

[Material]

## Rethinking of The cross-links between Tax treaties and Investment-related agreements

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### 1. Introduction

Both tax treaties (DTCs: Double Tax Conventions) and Investment-related agreements (IRAs)—WTO Agreements, FTA (Free Trade Agreement)/EPA (Economic Partnership Agreement) and BIT (Bilateral Investment Treaty) can be closely linked by the activities of multinational enterprises (MNEs), especially foreign direct investment (FDI). DTCs, like trade IRAs, contain expressly established international legal norms. Such a close linking may often give rise to the simultaneous application of their legal norms. Removing obstacles to trade between states, as the case may be, restrict a State's taxing power. In the same cases, national taxing systems, in turn, may distort such trade. Thus, it seems that there is relationship between trade liberalization through IRAs and the restriction on the exercise of State's taxing power or the coordination of taxing powers between trading countries. If so, we need to once again consider the meaning or the role of DTCs which serve to coordinate each contracting State's taxing power and to facilitate FDI flows between their states.

Looking at IRAs concluded by Japan, most of them (especially EPAs or BITs) in general cave out DTCs and grant superiority to DTCs over them to the extent of the inconsistency or conflict. For instance, Article 170 (2) of the Mexico-Japan EPA read as follows:

Nothing in this Agreement shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, *that convention shall prevail to the extent of the inconsistency*<sup>1)</sup>. [emphasis added]

This appears to indicate that IRAs and DTCs affect each of them, at the least from a Japan's perspective. However, it is not clear when or how such a conflict arises under IRAs. On the other hand, some of their Japanese IRAs do not provide for a DTC cave-out, and others do not

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1) The English text is available at <http://www.mofa.go.jp/region/latin/mexico/agreement/index.html>. As to BITs, for example, Art. 21 of the Uzbekistan-Japan BIT reads as follows: "Nothing in this Agreement shall affect the rights and obligations of either Contracting Party under any convention for the avoidance of double taxation. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency." However, Japan does not conclude DTC with Uzbekistan.

provide for a definition of taxation measures, while they cave these measures out of the application of their IRAs. In this case, whether or not the interaction or cross-link between IRAs and DTCs exists depends presumably on the interpretation of the relevant provisions of IRAs. These facts or situations involving the relationship between IRAs and DTCs also may hold true of some counties other than Japan.

**Legal structures - Japan's IRAs =**

**Japan's BITs:**

- Basically, many BITs exempt tax matters from the BIT's provisions - Tax carve-out.
- The scope of this carve-out, however, *differs slightly* from each other. (see Table 1)

<p><b>Type A,B,C</b></p> <ul style="list-style-type: none"> <li>■ 'Carve-out' of tax benefits or privileges granted by the CTC from NT/ MFN of the BITs.</li> </ul>	<p><b>Type D</b></p> <ul style="list-style-type: none"> <li>■ 'Cave-out' of tax benefits or privileges granted by the CTC or domestic from MFN of the BITs.</li> <li>■ DTC priority rule.</li> </ul>
<p><b>Type G</b></p> <ul style="list-style-type: none"> <li>■ DTC priority rule.</li> <li>■ 'Cave-in' of tax matters to given provisions (e.g. Expropriation, Dispute-settlement).</li> </ul>	<p><b>Type E,F</b></p> <ul style="list-style-type: none"> <li>■ No DTC priority rule.</li> <li>■ 'Carve-out' of taxation measures from most BIT's provisions.</li> <li>■ 'Cave-in' of tax measures to given provisions (e.g. Expropriation, Dispute-settlement).</li> </ul>

