclusion of taxation clauses in IIAs. Similarly, different FTAs address taxation issues in different depths. This section will cover FTAs that have 'general exceptions provisions' that enable States to take measure to prevent tax avoidance or to prevent conduct that result in

[143] Article 2.4.
[144] Article 3.5.
[145] Article 2.6.

BEPS. The Japan-Singapore FTA[146] provides that the exception measures include 'those that apply to non-residents or residents of a country in order to prevent the avoidance or evasion of taxes.' This would facilitate the parties to implement general anti-avoidance rules to prevent base erosion and profit shifting.

In addition, Article 71 of the New Zealand-Singapore FTA has a 'General Exceptions' clause provides as follows:

> Provided that such measures are not used as a means of arbitrary or unjustified discrimination against persons of the other Party or as a disguised restriction on trade in goods and services or investment, nothing in this Agreement shall preclude the adoption by any Party of measures in the exercise of its legislative, rule-making and regulatory powers:
>
> […] f) *necessary to secure compliance with laws and regulations relating to customs enforcement, tax avoidance or evasion* […] [emphasis added]

States which have signed FTAs with similar provisions can enforce conduct that results into BEPS using general anti avoidance rules in order to protect tax bases and prevent profit shifting by multinationals or associated enterprises.

2. FTA Provisions that are Neutral and Leave the Discretion to Enforce BEPS to the State

i. Provisions on scope of exclusion of tax issues

Many FTAs provide that the scope of the agreements do not apply to taxation measures. This is because taxation issues are usually coved in bilateral taxation agreements such as, double taxation treaties. For instance Article 5 of the Japan-Singapore FTA provides that the agreement shall not apply to taxation measures. A similar provision was found in New Zealand-Singapore Closer Economic Partnership Agreement (New Zealand-Singapore FTA) which Article 78 provides as follows:

> The provisions of this Agreement *shall not apply to any taxation measure*. "Taxation measure" means any measure imposing direct or indirect taxes including excise duties as defined by the domestic laws of the Parties so long as these duties are not used for the purpose of protecting the domestic industry of the Party imposing the duties. [emphasis added]

[146] Article 69(d)(iii).

In the Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore (India–Singapore FTA) the 'General Exception' clause has a provision on taxation which provides that bilateral double taxation avoidance agreements are exempted from the scope of this Agreement.[147] Most FTAs exclude taxation measures due to the fact that many countries address taxation issues in taxation treaties. The exclusion reserves the sovereign power to restrict BEPS under using taxation treaties.

3. FTA Provisions that Limit a State's Efforts to Prevent BEPS

i. Transfer of payments provisions could limit a State's efforts to prevent BEPS

Most FTAs have provisions on repatriation/transfer of payments. International transfers and payments comprise all kinds of transactions for currency.[148] The provisions on transfer of payments promote shifting of payments and profits between the parties as there are no restrictions in any transfers and payments by enterprises. Some agreements such as the Japan–Singapore FTA, India–Singapore FTA,[149] US-Bahrain FTA,[150] and US-Australia FTA[151] adopt provisions similar to GATS, Article XI to enable transfer of payments. For instance, Japan–Singapore FTA[152] provides that 'except for purposes of safeguarding the balance of payments, a party shall not apply restrictions on international transfers and payments for transactions relating to specific commitments.' The New Zealand–Singapore FTA also has a provision on repatriation and convertibility[153] in which the two parties commit to allow investors of the other Party, on a non-discriminatory basis, to transfer and repatriate freely and without undue delay their investments and proceeds from investment.

As discussed in the Chapter III of this paper,[154] investors are guaranteed to repatriate profits in as far as they comply with tax obligations derived from the national legislation of the host states and taxation is a sovereign prerogative of a State. In addition, GATS

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[147] Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore, Article 7.21.
[148] Rüdiger Wolfrum and Peter-Tobias Stoll (eds.), *WTO - Trade in Services* (Brill, 2008), at 245-257.
[149] Article 7.17.
[150] Article 10.10, provides that each Party shall permit all transfers and payments relating to the cross-border supply of services to be made freely and without delay into and out of its territory. It also provides that each Party shall permit such transfers and payments relating to the cross-border supply of services to be made in a freely usable currency at the market rate of exchange prevailing at the time of transfer
[151] Article 11.8.
[152] Japan-Singapore FTA, Article 67.
[153] New Zealand-Singapore FTA, Article 31.
[154] *See* Chapter III of this paper.

Article XI permits transfer of profits and revenue from one country to another in relation to provision of services so long as the balance of payments is not affected.

However the provisions on transfer of payments and repatriation of proceeds could also limit a country's efforts to prevent BEPS, through corporations using tax avoidance schemes in order to shift their profits from one tax jurisdiction to another without paying taxes or paying little taxes in comparison to level of economic activity in the host state. This can be illustrated in instances where multinational enterprises structure their taxation schemes so as to avoid paying legal taxes, for example by levying artificially high charges internally therefore decreasing taxable profit in the host state and shifting money to a low-tax state.[155] This has led to many multi-nationals, locating factories, financial services and distribution hubs and regional headquarters in low-tax jurisdictions while the country in which the economic activity takes place getting little or no taxes from profits made.[156]

The provisions permitting repatriation of profits and revenues back to the investor's host country could therefore enable multinational enterprises to shift profits through complex tax arrangements from one country to another to avoid tax. These provisions do not limit country's ability to restrict conduct that results BEPS unless there are specific limitations in the agreements.

A few FTAs have provisions that limit transfer and repatriation of profits for non-fulfilment of tax obligations or financial reporting obligations. For example, Article 10.10(4) of the Australia-Chile FTA has a limitation of transfer of profits for purposes law enforcement and investigations by financial regulatory authorities. It provides as follows:

> […] a Party may *prevent or delay a transfer through the equitable, non-discriminatory, and good faith application of its laws* relating to:
>
> (d) Financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; [emphasis added]

The above provision is a provision that could limit transfers of profits for purposes of enforcing conduct that results in BEPS, in the assumption that the laws prohibit tax avoidance or conduct that results in BEPS.

