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**Negotiating Group on the Multilateral Agreement on Investment (MAI)**

**Expert Group No.3 Expert Group No.3 on Treatment of Tax Issues in the MAI**

**REPORT TO THE NEGOTIATING GROUP**

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I am pleased to report to the Negotiating Group on the outcome of the 19-21 March meeting of the Expert Group N° 2 on the “Treatment of Tax Matters in the MAI”. This report consolidates the results of the Expert Group’s earlier meetings.

The Group confirmed that all tax matters should be dealt with in a separate article, following the approach involving a general “carve-out” of taxation in the MAI, with some aspects of taxation “carved-in”.

This report contains a Draft Article on Taxation containing provisions on expropriation, transparency, dispute settlement and definitions.

The Group has also considered possible inclusion of other provisions, but does not recommend inclusion of any additional provisions. The report contains commentary on these matters as well as on the topics for which text is proposed in the Draft Article on Taxation.

The Group highlighted in its report a few specific matters that should be considered further in the light of future development of the text of the MAI. The Group would welcome the opportunity to undertake this work on behalf of the Negotiating Group.

Chair

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## DRAFT ARTICLE ON TAXATION

1. Nothing in this Agreement shall apply to taxation measures except as expressly provided in paragraphs 2 to ...<sup>1</sup> below.
2. Article ... (Expropriation) shall apply to taxation measures.

*Interpretative Note: "When considering the issue of whether a taxation measure effects an expropriation, the following elements should be borne in mind:*

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<sup>1</sup> In addition to the paragraphs on expropriation and transparency which follow, some Delegations proposed a carve-in for national treatment. As an example on how national treatment could be carved in, the following wording was put forward:

"1. [paragraph 1.1 of] Article XX (National Treatment) shall apply to taxation measures, except that no claim that a taxation measure involves a discrimination<sup>1</sup> shall be submitted to dispute settlement by an investor of a Contracting Party pursuant to Article ... (Investor-State Dispute Settlement):

- (a) Unless the investor concerned has first referred to the Competent Tax Authorities of both Contracting Parties involved in the dispute the issue of whether the tax measure involves a discrimination, nor shall the claim be submitted to dispute settlement within the 24 month period immediately following such referral; and
- (b) If, within 24 months of the date of referral, the Competent Tax Authorities of both Contracting Parties concerned determine that the tax measure does not involve a discrimination.

2. However, nothing in the above-mentioned Article shall:

- (a) prevent the adoption or enforcement by the Contracting Party of any measure which:
  - (i) differentiates treatment between taxpayers who are not in the same circumstances, in particular with respect to residence, or
  - (ii) is aimed at ensuring the equitable or effective imposition, payment or collection of taxes, or
  - (iii) is aimed at preventing the avoidance or evasion of taxes,

provided that the measure does not arbitrarily discriminate between investors or investments of Contracting Parties or arbitrarily restrict benefits accorded under the provisions of this Agreement;

- (b) have the effect of extending fiscal advantages granted by the Party on the basis of any international agreement or arrangement by which it is or may be bound, or its membership of any Regional Economic Integration Organisation."

- a) *The imposition of taxes does not generally constitute expropriation. The introduction of a new taxation measure, taxation by more than one jurisdiction in respect to an investment, or a claim of excessive burden imposed by a taxation measure are not in themselves indicative of an expropriation.*
- b) *A taxation measure will not be considered to constitute expropriation where it is generally within the bounds of internationally recognised tax policies and practices. When considering whether a taxation measure satisfies this principle, an analysis should include whether and to what extent taxation measures of a similar type and level are used around the world.*
- c) *While expropriation may be constituted even by measures applying generally (eg, to all taxpayers), such a general application is in practice less likely to suggest an expropriation than more specific measures aimed at particular nationalities or individual taxpayers. A taxation measure would not be expropriatory if it was in force and was transparent when the investment was undertaken.*
- d) *Taxation measures may constitute an outright expropriation, or while not directly expropriatory they may have the equivalent effect of an expropriation (so-called "creeping expropriation"). Where a taxation measure by itself does not constitute expropriation it would be extremely unlikely to be an element of a creeping expropriation."*

3. Article ... (Transparency) shall apply to taxation measures, except that nothing in this Agreement shall require a Contracting Party to furnish or allow access to information covered by tax secrecy or any other provision or administrative practice protecting confidentiality in domestic laws or international agreements, and including information:

- a) contained in or exchanged pursuant to any agreement or arrangement relating to taxation between governments and investors;
- b) pursuant to any agreement with a foreign government concerning the application or interpretation of an international agreement relating to taxation in the case of an investor, including exchange of information between governments;
- c) concerning the identity of an investor or other information which would disclose any trade, business, industrial, commercial or professional secret or trade process;
- d) pertaining to the negotiation of tax treaties or of any other international agreement relating partly or wholly to taxation or the participation by a government in the work of international organisations; or
- e) the disclosure of which would affect the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, taxation, or any information the disclosure of which would aid or assist in the avoidance or evasion of taxes; [or]
- [f] the disclosure of which would be contrary to the general administrative practice of the Contracting Party.]

