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Between sovereignty and complexity: the settlement of tax disputes by the world trade organization

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ABSTRACT

The analysis of WTO law and the key disputes in 'trade and tax' field leads to interesting findings. The relationship between international trade law and domestic tax laws is not easy. First, the emerging picture is the difficulty of the trade regulatory framework and the jurisprudence to draw a clear line between what is permitted and what is not. Legal uncertainty is the word. This uncertainty has its root in the complexity of both domestic tax laws and the legal standards of trade law. Secondly, trade law often significantly impacts on governments' sovereignty. In a globalized world, this is inevitable. Thirdly, there is an evolution in how trade has had to deal with taxation. The focus has shifted from the traditional cases of favouritism, discrimination and protectionism to more difficult issues connected to key challenges of our times – tax avoidance, level playing field, competitiveness, carbon leakage, the digitization of the economy. More recently, even national security has added to the mix. This complexity in the 'trade and tax' relationship raises fundamental questions about the limited role trade law can play in solving taxation issues. The article claims that trade law can only offer partial solutions to key tax issues. By nature, trade law is more suited to regulate specific instances where tax is used as a tool of protection rather than systemic problems arising from the differences in domestic taxation and the lack of established rules to regulate new phenomena like digital services, for which multilateral tax treaties are the first-best.

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WTO dispute settlement; tax subsidies; tax discrimination; border tax adjustments; tax avoidance

1. Introduction

This article investigates the relationship between tax law, which is normally a domestic prerogative, and trade laws, especially those in the WTO, which are international in their reach. From this descriptive statement, tension already emerges.

The analysis will go to the very core of the key questions of the Symposium. What constraints do WTO disciplines put on Members' tax prerogatives? Are they really sovereign – sovereignty being a fundamental tenet of public international law – when it comes to taxation? From another angle, can trade law tackle the externalities the co-existence of different national tax systems inevitably cause, in particular, harmful tax competition practices as made evident by the OECD's BEPS project? Is the WTO Dispute Settlement System

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suited to deal with these systemic tax distortions? Or is it, rather, more efficient in regulating only specific occurrences of favouritism or protectionism carried out through tax?

The investigation is done through the analysis of the rich case-law in the WTO and also of topical measures – such as carbon taxes, digital services taxes, tax rulings or corporate tax law reform proposals – that have not been subject to WTO litigation (yet) but have nonetheless raised debate. One recurring theme is the intersection between taxation and key challenges of our times – tax avoidance, level playing field, competitiveness, carbon leakage, the digitization of the economy. To provide a comprehensive account, we adopt a broad notion of tax, including border tax measures (such as tariffs and duties) and internal tax measures, direct taxation and indirect taxation.

The article is organized as follows. After introducing the trade regulatory framework applicable to tax, the article analyses the issues of the 'tax and trade' litigation, with respect to border taxation and domestic taxation, border tax adjustments, subsidies, and tax avoidance. The final section wraps up and concludes.

2. Overview of tax rules in the WTO

To understand the scheme and logic of tax regulation in the trade context means going back to the General Agreement on Tariffs and Trade ('GATT') of 1947.[1] The first important distinction is that between border (or trade) instruments and beyond-the-border (or domestic) measures. While the former applies to imports only, the latter finds application to both imports and domestic goods. The immediate focus of the GATT was to achieve a negotiated reduction on tariffs.[2] Following its nature of 'negative integration' agreement, it did not purposively regulate the governmental power to introduce and maintain 'internal tax', the only requirement thus being one of non-discrimination, meaning National Treatment (NT) (Article III:2). While the regulation of border taxation (tariffs) and internal taxation is different, the discipline of both types of measures was necessary. The simple regulation of tariffs would have created a loophole, enabling countries to circumvent their tariff promises through discriminatory domestic policies.[3] Tariffs were subject to regular negotiations to reduce their ceilings. By contrast, the policy space to shape internal taxation largely remained untouched throughout the GATT and the WTO. A general defence clause strengthening policy space was introduced in the general exemptions in GATT Article XX.[4]

While these provisions generally regulate the power to tax at the border and internally, other important rules related to tax apply in specific scenarios, allowing, through the imposition of special duties, to counter dumping, subsidization and unforeseen circumstances when imports cause various types of injury to the domestic industry (called 'trade remedies'). Finally, other rules are applicable to subsidies (which may include tax measures) and largely addressing the situations where they cause serious prejudice to the interests of other nations (Article XVI) or affect their market access legitimate expectations (Article XXIII).