C. CONCLUSION

[155] See UK Parliament, HM Revenue and Customs: Annual Report and Accounts - Public Accounts Committee, 'Tax avoidance by multinational companies', available at: http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/71605.htm (last visited 9 December 2013).
[156] *Ibid.*

WTO agreements and FTAs impose obligations on States in international trade, therefore they do not prevent BEPS *per se*. They address the conduct of States for purposes of promoting international trade.

Some WTO provisions and FTA provisions have the potential to prevent BEPS, for example the customs valuation provisions in GATT which provide for arm's length principle of valuation and the exception in Article XIV(d) of GATS which enables a country to impose measures to prevent tax avoidance and evasion by service suppliers. Secondly, some provisions have the effect of limiting a State's efforts to prevent BEPS; such provisions include provisions that provide for transfer of revenue and profits. In addition, the non-discriminatory principles in Article I and III of the GATT have limited effect in preventing BEPS as the scope of taxation does not cover shifting of income tax by corporations. Consequently, WTO agreements and FTAs have little scope to prevent BEPS.

V. INTERNATIONAL SOFT LAW FAILS TO PREVENT BEPS

Apart from the inherent non-binding nature of soft law, international soft law standards also fail to prevent BEPS due to the lack of coherent soft law standards resulting in double *non*-taxation (A) and due to the possibilities of circumvention of existing standards resulting in treaty abuse or treaty shopping (B).[157] Thus, international taxation faces a collective action problem of tax competition that existing international soft law standards cannot solve due to being non-binding by nature, incoherent (A) and avertible (B).

Dominant actors in the creation of soft law standards for international taxation are the OECD and G20 Finance ministers and Central Bank Governors. As mentioned in the introduction of this paper, the OECD published an 'Action Plan on Base Erosion and Profit Shifting' launched in July 2013.[158] It was fully affirmed by the G20 Finance Ministers and Central Bank Governors at the July 2013 meeting in Moscow and the G20 Heads of State meeting in Saint-Petersburg in September 2013, resulting in a Tax Annex attached to the G20 Saint Petersburg Declaration. These two publications, as well as the OECD and UN Model Tax Conventions, provide important guidance to domestic taxation systems and thus, are essential soft law instruments in the regulation of international taxation. As elaborated in the OECD Action Plan, and as clarified below, future changes in soft law settings that would be implemented and harmonized across all domestic systems might provide opportunities to prevent BEPS in the face of lacking hard law regulating international taxation.

This section will first briefly recapitulate the most essential incoherencies of international corporate income taxation (A) as explained in the first chapter on terminology I.B and proposes to address this collective action problem through international cooperation. The second part of this section discusses the possibility of treaty abuse through problems in existing international standards (B), including (1) lax anti-abuse clauses, (2) avoidance of PE status and (3) deficient transfer pricing rules. Partially overlapping with section II of this paper, it addresses the deficits in existing the

[157] Treaty shopping refers to situations where benefit is drawn from a treaty without being the legitimate beneficiary of it, whereas treaty abuse relates to operations that result in situations contradicting the treaty. Treaty shopping is less of a concern in this paper since treaty shopping is directly addressed in a treaty, *e.g.* through countervailing measures. *See, Report of the Secretary-General on the Eleventh meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters* (E/2004/51), section III Treaty shopping and treaty abuses, para. 21.

[158] OECD has a long history of tackling the problem of tax base erosion and profit shifting which cannot be addressed thoroughly at this point. Several reports have been published analyzing in depth the issue, *see* OECD Website, 'Centre for Tax Policy and Administration', available at: http://www.oecd.org/ctp/.

OECD Model Tax Convention as identified by the OECD Action Plan as well as the recommendations made.

A. INCOHERENCE OF INTERNATIONAL CORPORATE INCOME TAXATION RESULTING IN DOUBLE *NON*-TAXATION

1. Lacking International Soft Law Standards to Coordinate Domestic Taxation

No international soft law recommendations or standards exist that coordinate domestic taxation rules adequately and provide best practice in the design of rules to prevent base erosion.[159] The lack of coherent soft law standards, in turn, enables unintended double *non*-taxation and BEPS to occur. The interaction of domestic tax systems creates overlaps and gaps that can be used by MNEs to artificially shift profits away from the country of value creation.[160]As explained in section I.B. above, several deficits exist in the current framework of international corporate income taxation that result in double *non*-taxation due to a lacking international cooperation. These relate to

1) Uncoordinated domestic rules leading to hybrid mismatch arrangements: Domestic law provisions allow tax exemption and recognition of deductible payments that are also deductible in other jurisdictions, that are not includible in income payments or that are subject to controlled foreign company rules.[161]
2) Double *Non*-taxation due to Circumvention of Domestic Anti-avoidance Rules: Anti-Avoidance rules are not strong enough and allow the routing of income from resident enterprise to non-resident affiliates. There are no best practices in the design of legislation to strengthen anti-avoidance rules on a domestic level, *e.g.* through the introduction or strengthening of controlled foreign company (CFC) rules.[162]
3) Double *Non*-taxation due to Deductibility of Interest and other Expenses: The excessive deductibility of interest and other financial expenses allow double *non*-taxation. There is a lack of international soft law guidance on pricing of related party financial transactions, including derivatives, financial and performance guarantees.
4) Harmful Taxation Practices Lead to a 'Race to the Bottom' of Applicable Tax Rates on Certain Mobile Sources of Income: Although the international community would equally benefit from the even distribution of profits, individual countries gain more by attracting investments through a

[159] OECD, *Action Plan, supra* note 2, at 18.
[160] *Tax Annex, supra* note 4, para. 5.
[161] OECD, *Action Plan, supra* note 2, at 15.
[162] OECD, *Action Plan, supra* note 2, at 16.

comparatively lower tax base. Since tax competition and a ‘race to the bottom’ form a basis for tax base erosion and tax avoidance, cooperation and improved transparency and information sharing between tax administrations is an essential strategy to counter BEPS and to address the collective action problem that paralyzes the international community.

2. Lacking Transparency and Clarity on *Aggressive Tax Planning*[163] and Transfer Pricing

International transparency and cooperation are the most useful way of tackling the collective action problem by building trust in the joint action of the international community.