4.<sup>2</sup> [a] The provisions of Article [C] (State to State Dispute Settlement) and Article [D] (Investor to State Dispute Settlement), except for paragraph 1b of Article [D], shall apply to disputes under this Article with regard to taxation measures [to the extent that they fall outside the scope of mutual agreement procedures provided for in double taxation agreements.] However, the issue of whether the measure complained of falls within the definition of taxation measures at paragraph [ ] below shall be decided first.

b) Article [D] (Investor to State Dispute Settlement) shall apply to disputes under this Article with regard to taxation measures subject to subparagraph a) above and to the following provisions:

- i) at the request of the Contracting Party to the dispute, any issue referred to in subparagraph (a) above, or any claim that a taxation measure constitutes an expropriation shall be referred to the Competent Tax Authorities of the Contracting Party of the Investor and the Contracting Party to the dispute, and the proceedings regarding those issues under Article [D] shall be suspended; and
- ii) notwithstanding paragraph 1(b) of Article [C], if the Competent Tax Authorities determine that the measure does fall within the definition of taxation measures at paragraph [ ] below this Article shall apply, and if the Competent Tax Authorities determine that the measure does not involve an expropriation, the proceedings regarding that issue under Article [D] shall be terminated. If the Competent Tax Authorities concerned do not so determine within [9] months, it may be submitted for resolution [by agreement of] [at the request of either of] the Contracting Parties concerned by arbitration pursuant to Article [C], and any award of a Tribunal pursuant to Article [C] shall be binding upon the Tribunal constituted under Article [D].

c) Any Tribunal under Article C or D shall, at the request of either Party to the dispute, convene a technical review board of taxation experts, as provided in Articles [C.5] and [D.13], to consider a taxation matter and shall take its views into account.<sup>3]</sup>

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<sup>2</sup> There is agreement on the need for a provision along the lines of paragraph 4, but the text needs refinement. Several delegations maintained scrutiny reservations on the text of paragraph 4. Clearly additions or alterations to this text would need to be made if taxation measures are carved into MAI disciplines other than Expropriation and Transparency. One delegation reserves its position on MAI dispute settlement procedures.

<sup>3</sup> One delegation puts forward the following alternative language for this paragraph:

“Any Tribunal under Article C or D shall, at the request of either Party to the dispute, convene a technical review board of taxation experts, as provided in Articles [C.5] and [D.13], to consider a taxation matter and shall base its findings on the views expressed by such board.”

5. For the purposes of this Article:

a) A Competent Tax Authority means the minister or ministry responsible for taxes or their authorised representatives.

b) “Taxation measures” include

i) any provision relating to taxes of the law of the Contracting Party or of a political subdivision thereof or a local authority therein, or any administrative practices of the Contracting Party relating to taxes; and

ii) 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.

*Alternative A*

[For greater certainty “taxes” for the purposes of this Article shall be taken to include [social security measures/contributions] [and customs duties].

*Alternative B*

Taxes shall be taken for this purpose to include direct taxes, indirect taxes and [social security measures/contributions] [ and customs duties].

*Interpretative Note: For greater certainty, Article XX (most favoured nation treatment) shall not be invoked to avoid the provisions of paragraph ... (dispute settlement) of this Article.<sup>4</sup>*

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<sup>4</sup> Several delegations maintain a scrutiny reservation on the text of this Note.

## COMMENTARY

### Expropriation

1. The Group agreed to carve in taxes for expropriation and agreed on the text set out in paragraph 2 of the Draft Article on Taxation.
2. The Group reconfirmed that taxes as such are not expropriatory. It developed a clarifying text providing elements to be considered when determining whether a specific measure should be considered expropriatory. The Group agreed that the text should be included in the MAI as an Interpretative Note having full legal force.
3. Most delegations supported inclusion of the following additional statement in the Interpretative Note: *"MAI Parties understand that no taxation measures of the Parties effective at the time of signature of the Agreement could be considered as expropriatory or having the equivalent effect of expropriation."* Some delegations were not in a position to associate themselves with such a statement.
4. The Group agreed that the Tax Authorities of only two countries should be involved in the procedure described in paragraph 2 and both should be MAI Parties. One of the Parties would certainly be the host country to the investment, but the other might need to be defined taking into account the extent to which indirect investments will be covered by the MAI [see Consolidated Text, DAF/MAI(96)16/REV1, paragraphs 15-21].