[1] See DA Irwin, P Mavroidis and AO Sykes, *The Genesis of the GATT* (Cambridge University Press, 2008).
[2] As well as prohibit quotas.
[3] P Mavroidis, *The Regulation of International Trade – Volume 1 – GATT* (MIT Press, 2016) 31.
[4] All this under the benign eye of the Most-Favoured Nation ('MFN') principle, which extended the benefits of the negotiations to all players, especially the weaker ones.

The GATT is still the prevailing legal framework of taxation for trade in goods. With the WTO, tax subsidies have been further regulated under the more specific Agreement on Subsidies and Countervailing Measures (ASCM) and the Agreement on Agriculture (AA).

One important WTO innovation is the introduction of the General Agreement on Tariffs and Trade (GATS). While there are no rules on tariffs on services,[5] the agreement applies to both direct and indirect taxation, mostly through the rules on non-discrimination (MFN and NT).[6] In other words, the language of these provisions is sufficiently broad to cover taxation on both specific services and on income derived from trade in services. The status of tax in the trade context was a key topic in the GATS negotiations.[7] This explains the existence of few specific provisions in the agreement which effectively grant significant policy space to members or, better, seem to highlight the intention of the parties to give precedence to international tax treaties over trade laws.[8]

3. Tariff and duties litigation

Differently from quotas, and in particular zero-quotas (i.e. prohibitions), tariffs can hardly be explained with the pursuit of policy goals different from protection (and, partly, revenue-raising).[9] Through the years, the case-law had to grapple with several issues.[10] While the GATT does not regulate export taxes (which are thus permitted), some discipline can be found in Protocols of Accession.[11] A difficult issue is whether export taxes can be conceptualized as subsidies because of their impact on domestic demand and prices.[12]

Far more significant are 'trade remedies' The compliance of these measures with trade law has generated an extremely rich jurisprudence. Without indulging in the legal details, it is here sufficient to highlight its political significance. Trade remedies are the most traditional instruments governments use. Given the binding of tariffs operated by the GATT, they have become the most common policies to protect domestic industries. Their political salience is high because the political economy surrounding their imposition (and the

[5]Market access commitments only focus on quantitative and qualitative obstacles to trade (Article XVI).

[6]In the GATS, while MFN is a general obligation, both market access and national treatment are specific commitments since they only apply insofar as Members have accepted such commitments (and within the limits they have set) in the service sector at issue.

[7]See the interesting comments of Lesley Samuels who was directly involved in the GATS negotiations. LB Samuels, *Treatment of Tax Measures Under International Trade and Investment Agreements: The GATS Compromise* (2008) 102, Proceedings of the Annual Meeting (American Society of International Law) 52–53.

[8]Article XXII explicitly excludes the possibility of raising NT claims in consultations 'with respect to a measure of another Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation'. Moreover, the 'General Exceptions' (Article XIV) enable Members to adopt measures necessary to prevent 'deceptive and fraudulent practices' (item c), 'aimed at ensuring the equitable or effective imposition or collection of direct taxes' (d), or to give effect to an agreement on the avoidance of double taxation' (e). A footnote to letter (d) includes examples of broadly-defined measures ensuring equitable or effective tax imposition or collection with the result that this regulation has been considered to create a 'carve-out' for direct taxation. See Samuels, *Treatment of Tax Measures* (n 7) 53–55. Similarly, M Daly, *Is the WTO a World Tax Organization? A Primer on WTO Rules for Tax Policymakers* (International Monetary Fund 2016) 27.

[9]Mavroidis, *The Regulation of International Trade* (n 3) 135–36.

[10]Due to its technical nature, this caselaw has a limited significance for this article.

[11]For example, China's Protocol of Accession prohibits export taxes. See Appellate Body Report, *China – Measures Related to the Exportation of Various Raw Materials*, adopted 22nd February 2012, WT/DS394/AB/R; Appellate Body Report, *China – Measures related to the Exportation of Rare Earths, Tungsten and Molybdenum*, adopted 29 August 2014, WT/DS4131/AB/R.