There is lacking transparency on aggressive tax planning arrangements as well as transfer pricing schemes and value-chain creation.[164] Transparency here refers to a certain standard of international cooperation to ensure exchange and collection of data on aggressive tax planning and transfer pricing schemes. Domestic tax policies designed in isolation provide opportunities for tax planning. BEPS, in contrast, occurs on a global scale. Opportunities for BEPS can only be discovered through information exchange and transparency between governments as well as disclosure by taxpayers.[165] Taxpayers so far are not obliged to disclose tax-planning strategies. Transfer pricing documentation requirements are burdensome and not target-oriented. Improved transparency and exchange of information between tax administrations of member countries as well as certain disclosure requirements for taxpayers is thus a major goal of OECD and G20 Member States.

In 2012, Article 26 setting the international standard on exchange of information of the OECD Model Tax Convention was updated.[166] Article 26 now includes group requests. This means that tax authorities can request information on a group of taxpayers, without individual naming. In general, The OECD Action Plan emphasizes the need to develop measures of the scale and impact of BEPS.[167] Data collection methodologies can help determine what types of data tax payers should provide to tax administrators. In the Tax

[163] Term borrowed from OECD, *cf.* OECD, *Action Plan*, *supra* note 2, and *supra* note 158.
[164] OECD, *Action Plan, supra* note 2, at 21 ff.
[165] *Tax Annex, supra* note 4, para. 7.
[166] Article 26 defines the international standard on exchange of information. It provides for information exchange on request, where the information is ‘foreseeably relevant’ for the administration of the taxes of the requesting party. *See,* OECD, Centre for Tax Policy and Administration, *Tax: OECD updates OECD Model Tax Convention to extend information requests to groups* (18 July 2012), available at: http://www.oecd.org/ctp/taxoecdupdatesoecdmodeltaxconventiontoextendinformationrequeststogroups.htm.
[167] OECD, *Action Plan, supra* note 2, at 21 ff.

Annex to the G20 Leaders Declaration from September 2013, G20 Finance ministers and Central Bank Governors re-affirm their commitment to a new global transparency standard: automatic exchange of information.[168] This commitment is complimented by work of the OECD to develop the new single global standard for a multilateral automatic exchange of information.

The collective action problem that is identified in the above mentioned inconsistencies of the current framework of international corporate income taxation could be tackled by providing for increased transparency, exchange of information and international cooperation on tax matters. This resolves the distrust operating at the heart of every collective action problem, and the defeats the purpose of tax competition for investment. Apart from international cooperation and transparency, it was shown in section II that taxation treaties are the most important source of law that directly apply to tax matters (as compared to international investment or trade law). International soft law can provide international standards guiding governments in negotiating and implementing taxation treaties by offering best practice examples, *e.g.* in the formulation of clear and effective provisions for tax treaties. This is where a reform of international soft law is relevant, such as envisioned in the OECD Action Plan.

B. Circumvention of Existing International Standards Providing Opportunities for Treaty Abuse

Income is detached from the economic activity creating income. This is possible through legal loopholes in taxation treaties through lax anti-abuse clauses (1), gaps in the definition of permanent establishment (2) and in transfer pricing rules (3).

1. Treaty Abuse due to Lax Anti-abuse Clauses

Existing anti-abuse treaty clauses are not strong enough to prevent treaty abuse and are often circumvented. Improper use of treaties, or treaty abuse, refers to situations where MNEs exploit the differences between countries' tax laws to secure the benefits of the tax advantages available both under domestic laws and/or under double tax conventions.[169] International soft law tools can provide best practice examples on the design of assertive and effective anti-abuse treaty clauses.

Tax avoidance has been generally addressed in the Convention in numerous provisions, but specific and precise provisions are needed to address the particular avoidance strategy in question. The Commentaries recommend the inclusion of specific provisions

[168] *Tax Annex, supra* note 4, para. 3.
[169] OECD, *Commentaries, supra* note 23, Commentary on Article 1, at 59, para. 7.1.

aimed at countering particular avoidance strategies in a given bilateral treaty setting. The Model Tax Convention seeks to specify a single rule for each situation, but nonetheless attempts to provide leeway for a certain margin of appreciation in the effective implementation through member countries.[170] The Commentaries exist to provide guidance in fleshing out the rules in bilateral tax treaties; and in the interpretation of tax issues by tax administrations and taxpayers the like. Thus, the avoidance in treaty abuse should be addressed through changes both in the Model Tax Convention as well as the Commentaries. Tax avoidance is explicitly dealt with in the Convention in several instances. Tax avoidance is addressed, for example, by the introduction of the concept of 'beneficial owner' (Articles. 10, 11 and 12) or special provisions, such as Paragraph 2 of Article 17 addressing artiste-companies. Also the Commentaries include a number of example provisions that can be used to address treaty abuse.[171] However, the OECD Action Plan nonetheless advocates the development of precise model treaty provisions and recommendations to counter double *non*-taxation through treaty abuse.[172]

The majority of countries have neither incorporated anti-avoidance rules into their domestic tax systems or nor anti-abuse rules in bilateral tax treaties.[173] This might be caused by the inherent non-binding nature of soft law combined with the collective action problem stipulated above. Coherent and strong anti-abuse and anti-avoidance rules are necessary to prevent treaty abuse and treaty shopping.[174] International cooperation and transparency will be key in addressing dilemmas of collective action.