**(Table 1) The Scope of Application of BITs to Tax Matters**

**Japan's BITs**

Type A (China, Egypt, Sri-Lanka)	Type B (Turkey, Bangladesh, Pakistan, Russia, Turkey)	Type C (Mongolian)	Type D (Iraq, Kuwait, Uzbekistan)
<ul style="list-style-type: none"> <li>● Carve-out of special tax advantages under reciprocity or DTC from MFN / NT</li> </ul>	<ul style="list-style-type: none"> <li>● Carve-out of special tax advantages under reciprocity with a third party or DTC from MFN / NT</li> </ul>	<ul style="list-style-type: none"> <li>● Type B +</li> <li>● Carve-out of different treatments between residents and non-residents under domestic law from MFN / NT</li> </ul>	<ul style="list-style-type: none"> <li>● Carve-out of special tax advantages under reciprocity with a third party or the DTC with a third party from MFN +</li> <li>● Carve-out of different treatments under domestic law from NT +</li> <li>● Carve-out of the DTC from BIT's all provisions, and the DTC prevails to the extent of the inconsistency.</li> </ul>
<p><b>Type E</b> (Korea, Viet Nam)</p> <ul style="list-style-type: none"> <li>● Carve-out of taxation measures from BIT's provisions +</li> <li>● Exception (=Cave-in of taxation measures)                             <ol style="list-style-type: none"> <li>① Transparency (Information exchanges)</li> <li>② NT in access to justice.</li> <li>③ Fair &amp; Equitable Treatment and Expropriation on investments.</li> <li>④ Denial of Benefits</li> <li>⑤ Dispute-settlement Procedures regarding ①, ②, ③, ④</li> </ol> </li> </ul> <p>No reference to the DTCs.</p>		<p><b>Type F</b> (Cambodia, Lao)</p> <ul style="list-style-type: none"> <li>● Type E +</li> <li>● Lack of ④</li> </ul>	<p><b>Type G</b> (Peru, Papua New Guinea, Colombia, China-Korea-Japan trilateral)</p> <ul style="list-style-type: none"> <li>● Type F +</li> <li>● Carve-out of the DTCs from BIT's all provisions, and the DTCs prevail to the extent of the inconsistency.</li> </ul> <p>*China-Korea-Japan trilateral BIT ⇒Lack of ①, ②</p>

(Table 2 ) Scope of Application of EPAs to Tax Matters

Japan's EPAs				
Contracting party	Trade in Services Chapter		Investment Chapter	
	Carve-out	Carve-in	Cave-out	Cave-in
Singapore	General: Carve-out of taxation measures / Exception (Cave-in): Transparency, Confidential information			
	Art. XXII(3) of GATS	Art. XIV(d) of GATS		Expropriation/Dispute-settlement
Mexico	General: *Carve-out of taxation measures, *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency)			
				Expropriation/Dispute-settlement
Malaysia, Thailand	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency ) / Exception (Cave-in): Transparency, Confidential information			
	Art. XXII(3) of GATS			Expropriation/Dispute-settlement
Chile	General: *Carve-out of taxation measures / *Cave-out of the DTC			
		To the same extent as covered by the GATS		Expropriation
Indonesia	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency ) / Exception (Cave-in): Transparency, Confidential information			
				Expropriation/Dispute-settlement
Brunei	General: *Carve-out of taxation measures / Exception (Cave-in): Transparency, Confidential information			
				Expropriation/Dispute-settlement/Access to the Courts of Justice
No reference to DTCs.				

(Table 2 ) Scope of Application of EPAs to Tax Matters (Cont.)

Japan's EPAs				
Contracting party	Trade in Services Chapter		Investment Chapter	
	Carve-out	Carve-in	Cave-out	Cave-in
ASEAN	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency ) / Exception (Cave-in): Transparency, Confidential information			
				No expropriation provision
Philippines	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency )			
				Expropriation/Dispute-settlement/Access to the Courts of Justice
Swiss	General: *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency )			
			<ul style="list-style-type: none"> <li>• NT for the scope of the DTC</li> <li>• NT/MFN for dispute settlement</li> </ul>	<ul style="list-style-type: none"> <li>• NT/MFN ⇒ apply to Art. XIV (d) and (e) of GATS, mutatis mutandis</li> <li>• Expropriation/Dispute-settlement</li> </ul>
Viet Nam	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency ) / Exception (Cave-in): Transparency, Confidential information			
	Art. XXII(3) of GATS			No chapter
India	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency ) / Exception (Cave-in): Transparency, Confidential information, Review and Appeal			
	Art. XXII(3) of GATS			
Peru	General: *Carve-out of taxation measures *Cave-out of the DTC (priority for the DTC to the extent of the inconsistency ) / Exception (Cave-in): Transparency, Confidential information			
				No chapter