### Transparency

5. The Group agreed to carve in transparency.
6. The Group also agreed that the general Article on transparency in the consolidated text (paragraphs 2.1, 2.2 and 2.3) should apply to taxes. However the Group considers the inclusion of the term "policies or practices" in paragraph 2.3 of the general Article on Transparency to be necessary for tax purposes, and additional text needs to be included in the Taxation Article to protect the confidentiality of certain types of information specific to tax matters, including information shared between the Authorities of different countries on a confidential basis. The Group developed an agreed text for this purpose (paragraph 3 of the Draft Article on Taxation).

## **National Treatment**

7. The vast majority of delegations was opposed to any carve-in for taxes with respect to National Treatment. These delegations emphasised the need to see tax measures affecting National Treatment in the context of international treaty obligations and tax policy as a whole, and the need of governments to preserve the freedom to introduce new measures especially in the light of economic and technological developments. These delegations also emphasised the extent to which tax treaties, including the protection provided by non-discrimination obligations, provide comprehensive protection to investors. Moreover these delegations emphasised that double taxation agreements cover most OECD countries and that the mutual agreement procedures under tax treaties have a long and successful history of resolving tax disputes within a reasonable time period. Subjecting taxes to the national treatment obligation would undermine both tax agreements (through forum shopping) and the MAI. This problem could be aggravated by the accession to the MAI of Non-OECD Members, particularly certain countries with which OECD Members would not be willing to conclude tax treaties. Problems of legal interpretation were also mentioned as creating uncertainty and exposing Tax Authorities to unjustified dispute settlement claims. These delegations shared the concern that any carve-in for taxes with respect to National Treatment would not allow the effective operation of its anti-avoidance measures and tax treaty network. Based on these arguments and taking into consideration points raised in paragraph 8, the consensus of the Group was to present a single text to the Negotiating Group with a footnote.

8. Five delegations favoured a "carve-in" for taxes with respect to National Treatment subject to safeguards specific to taxation. One of the delegations with the support of one other provided a text specifying what this carve-in provision might entail. The five delegations considered that the MAI, as a high standards investment agreement, should not carve-out taxation measures from National Treatment. These delegations agree that the tax treaty network, though extensive, does not cover all likely signatories to the MAI (nor even all OECD countries). In their view some treaties do not contain a sufficiently comprehensive non-discrimination provision. They also felt that incorporating the National Treatment obligation in the body of the text would strengthen the accession criteria from a tax policy viewpoint. These delegations also argued that subjecting tax disputes arising in connection with National Treatment to binding disputes settlement procedures under the MAI would encourage tax authorities to resolve disputes that would not otherwise be resolved (within a reasonable period of time) in accordance with the mutual agreement procedures established under double taxation agreements. These delegations felt that the tax policy concerns that had been identified in paragraph 7 were adequately addressed by the text provided by one of them. The Group did not discuss this text in detail, however, as the vast majority did not feel that such a carve-in was appropriate.

## **Most Favoured Nation Treatment**

9. The Group agreed that neither direct taxes proper nor social security contributions/taxes should be carved into the MFN provision of the MAI.

10. The Group also agreed that as indirect taxes do not usually discriminate against foreign investors and are, in any case, adequately covered both by non-discrimination provisions in bilateral tax treaties and similar provisions in other multilateral agreements, such taxes should not be carved-in into the MFN provision either.

## **Performance Requirements**

11. Many questions were raised as to the potential impact of the discipline on Performance Requirements on standard features of the tax systems of Member countries. Based on the difficulties that the current Performance Requirements text would pose for Member countries' tax systems, the Group, at this stage, does not recommend covering taxes.

## **Transfers**

12. The Group agreed that taxation measures should not be subject to the Article on transfers.

## **Investment Incentives**

13. In response to the request from EG 3, the Group had an extensive discussion on the desirability and feasibility of including tax incentives in the national treatment and MFN articles. This discussion took place in the light of the emerging consensus in EG 3 that investment incentives should be subject to both national treatment and MFN obligations, without necessarily including explicit text to this effect.