Anti-avoidance rules[175] are circumvented and rendered inapplicable through various strategies, for example:

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[170] OECD, *Action Plan, supra* note 2, Introduction, I -8.
[171] For example, the Commentary on Article 10 (Dividends), para. 17, provides: The reduction envisaged in subparagraph a) of paragraph 2 should not be granted in cases of abuse of this provision, for example, where a company with a holding of less than 25 per cent has, shortly before the dividends become payable, increased its holding primarily for the purpose of securing the benefits of the abovementioned provision, or otherwise, where the qualifying holding was arranged primarily in order to obtain the reduction. To counteract such manoeuvres Contracting States may find it appropriate to add to subparagraph a) a provision along the following lines: provided that this holding was not acquired primarily for the purpose of taking advantage of this provision. OECD, *Commentaries*, s*upra* note 23, Commentary on Article 10, at 190, para. 17.
[172] OECD, *Action Plan, supra* note 2, at 19.
[173] This is reflected in the Action 2 and 6 of the OECD Action Plan. This was also mentioned in preceding OECD reports, such as OECD, *Harmful Tax Competition*, *supra* note 8, Recommendations 1, 2, 9, 10, etc.
[174] *See* OECD, *Commentaries*, s*upra* note 23, Treaty abuse has been particularly addressed by the OECD amendments to the Commentary to Article 1.
[175] Anti-abuse clauses mostly are used to apply within treaties, whereas anti-avoidance rules are used implemented in domestic tax systems.

(a) if the rules only apply to tax-planning strategies that incorporate low tax jurisdictions, then tax-planning strategies involving high tax jurisdictions are not covered by such anti-avoidance rules;
(b) the provision of loans through a foreign branch that is subject to a low-tax regime while residing in a high tax jurisdiction, enables the avoidance of said rules due the deductibility of interest payment in the high tax jurisdiction (*see* A. 3 above, Chapter I. B);
(c) the use of hybrid entities that are treated as a taxable person in one country but are 'transparent' in another avoids taxation because they are 'invisible' (*see* also Figure B.2 below);
(d) the interposition of intermediate entities in treaty jurisdictions so as to benefit from the relevant tax treaty in force, including conduit companies and derivatives (to reduce or eliminate withholding taxes);
(e) the use of hybrid instruments that are, like hybrid entities, subject to different treatment in different countries, *e.g.* considered as equity in one country and as a debt instrument in another country.[176]

Thus, and as already stated in the Commentaries on the Articles of the OECD Model Tax Convention (hereinafter Commentaries), general anti-abuse provisions, such as the arm's length principle discussed below, are insufficient in preventing particular forms of tax avoidance.[177]

2. Treaty Abuse due to Avoidance of PE Status

PE is the fixed place of business that gives rise to income or VAT liability. PE status covers local subsidiaries of multinationals when they act as distributors. Artificial avoidance of PE status is possible due to the definition of PE status in tax treaties, which grants leeway to independent entities.[178] Treaty rules for taxing business profits have incorporated the soft law principle of 'permanent establishment' as a nexus or threshold rule to determine whether or not a country has taxing rights.[179] However, commission agents and other independently acting agents can sell goods while the profits of these sales are not taxable to the same extent as they would be if sold by the PE distributor.[180] Local subsidiaries often act under 'commissionaire arrangements' to avoid the PE status.[181] In a like manner, MNE's artificially distribute their operations

[176] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 40.
[177] OECD, *Commentaries*, *supra* note 23, at 61, para. 9.6.
[178] OECD, *Action Plan, supra* note 2, at 19.
[179] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 34.
[180] Article 5.6 states that an enterprise shall not be deemed to have a PE 'merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status.'
[181] For tax purposes in civil law jurisdictions, a commissionaire is not generally viewed as a

among multiple entities and countries to qualify for PE exceptions for ancillary activities.[182] Since the principle of permanent establishment is incorporated in most taxation treaties, it is further discussed in the Chapter II of this paper. In conclusion, PE status is avoided through the use of commissionaire arrangements and the ancillary activity exemption.

3. Treaty Abuse due to Deficient Transfer Pricing Rules

Intangibles and other mobile assets are moved amongst States for less than their full value providing opportunities for tax avoidance. For intangibles, this is possible because of an unclearly delineated definition of intangibles and a lack of transfer pricing rules for transfers of intangibles.[183] Regarding risks and capital, the current transfer pricing rules allow inappropriate returns for entities that merely have assumed risks or provided capital.[184] Finally, regarding other high-risk transactions, BEPS is not prevented, as rules often do not cover transactions involving third parties.[185] This is the case for transfer pricing rules applying to global value chains. In conclusion, transfer-pricing rules are misapplied in some instances to separate revenue from the economic activity that created it and shift the relevant income into low tax environments.

C. CONCLUSION

The OECD Action Plan more adequately stipulates the recommendations to be drawn from above analysis on international soft law standards in relation to BEPS. Most importantly, international cooperation and transparency will be key in addressing the inconsistencies of current un-coordinated domestic rules and in tackling the dilemma of collective action, as was elaborated in the section A. Apart from that, international soft law standards need to be improved to provide best practice examples to national governments in the design and implementation of taxation treaties. Section B. re-iterated some of the above-mentioned problems with taxation treaties and focused on the possibility of treaty abuse as identified in the OECD Action Plan. Treaty abuse is possible through lax anti-abuse clauses (1), through the definition of PE (2) and deficient transfer pricing rules (3). First, more stringent anti-abuse rules are necessary. Most importantly, several countries have neither incorporated anti-avoidance rules into their domestic tax systems or nor anti-abuse rules in bilateral tax treaties.[186] This might

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dependent agent by virtue of the commissionaire status. Its activities and place of business are not attributed to the principal.

[182] OECD, *Action Plan, supra* note 2, at 19.

[183] OECD, *Action Plan, supra* note 2, at 20.

[184] OECD, *Action Plan, supra* note 2, at 20.

[185] OECD, *Action Plan, supra* note 2, at 20.

[186] This is reflected in the Action 2 and 6 of the OECD *Action Plan*. This was also mentioned in preceding OECD reports, such as OECD, *Harmful Tax Competition, supra* note 8,

be caused by the inherent non-binding nature of soft law combined with the collective action problem stipulated above. Coherent and strong anti-abuse and anti-avoidance rules are necessary to prevent treaty abuse and treaty shopping.[187] The excessive reduction of withholding taxes through interposed (artificial) entities in the State of residence (treaty shopping) was also touched upon. These also need to be addressed by revision of treaty language. Second, the current concept of permanent establishment has to be reconsidered, as mentioned above. Thirdly, and lastly, transfer pricing rules are misapplied so as to separate revenue from the process of value creation. As mentioned in the Chapter II, future efforts need to refine the standards for allocation of risk and intangibles and to re-align value creation with the associated function/asset/risk. In general, international cooperation, transparency and disclosure by taxpayers are key strategies to uncover and tackle BEPS. Thus, the OECD proposed the introduction of a multilateral instrument of tax cooperation to enhance the implementation of measures tackling BEPS and to amend bilateral taxation treaties.[188] Finally, the creation of an international infrastructure, *Tax Inspectors without Borders* (TIWB), is intended address the even more pressing needs of developing country member States who often lack the capacity to adequately deal with international tax matters.[189] This infrastructure is intended to share tax-auditing expertise with developing countries. TIWB shall be launched in early 2014.