## 2. Study object and background

The object of this study is mainly to explore the possible of the cross-links or conflicts between DTCs and IRAs. This is because I believe that the substance of arguments from the standpoint of trade or investment is not always contrary to the elimination of a difference (or discrimination) between domestic and foreign investments in the context of the object and purposes of the DTCs, and that seeking to such a possible of the cross-links or conflicts may contribute to make more developments of the DTCs. Recently, there has been an increase in the number of literature viewing the relationship the area of trade law that of tax law<sup>2)</sup>. However, few would argue specifically the above inconsistency or conflict under EPAs or BITs, or how to interpret and apply the relevant provisions of IRAs in the case of the lack of a DTC cave-out clause or a definition of taxation measures.

## 3. Approach and questions

In the light of the legal structures of the IRAs or the object and purposes of the IRAs, this study explores the meaning or role of the DTCs, especially focusing on non-discrimination rules under the DTCs. The main study questions for example are summarized as follows:

### (1) When or how a conflict between DTCs and IRAs arises?

As already mentioned above, under most of EPAs or BITs the DTC has priority over the EPA or BIT to the extent of the conflict between them. Here we considers the cases where such a conflict arises. One such case could be where non-discrimination principles which are commonly laid down in both DTCs and EPAs or BITs may conflict with each other. For example, it is the case where the National Treatment provision of EPAs or BITs and the Non-discrimination provision of the DTCs simultaneously apply to a taxation measure. There are also cases where with regard to a taxation measure the conflict between such a National Treatment provision and the distributive provisions of the DTCs, especially Business Profits provision of the DTCs may arise because it is said that the Business Profits provision of the OECD Model Tax Convention originates in the principle of “equitable treatment of commerce” under Article 23 (e) of the Covenant of the League of Nations, like agreements related trade and investment, as a historical fact. Taking these my views into account, I compare the legal structures of the EPAs or BITs with the Non-discrimination provisions of DTCs, and I examine or show hypothetical cases of conflicts between DTCs and IRAs (the EPAs or BITs), referring to tax case laws regarding the Non-discrimination provisions of the DTCs in some counties.

### (2) Whether or not IRAs apply directly to a taxation measure in the case of the lack of a DTC cave-out clause or a definition of taxation measures?

Theoretically, there is no conflict between DTCs and IRAs in the case of the lack of a DTC cave-out clause or a definition of taxation measures. I consider that there exists this conflict if

2) For example, Lang/Herdin/Hofbauer (eds.), *WTO and Direct Taxation* (Alphen aan den Rijn: Kluwer Law International, 2005). See also Arthur J. Cockfield and Brian J. Arnold, “What Can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model”, Vol. 2, No. 2 (2010).

**Result (3-1): Possibly of overlap or conflict - Japan's perspective -**

**In the case of the EPAs that include the DTC priority rule - Services Chapter**

Simply cave-out of the DTC from GATS-NT  
(Mexico EPA, Chile EPA, Philippines EPA)

Not insert Art. XIV (d) GATS

GATS NT provision vs. DTC's PE nondiscrimination provision (e.g. Art. 24 (3) OECD Model)

**In the case of the GATS-Model 3 (commercial present =PE)**

- DTC & GATS discrimination type
- GATS: direct discrimination of a foreign service supplier
- DTC: e.g. Art. 24 (3) OECD Model ⇒ direct discrimination of a nonresident person.

From the angle of discrimination type, it appears likely to overlap or conflict between the GATS and the DTC with regard to the taxation on business profits.