14. On the issue of limiting or restricting the scope of tax incentives, the Group noted the distorting effect of positive discrimination in favour of foreign investors, but also the ongoing work of this issue in other fora. Discussions showed that defining tax incentives generally, and undesirable ones particularly, would be extremely difficult. Also, the vast majority of delegates felt that the approach to carving out taxation measures from national treatment and MFN obligations should include taxation incentives as such incentives are clearly taxation measures. There should therefore be no carve-in of taxation measures to incentives provisions. The vast majority of the Group did not see any reason for subjecting tax incentives to any disciplines different from those applying to taxation measures in general.

15. However, some delegations believed that including tax incentives would add to the value of the proposed disciplines of the incentives Article, and would avoid a shift from non-tax incentives (covered by the investment incentives Article) into tax incentives (not covered). These delegations therefore proposed a carve-in of tax incentives for purposes of the investment incentives Article. One delegation felt that it would, in principle, be possible to define specific tax incentives, a view supported by another delegation. The vast majority of delegations rejected this view, and examples were given to illustrate the difficulty.

16. Equally, it might be observed that work has only recently begun in the WTO on a subsidies code under the GATS and in the CFA special sessions on harmful tax competition. So there must be concern that work in the MAI on further disciplines on incentives risks running into conflict with work elsewhere if attempts are made to plan out a programme of future work at this stage; it may be possible to develop a programme later, but it would appear sensible to consider this only after a full appraisal has been carried out into exactly how any MAI disciplines are intended to fit with those being developed elsewhere (and the relative time-scales involved).

## **Dispute Settlement**

17. The Group considered that dispute settlement would not only arise for taxation to the extent that taxation matters were carved back into the MAI, but also for the purpose of determining what constitutes a taxation measure for the purpose of the carve-out.

18. To the extent that tax matters are covered under the MAI disciplines other than transparency and expropriation, the Group agreed that primacy should be given to mutual agreement procedures under tax treaties. Tax authorities should have the necessary flexibility to settle tax related disputes and tax expertise should be required at all stages of MAI dispute settlement including consultations and arbitration procedures although this might not need to be explicit in the case of state-to-state disputes.

19. One delegation pointed out that unrestricted access to the Investor to State dispute settlement procedures was a core feature of the MAI. While recognising that the appropriate input of tax experts and competent tax authorities into the procedures was a justified concern, it considered that some features of the Draft Taxation Article contain major changes to the general rules on Investor to State dispute settlement. This particularly concerns the possibility to suspend an Investor to State procedure and turn it into a State to State procedure under certain conditions. It would also arise if the proposal, currently set-out in a footnote, were adopted to bind a panel to the findings of a review board of tax experts.

20. Some delegations noted that a procedural modification to Investor-State dispute settlement in the case of expropriation claims involving taxation measures is a standard feature of their country's investment treaties.

21. Taxation measures are generally not subject to dispute settlement. The fact that the proposed paragraph in the Taxation Article on dispute settlement is a significant departure from this practice underlines the insertion of the footnote by one delegation.

### **Relationship between the MAI and Other International Agreements**

22. The Group did not see any benefit from carving taxation measures into the "non-derogation" clause [DAFFE/MAI/EG3(96)7].

23. The Group noted that, however remote, the possibility existed that an investor of a MAI Contracting Party might seek to obtain access to international arbitration rather than the arbitration procedures provided in the Taxation Article by relying on its bilateral investment agreements in combination with the MFN provision in the MAI. To avoid this possibility, the Group agreed to an interpretative note to the Draft Article on Taxation.

### **Accession**

24. The Group expressed concern about accession to the MAI of "tax havens", whether as Contracting Parties or as dependent territories of Contracting Parties. It was generally felt that tax havens, which are usually characterised by low (or zero) tax rates and/or extremely narrow tax bases as well as bank secrecy laws restricting exchange of tax information, provide opportunities for tax evasion and therefore pose a serious threat to countries' tax revenues.

25. The Group believed that the above concern would not require specific accession criteria if taxation were subject to neither national treatment nor MFN obligations under the MAI.

26. The Group considered nevertheless that tax policy considerations should be taken into account in accession to the MAI. It therefore considered that tax authorities should be involved in the process by which accession candidates are judged.

## **Definitions**

27. A large majority of delegations were in favour of defining taxes in order to provide certainty for investors by clarifying the dividing line between those measures that are carved out or back into the MAI.

28. The main outstanding issue is whether or not the definition of “taxes” should include social security measures or contributions, which are not normally considered taxes in some countries. This matter remains to be resolved.

29. The reference to customs duties is a placeholder pending clarification of the relationship between the MAI and international trade in goods and services.