Recommendations 1, 2, 9, 10, etc.

[187] *See* OECD, *Commentaries*, s*upra* note 23, Treaty abuse has been particularly addressed by the OECD amendments to the Commentary to Article 1.

[188] OECD, *Action Plan, supra* note 2, at 24.

[189] OECD, *Addressing Base Erosion and Profit Shifting, supra* note 1, at 87.

GENERAL CONCLUSION

This memorandum has shown that existing international economic law does not effectively prevent BEPS from occurring. The main reasons are summarized as follows.

Firstly, bilateral taxation treaties, which are applicable to income of private companies though, leave legal loopholes that make strategic tax planning possible resulting in BEPS:

- The status of PE, which is a relevant concept for the allocation of taxation jurisdiction among States, can be manipulated by MNEs through the artificial qualification of their operations. As a result, traditional notion of PE is no longer an effective nexus providing a basis for taxation, resulting in tax base erosion.
- Exemption rules, originally designed to prevent double-taxation, can be exploited in a way to lead to double *non*-taxation and thereby BEPS, by the combination of overlapping exemption rules of several States through strategic tax planning.
- The arm's length principle, which is the general principle underlying transfer pricing allocations, can be abused so as to separate income from the economic activity that produces it and thereby provide opportunities for BEPS, by recognizing the transferal of risks and intangibles among intra-group enterprises to more favourable tax jurisdiction.

Secondly, since international investment law regulates the conducts of host States, not investors, it has by definition little chance to address BEPS. In addition to this, several limitations have been identified:

- A lot of investment treaties exclude taxation issues from their scope of application, though the extent varies one treaty from another. Accordingly, issues relating to BEPS are placed outside the scope of investment treaty law to that extent.
- To the extent that a BIT is applicable to taxation, it can be a regulatory measure to be scrutinized by investment arbitration. One cannot therefore *a priori* exclude the possibility that a measure against BEPS is alleged to constitute a violation of BITs. Still, since a *bona fide* fight against BEPS does not need to be discriminatory, the probability will be low.
- In addition to BIT provisions, obligations resulting from 'tax stabilization clauses' in state contracts can be another limitation to the taxation power of States, including actions against BEPS.

- Conversely, the only instrument available for a State to tackle BEPS in the context of investment law is counterclaims before investment arbitration. Nevertheless, in the light of current jurisprudence, which requires 'close connection' between a primary claim and a counterclaim, the usefulness will be limited.

Thirdly, in a similar vein, since international trade law imposes obligations on Member States, but does not impose any obligation on private actors, it has by definition little chance to address BEPS. In addition to this, the following has been identified:

- GATT has little scope to address BEPS because its purpose is to promote trade in goods. It does not address measures that affect taxation of income by multinational corporations, which is the key issue in BEPS.
- Provisions on transfer of payments could allow corporations to use tax avoidance schemes to shift their profits from one tax jurisdiction to another without paying taxes or paying little taxes in comparison to level of economic activity in the host state.

Finally, international soft law standards provide opportunities for double non-taxation due to lacking coherence and problems in enforcement:

- The incoherence of domestic rules as expressed in hybrid mismatch arrangements, the circumvention of CFC rules as well as the excessive deductibility of interests lead to double non-taxation, a primary cause of BEPS.
- International cooperation on taxation matters and exchange of information between tax authorities is still insufficient to capture the overall fiscal scheme and aggressive tax planning of MNEs, providing a room for BEPS.
- International soft law standard for taxation treaties are inadequately implemented, in particular regarding anti-abuse clauses. Current soft law tools, such as the OECD Model Tax Convention, cannot address the challenges of modern global market.

On the other hand, this memorandum has suggested several proposals for amelioration to existing system:

- As the reservation provided in Article XIV of GATS shows, States reserve their rights to ensure 'the equitable or effective imposition or collection of direct taxes' 'in order to prevent the avoidance or evasion of taxes.' Accordingly, international law does not prevent State from tackling BEPS, including taking such measures as described in the OECD *Action Plan*.
- Article VII GATT, 1947 permits use of arm's length principle in the valuation

of goods by associated enterprises; it has possibilities to prevent BEPS if properly applied by Customs Administrations.

- The analysis on taxation treaties revealed severe legal loopholes in bilateral taxation treaties as far as they are modelled on the OECD Model Tax Convention. Problems in allocating the jurisdiction to tax, overlapping exemption and uncoordinated transfer pricing rules need to be addressed by refining the OECD Model Tax Convention.
- International soft law standards need to be better enforced so as to ensure coherence among domestic taxation system and bilateral tax agreements. International cooperation on tax matters between tax authorities and disclosure and transparency on sides of taxpayers is essential in uncovering the many mechanisms of BEPS and in tackling the collective action problem which hinders the elimination of BEPS.
- Counterclaims before investment arbitration has a room for amelioration. In line with COMESA Investment Agreement, which permits countermeasures based upon non-fulfillment of domestic obligation, the system could be adjusted to enable counterclaims alleging tax evasion by investors, and eventually to prevent BEPS from occurring to that extent.

On the whole, filling gaps in current bilateral taxation treaties would be most effective as well as realistic way to address BEPS as it is this kind of treaties that directly deals with taxation matters. To accelerate such an up-to-date of taxation treaties by States, coherent international soft law standards, including rules on arm’s length principle, CFC rules as well as exemption rules, need to be elaborated.