**GATS Comparator**

- Inconsistent with the DTC ⇒ with regard to activity
- Consistent with the DTC ⇒ with regard to tax treatment (e.g. the application of tax rate)

cf. OECD Model Commentary on Art 24 (3), para. 36.

Y-1 Co. ← compare → X Co.  
Y-2 Co. ↑

Whether or not one may identify Y-1 Co. with Y-2 Co. ?

**In the case of BITs/EPAs that do not include the DTC priority rule (Cont.)**

No reference to DTC, but reference to taxation measures (Type E, F, Singapore EPA etc.)

BIT's or EPA's Transparency/Confidential Information provision vs. DTC's Information Exchange provision (e.g. Art.26 OECD Model)

- BIT or EPA: a party is not required to provide the confidential information which would prejudice *privacy or legitimate commercial interests* of particular enterprises.
- DTC: e.g. Art.26 (1)(c) OECD Model ⇒ Commercial Industrial Business Secret e.g. Art.26 (5) OECD Model ⇒ Bank secrecy.
- Art.3 of the Singapore-Japan EPA: a party is not required to provide information relating to the *affairs and accounts of customers of financial institution* ⇔ Art. 26 (5) of the Singapore-Japan DTC (≠ Art. 26 (5) OECD Model: the request of bank secrecy).

No provision regarding DTC Priority rule

**Result (2-1) : Possibility of overlap or conflict – Japan's perspective -**

**In the case of BITs/EPAs that include the DTC priority rule**

" In the event of any inconsistency between (BIT/EPA) and (DTC), that convention shall prevail to the extent of the inconsistency" (Type D,G, Most Japan's EPA)

NT provision of BIT or the Investment Chapter of EPA vs. DTC's non-discrimination provision

**BIT/ EPA :**

- No less favorable treatment of a foreign investor and its investment that stands "in like circumstances" with a domestic investor and its investment regarding investment activities
- Broad and open-ended definition of ' investor ', ' investment ' or ' investment activities '
- ⇒likely to raise a overlap with the DTC 's non-discrimination ( e.g. Art.24 (1) , (3) , (5) of the OECD Model )
- The inconsistency depends on the interpretation of the term ' in like circumstances ' (= Comparator standard )

**BIT/EPA - term definition -**

Term	definition
Investor	<ul style="list-style-type: none"> <li>✓ a natural person</li> <li>✓ an enterprise</li> </ul> <p>any legal person or any other entity duly constituted or organized under the laws and regulations of the home-State</p>
Investment	<ul style="list-style-type: none"> <li>✓ an enterprise and a branch of an enterprise</li> <li>✓ shares, stocks , bonds, debentures etc.</li> </ul>
Investment activities	<ul style="list-style-type: none"> <li>✓ establishment, acquisition , operation, management, maintenance, etc.</li> </ul>

Trigger the application of Art.24 (1) or (5) OECD Model

**Further Analysis : Non-discrimination provisions overlap or conflict**

**Relationship between BIT/EPA-Investment Chapter NT and DTC Nondiscrimination**

**BIT/ EPA NT vs. DTC's Nationality non-discrimination (e.g. Art.24 (1) OECD Model)**

- **BIT/EPA : definition of "investor" ⇒ a juridical person : Incorporation theory (place of incorporation).**
- In the case of the company incorporated in the investor-State that would have its place of effective management in the invest-State following Real Seat theory (place of effective management).
  - ➔ cf. 2010 OECD Commentary on Art.24 (1), para 20.
- Interpretation of the term " in like circumstances " under the BIT/EPA ⇔ phrase " in the same circumstances, in particular with respect to residence " under Art.24 (1) OECD Mode.

**BIT/ EPA NT vs. DTC's foreign control non-discrimination (e.g. Art.24 (5) OECD Model)**

- **BIT/EPA : the NT applies to " investment " in the invest-State.**
- In the case where an " investment " is an enterprise.
- Interpretation of the term " in like circumstances " under the BIT/EPA ⇔ phrase " similar enterprises " under Art.24 (5) OECD Model.

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graph TD
    Comparison[Comparison] --> BIT[EPA]
    Comparison --> DTC[DTC OECD Model]
    BIT --> BIT_Circ[in like circumstances]
    DTC --> DTC_Circ[in the same circumstances  
other similar enterprises]
    BIT_Circ --> Standards[Standards or criteria of comparison]
    DTC_Circ --> Standards
    Standards --> Economic[Economic standard =A: market actors are in a competitive relationship]
    Standards --> Subjective[Subjective standard =B: aim and effect test]
    Standards --> Combination[Combination standard: Combine A and B]
    Economic --> TaxPay[tax liability or ability to pay, etc.]
    Subjective --> TaxPay
    Combination --> TaxPay
    Note[It's important how 'tax liability' or 'ability to pay' may be interpreted in A or B standard]
    
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**Comparative Analysis (1): Performance Requirements (PR) provision**

**'Cave-in' of taxation measures to PR provision in the NAFTA and the 2012 US Model**

**Relationship between DTC Priority rule and Tax advantages for foreign investors**

- Difficult to find the borderline prohibited tax advantages and approved tax advantages in the context of the DTC's nondiscrimination.
- Unclear to what extent the DTC's nondiscrimination applies to such tax incentive measures for foreign investors. ⇒ e.g. Applicable to PE nondiscrimination (Art.24 (3) OECD Model )
  - ➔ cf. 2010 OECD Model Commentary on Art.24 (3), paras. 43-45.

**Comparison with Japan's BITs or EPAs**

- Non-application of taxation measures to the PR provision.
- However, application of the DTC priority rule in common.

① The necessity of such tax matters cave-in provision to the PR provision of the BITs or the EPAs in terms of cooperative competitions.?

**PRs as condition of receiving tax advantages**

**General prohibition:**

- connected to the achievement of a local content rate;
- connected to the purchase or uses of locally produced goods or the manufacture of good ;
- ..... etc.

**Exception to General prohibition :**

- connected to locating production, providing a service, training or employing workers, constructing or expanding particular facilities in its territory
- connected to carrying out R&D in its territory
- (e.g. investment tax credits, R&D tax credit, etc.)

domestic law prevails over international treaty in a county, such like Japan. In other words, this is that the conflict between DTCs and IRAs may arise if the IRAs apply directly to a taxation measure under such a domestic tax law because of the lack of a DTC cave-out clause or a definition of taxation measures. The possibility of such a conflict will be discussed further on in this study, taking account of Art. 30 of the Vienna Convention on the Law of Treaties or the

recent Japanese tax case law dealing with the relationship Hong King-Japan BIT and former Japanese CFC legislation.

#### 4. Conclusions

- (1) Causes of overlaps or conflicts between IRAs and DTCs and Tentative ways to avoid them.
  - The lack of the DTC priority rule in the IRAs raises such overlaps (or conflicts) because of similar rules. But, this priority rule is not versatile.
  - The DTC priority rule consists of two sentences: First sentence provides for the ‘cave-out’ of the DTC from all provisions. Second sentence provides for the DTC priority rule in the event of any inconsistency between BIT/EPA and DTC. Why is this second sentence inserted?
  - The necessity of the second sentence results from the unstable interpretations of terms employed by the DTCs which are similar to those of the IRAs - ‘likeness’ and ‘same circumstances’, or ‘other similar enterprises’ etc. The second sentence only shows the requirements to secure a State’s taxing powers from the side of tax law’s field.
  - A better way to avoid overlaps (or conflicts); the approach observed in US Model (see table 3) or clarification of the above terms in OECD Commentary.
- (2) Effectual tax matters provisions (Tax carve-out/in) in IRAs.
  - Reconsider the scope of ‘Carve-in’ of taxation measures - i.e. taxation measures apply to the PR provision or the provision regarding the denial of the BIT’s benefits.
  - In this case, enough communication between relevant authorities.

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