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ANNEX A WTO JURISPRUDENCE ON TAXATION

The implementation of the WTO rules concerning international trade has increased the scope of conflict between these rules and members' tax laws, leading to disputes between Members. This part will cover some WTO disputes involving direct and indirect taxation and examine if they had any impact on tax base erosion and profit shifting. It will demonstrate that WTO tax disputes have not had an effect on BEPS as they have been mainly cases on discrimination in the application of indirect and direct taxes and disputes on subsidies. The tables are as follows: first, WTO disputes on discrimination; second, WTO disputes on tax treatment for exports.

A. WTO Disputes on Discrimination

CASE	ISSUE	DECISION	IMPLICATION ON BEPS
United States - Florida Excise Tax Complainant: Brazil DS250	Brazil complained that the incidence of excise tax on imported processed citrus products and not on domestic products on its face constituted a violation of Articles II:1(a), III.1 and III:2 of GATT 1994.	A mutually agreed solution was reached under Article 3.6 of the DSU	None
China-Taxes Complainant: United States DS358	This concerned measures granting refunds, reductions or exemptions from taxes and other payments owed to the Government by enterprises in China. Measures were found to be inconsistent with Article 3 of the SCM Agreement. Further, the United States claimed that, to the extent the measures accord imported products treatment less favourable than that accorded "like" domestic	A mutually agreed solution by way of MOU between US and China, in 19Dec.2007	None

	products, they are inconsistent with Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement.		
China – Taxes **Complainant: Mexico** **DS359**	This concerned measures granting refunds, reductions or exemptions from taxes and other payments owed to the Government by enterprises in China. Measures were found to be inconsistent with Article 3 of the SCM Agreement. The measures were also found to be inconsistent with Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement.	A mutually agreed solution by way of MOU between Mexico and China, on 7 February 2008	None
Thailand–Cigarettes **Complainant: Philippines** **DS 371**	Philippines alleged Thailand had contravened; GATT 1994: Art. II:3, III:2, III:4, VII:1, VII:2, VII:5, X:1, X:3, X:3(a), II:1(b) Customs valuation (Article VII of GATT 1994): Art. 1.1, 1.2, 1.2(a), 1.2(b), 2, 3, 4, 5, 6, 7, 10, 13, 16	- The Panel found that the valuation decisions by Thai Customs were inconsistent with both substantive and procedural obligations under, inter alia, Articles 1.1 and 1.2(a), and 16 of the Customs Valuation Agreement(CVA). -The Appellate Body (AB) upheld the	None.[190]

[190] The violation of the Article VII:2 of the Customs Valuation Agreement related to the fact that Thailand did not use transaction value as the primary basis for customs valuation as required and failed to conform to the sequence of valuation methods mandated by the Customs Valuation Agreement, rather it used a valuation method with no basis in the Agreement. The dispute may not have had a direct effect on BEPS, but the case illustrates how issues relating to valuation that could have an effect on BEPS can be addressed in the WTO Dispute Settlement.

		Panel's finding that Thailand acts inconsistently with Article III:2,III:4, X:3	
Peru — Tax Treatment on Certain Imported Products Complainant: Chile DS255	Violation of GATT 1994,Art.III ,in respect of Peru's tax treatment on imports of fresh fruits, vegetables, fish, milk, tea and other natural products. Chile considered that the different tax treatment between domestic and imported products constituted a violation by Peru of its national treatment	Case Settled or terminated (withdrawn, mutually agreed solution) on 25 September 2002	None
Uruguay — Tax Treatment on Certain Products (Complainant: Chile) DS 261	Violation of GATT 1994 Art I, III .Taxable income for Uruguay's Internal Specific Tax is determined by using a fictitious price. According to Chile, this system would increase the taxable income if compared to the real sales price, especially in the case of foreign goods. Chile submits that the Uruguay's Internal Specific Tax (IMESI) violates Articles I and III of GATT 1994 because it establishes a tax system based on the use of fictitious prices in order to determine the taxable	Case settled or terminated(withdrawn, mutually agreed solution)	None

	income.		
Turkey -Taxation of Foreign Films Revenues Complainant-United States DS43	Violation of Article III of GATT 1994 Issue concerned Turkey's taxation of revenues generated from the showing of foreign films.	A mutually agreed solution reached	None

B. WTO Disputes on Tax Treatment For Exports: Violation of Agreement on Subsidies and Countervailing Measures (SCM)

CASE	ISSUE	DECISION	IMPLICATION ON BEPS
Belgium — Certain Income Tax Measures Constituting Subsidies Complainant: United States DS127	Violation of Agreement on SCM: Art. 3 that Belgian corporate taxpayers receive a special BEF 400,000 (index linked) tax exemption for recruiting a departmental head for exports (known as an "export manager"). The US contended that this measure constitutes an export subsidy	Still in consultation.	None
Netherlands — Certain Income Tax Measures Constituting Subsidies Complainant: United States DS 128	Violation of Agreement on SCM: Art. 3, that under Dutch income tax law, exporters may establish a special "export reserve" for income derived from export sales. The US contended that this measure constitutes an export subsidy	Still in consultation.	None
Greece — Certain Income Tax Measures Constituting Subsidies Complainant :United States DS129	Violation of the Agreement on SCM, Art 3, under Greek income tax law, Greek exporters are entitled to a special annual tax deduction calculated as a percentage of export income. The US contended that this measure constitutes an export subsidy.	Still in consultation.	None

Ireland — Certain Income Tax Measures Constituting Subsidies Complainant: United States DS 130	Violation of the Agreement on SCM Art 3, under Irish income tax law, "special trading houses" qualify for a special tax rate in respect of trading income from the export sale of goods manufactured in Ireland. The US contended that this measure constitutes an export subsidy	Still in consultation	None
France — Certain Income Tax Measures Constituting Subsidies Complainant: United States DS131	Violation of Agreement on SCM Art 3, under French income tax law, a French company may deduct temporarily, certain start-up expenses of its foreign operations through a tax-deductible reserve account and a French company may establish a special reserve equal to ten per cent of its receivable position at year end for medium-term credit risks in connection with export sales. According to US the measures were subsidies	Still in consultation	None
United States — Tax Treatment for "Foreign Sales Corporations" DS 108 Complainant: European Community	Violation of Agreement on Agriculture (AoA): Art. 1, 3, 8, 9, 10 GATT 1994: Art. III:4, XVI Agreement on SCM: Art. 3.1(a), 3.1(b) US tax exemptions for Foreign Sales Corporations ("FSC")[191] in respect of their export-related Foreign -source trade income. All foreign goods, including agricultural products, affected by the US measure.	The WTO panel and Appellate Body held that the FSC/ ETI regime was in violation of Articles 3.1(a) and 3.2 of the SCM Agreement, Article III(4) of the GATT, and Articles 10.1, 8 and 3.3 of the Agreement on	None

[191] FSC are foreign corporations in charge of specific activities with respect to the sale or lease of goods produced in the United States for export outside the US. In practice, many FSCs are controlled foreign subsidiaries of US corporations, as FSCs affiliated with its United States supplier receive greater benefits under the programme.

		Agriculture.	
Canada - Measures Affecting the Export of Civilian Aircraft-DS 70 **Complainant-Brazil**	Violation of Agreement on SCM: Art. 3, 3.1(a), 3.2 -Canadian measures providing various forms of financial support to the domestic civil aircraft Industry.	The Panel found that certain of Canada's measures were inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.	None
United States-Measures Affecting Trade in Large Civil Aircraft-DS 353 **Complainant: European Community**	Violation of GATT 1994: Art. III:4 Agreement on SCM: Art.3.1(a), 3.1(b), 3.2, 5(a), 5(c), 6.3(a), 6.3(b) and 6.3(c) This dispute concerns a number of US measures affecting trade in large civil aircraft ("LCA"). The EC claimed that the United States has provided subsidies to US producers of LCA, namely The Boeing Company, and that such subsidies are prohibited and/or actionable under the SCM.	The Appellate Body modified the Panel's ruling and found that the US had violated Article 1.1,2, 5(c) and 6.3(b) and (c) of the Agreement on SCM	None

Annex B Investment Arbitration relating to Taxation

In addition to cases relating to tax evasion and tax-related counterclaims, which are dealt in the body part of this memorandum, this list is to show an overall picture on investment arbitration dealing with taxation.

Relevant cases were collected as far as possible, though it would not be comprehensive.

Case Name	Forum/Case No.	Relevant IIAs	Type of Taxation Alleged and Issues	Outcomes
Amco Asia v. Indonesia (resubmission)	ICSID Case No. ARB/81/1	Contract	Respondent alleged 'tax fraud' by claimants via as counterclaim. The question whether the Tribunal has jurisdiction over the counterclaim for tax fraud or not.	Tribunal rejected jurisdiction on tax fraud counterclaim, on the basis of distinction between rights/obligation resulting from general law of Indonesia and that from an investment agreement (Decision on Jurisdiction 1988, paras.125-6)
Benvenuti & Bonfant v. People's Republic of the Congo	ICSID Case No. ARB/77/2	Contract	The respondent raised counterclaims on damages for non-payment of duties and taxes on imported goods.	Although based upon a tautological reasoning (see Part III.B.), Tribunal found jurisdiction on counterclaim (Award 1980, para.4.104) but eventually found no violation due to the insufficient evidence presented.
Duke Energy v. Ecuador	ICSID Case No. ARB/03/28	US/Ecuador BIT	Claimant alleged that the tax authority's tax assessment breached Peru's contractual obligation (tax stabilization clause) to allow free transfers. Respondent argued the scope of free transfer and the conditions.	Tribunal found Respondent liable for breach of the guarantee of tax stabilization, and ordered damages (Award 2008, paras.142, 501).
EDF v. Romania	ICSID Case No. ARB/05/13	UK/Romania BIT	Claimants who operated duty-free business within airports alleged that the conducts of Respondents relating to revocation of the duty-free licenses violated the BIT (FET, discrimination,	Tribunal found no violation of the BIT by respondent (Award 2009, para.330).

			expropriation, umbrella clause).	
EnCana v. Ecuador	LCIA Case No. UN3481	Canada/Ecuador BIT	As a result of the actions of Respondent in denying VAT credits/refunds and seeking collection of credits/refunds previously granted to its subsidiaries, EnCana alleges violations of the BIT (MFN, NT, FET, expropriation).	Tribunal denied jurisdiction over MFN, NT, FET claims because of the taxation exclusion clause. And the Tribunal required, for 'indirect expropriation', that a tax law be 'extraordinary, punitive in amount or arbitrary in its incidence' and rejected the claim on expropriation (Award 2006, paras.168, 177).
Feldman v. Mexico	ICSID Case No. ARB(AF)/99/1	NAFTA	Claimant US cigarette exporter alleged decision by Mexican government not to rebate taxes on its cigarette exports as the violation of NAFTA (NT, expropriation).	Tribunal rejected the investor's expropriation claim, whereas upheld the claim of a violation of NT (paras.209, 210). The proceedings to set aside the Award was initiated by Mexico before the Ontario Superior Court of Justice but finally rejected.
Gottlieb v. Canada	Ad hoc UNCITRAL arbitration	NAFTA	Claimant alleged that Canada caused massive destruction to the investment holdings of thousands of individual American investors when it announced its change in the tax treatment of Canadian income trusts in the energy sector (MFN, NT, FET, expropriation).	US and Canada tax authorities agreed that the measures at issues are not expropriation ('tax veto') (2008). *The outcome of the rest of the claims is unknown to this research.

Grand River v. USA	Ad hoc UNCITRAL arbitration	NAFTA	Canadian manufacturer and wholesaler of tobacco products alleged that its business was harmed by the treatment of non-participating manufacturers under the agreement between US states and the major tobacco companies, by tax on cigarettes (MFN, NT, FET, expropriation).	Tribunal concluded that the measures at issue did not constitute an expropriation, and the claimant did not establish the violation of NAFTA Article 1102, 1103 and 1105 (Award 2011, para.7).
Hulley v. Russia	PCA Case No. AA 226	ECT	Claimants characterize a series of criminal investigations were initiated by Russia against Yukos [Claimant has the shares] as harassment, intended to lead to the nationalization of Yukos' assets. Respondent contends that its actions were in response to illegal acts committed by Yukos and its officers and shareholders. Respondent contends that Yukos was a "criminal enterprise," engaged in a variety of tax evasion schemes and other fraudulent activities.	Tribunal deferred its decision on the objection to jurisdiction and admissibility to the merits phase of the arbitration (Interim Award 2009, para.600). [Pending Case]
Lacich v. Canada	Ad hoc UNCITRAL arbitration	NAFTA	Claimant alleged that Canada caused massive destruction to the investment holdings of thousands of individual American investors when it announced its change in the tax treatment of Canadian income trusts in the energy sector (MFN, NT, FET, expropriation). *Similar background as in Gottlieb v. Canada is written in the notice of intent to initiate arbitration.	Notice of intent to initiate arbitration was subsequently withdrawn by investor.

Link-Trading v. Moldova	Ad hoc UNCITRAL arbitration	US/Moldova BIT	Claimant alleged that the change of the customs and tax treatment of its customers violated governmental guarantees of tax stability and tantamount to an expropriation of its investment without compensation. Respondent asserted that the change in customs and tax treatment was not a breach of any obligation but a normal and proper exercise of regulatory power.	Tribunal found that Respondent did not violate the BIT, by virtue of Respondent's reduction or elimination of the exemption from customs duties and taxes applicable to imports of goods by Claimant's customers onto the customs territory of the Republic of Moldova (Award 2002, pp.4, 31).
Mobil v. Venezuela	ICSID Case No. ARB/07/27	Netherlands/Venezuela BIT	Corporate income tax is concerned, but the detail seems to be still unknown since the proceeding is still pending.	Tribunal found jurisdiction (Decision 2010). [Pending Case]
Noble Energy v. Ecuador	ICSID Case No. ARB/05/12	US/Ecuador BIT	Claimants alleged that Ecuador changed the mechanism for the payment of VAT, causing a dramatic increase in its unpaid receivables, which making it impossible for the company to continue operating in a sustainable way.	Tribunal accepted jurisdiction (Decision 2008), but the dispute subsequently settled by agreement.
Occidental v. Ecuador (LCIA case)	LCIA Case No. UN3467	US/Ecuador BIT	Claimant was entitled to obtain VAT refunds on payments relating to export of oil, but subsequently Ecuador changed the position. Claimant alleged that the actions of the Ecuado amounted to breaches the BIT (NT, FET, expropriation).	Tribunal found that the failure to refund the VAT was due not to any deliberate action, but from 'an overall rather incoherent tax structure' and thereby found the violation of NT and FET (Award 2004, para.200).
Phoenix Action v. Czech Republic	ICSID Case No. ARB/06/5	Israeli/Czech BIT	The case related to the criminal investigation to the alleged tax and custom duty evasions, and income tax fraud.	Tribunal rejected jurisdiction as the Tribunal concludes that the Claimant’s purported investment does not qualify as a protected investment under the ICSID Convention and the BIT (Award 2009, para.145).

Plama v. Bulgaria	ICSID Case No. ARB/03/24	ECT	Claimant contends that, because Bulgaria lacked appropriate accounting rules and tax legislation, the discount or rescheduling of Claimant's debts in its Recovery Plan resulted in artificial profit which became taxable and thus created a new debt for the company, requiring an accounting reserve in its books (FET, expropriation).	ECT excludes taxation from its scope of application but Tribunal found that even putting aside Article 21 of the ECT, no action by Respondent which comes anywhere near to being unfair or inequitable treatment or amounting to expropriation (Award 2008, paras.266-7).
Renta 4 v. Russia	SCC Arbitration V (024/2007)	Spain/Russia BIT	Claimants contend that the freeze on Yukos' [*i.e.* Claimant was a shareholder] asset and the subsequent prevention on Yukos from discharging tax liabilities constitute expropriation, whereas Respondent countered that they were reasonable response to Yukos' 'tax evasion.'	The Tribunal finally found that constituted an expropriation, but with emphasis on the 'case-by-case, fact-based inquiry.' (Award 2012, para.181-3)
RosInvestCo v. Russia	SCC Arbitration V (079/2005)	UK/USSR BIT Denmark/Russia BIT	Claimant asserted that Respondent misused its police powers in the tax assessments whereas Respondent countered that the tax assessments were a legitimate consequence of Yukos' [Claimant's subsidiary] flagrant breaches of tax laws, or in the words of Respondent, aggressive tax evasion practice.	Tribunal considered tax assessment as an element to conclude Respondent's measures were an unlawful expropriation 'seen in their cumulative effect towards Yukos.' (Award 2010, para.497-8, 633)
Sergei Paushok v. Mongolia	Ad hoc UNCITRAL arbitration	Russia/Mongolia BIT	Respondent asserted counterclaims including tax evasion by the investors, submitting that claimants owe Windfall Profits Taxes they caused GEM [company owned by the investors] to evade in violation of law, and claimants owe taxes, fees and levies they caused GEM to evade by illicit	Tribunal found no jurisdiction on counterclaim, on the basis of no 'close connection' with main claim and/or 'principle of non-extraterritorial enforceability of national public laws.' (Award 2011, para.677-699)

			intergroup transfers, including non-arm's length transfers.	
Tokios Tokeles v. Ukraine	ICSID Case No. ARB/02/18	Lithuania-Ukraine BIT	Claimant assets that the tax authorities of the Respondent initiate and carry out tax investigation against the claimant to punish for producing campaign materials for political opponents of the government, whereas the respondent counters that the authorities' investigation was legitimate as the claimant had business relations with fictitious enterprises (expropriation, FET, full protection and security).	Claimant failed to satisfy the burden of proof to show that the government agencies' various conducts damaged its reputation or customer relationships and significantly impaired its ability to operate. (Award 2007, paras.122, 136-7).
Veteran Petroleum v. Russia	PCA Case No. AA 228	ECT	See, Hulley v. Russia above	See, Hulley v. Russia above
Yukos Universal v. Russia	PCA Case No. AA 227	ECT	See, Hulley v. Russia above	See, Hulley v. Russia above