[12]Case-law has consistently concluded the notion of subsidy does not cover export restraints (including tax). See Panel Report, *United States – Measures Treating Export Restraints as Subsidies* (DS194).

opposition to their imposition) is often complex, with different special interests and ideas fighting in different directions.

Their legal disciplines are elaborate but uncertain and pliable (and controversial).[13] In the case of safeguards, the complexity of the law (better of the interpretation carried out by the adjudicating bodies) has led governments to achieve the objective of protection via different, more friendly tools, like anti-dumping and countervailing duties.[14] The main point to take from this brief analysis is that these duties are particularly common and, at the same time, controversial and litigated.[15]

Most recently, the adoption of tariffs has generated new litigation with the awakening of an old, largely dormant provision on 'Security exceptions' (GATT Article XXI). The use of this defence has raised alarm about its potential 'Pandora's box' impact. The dispute settlement mechanism was first called to interpret this provision in the *Russia – Ukraine* dispute in the WTO era.[16] The key message was that governments do not have a completely free hand in alleging security as policy justification, noting that national security defences must 'meet a minimum requirement of plausibility in relation to the proffered essential security interests'.[17] The *leitmotiv* coming out from these cases is that justifications supporting otherwise illegal measures must be properly substantiated.

4. National treatment cases: when is domestic taxation protectionist?

GATT Article III is a crucial provision in the GATT architecture. It introduces a general trade rule governing *all domestic policies*. In truth to the negative integration ethos of the GATT, this is a simple rule of non-discrimination between imported and domestic goods. This also applies to 'internal taxation', which is any tax that is not applied at the border (and which, contrary to tariffs, may well be justified by endless public policy goals, expression of the preferences of the relevant jurisdiction). The concepts of 'internal tax' or 'internal charge' only refer to indirect taxes, that is, taxes directly applied to products.

Paragraph 1 prohibits the application of internal measures to imported or domestic products 'so as to afford protection'. Under Article III the name for protectionism is discrimination. Paragraph 2 outlines two different prohibitions of discrimination depending on the relationship existing between imported and domestic products, i.e. whether they are 'like' or 'directly competitive and substitutable' ('DCS') between each other.

The case-law has soon made it clear that the legal standard of (non-)discrimination for 'like' products is stricter than that for 'DCS' products. Any difference to the detriment of 'like' imported goods is prohibited.[18] By contrast, the adjudicating bodies have been at pain in identifying a clear test or methodology to determine whether, for products

[13]See D Palmeter, 'The Capture of Antidumping Law' (1989) 14 *Yale J Int L* 182; B Linsdey and D Ikenson, *Antidumping Exposed: The Devilish Details of Unfair Trade Law* (2003).
[14]See A Sykes, *The Agreement on Safeguards: A Commentary* (Oxford University Press, 2006).
[15]According to official figures (1995–2020), the Agreement on Anti-Dumping is the second most litigated agreement (after the GATT), the ASCM (which, however, includes both subsidy and CVD issues), standing in the third position.
[16]Panel Report, *Russia – Measures Concerning Traffic in Transit*, adopted on 26 April 2019, WT/DS512/R.
[17]Ibid., para. 7.138. The *Saudi Arabia– Qatar* Panel report further found that a connection must exist between governmental measure and national security claim. See Panel Report, *Saudi Arabia – Measures Concerning the Protection of Intellectual Property Rights*, WT/DS567/R, adopted on 16 June 2020 (appealed) para 7.4.3.3.4. Similarly, in the *US – Tariffs on Goods from China*, the Panel rejected the 'public morals' justification raised by the US. See Panel Report, *United States – Tariff Measures on Certain Goods from China*, adopted on 15 September 2020, WT/DS543/R.
[18]Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, adopted 1 November 1996, WT/DS8/AB/R at 23.

that, though not 'like', are 'DCS', a 'differential tax treatment' (i.e. the fact that imported and domestic products are 'not similarly taxed') equals to 'affording protection' to domestic production, or whether additional elements are needed to show protection.[19]

What must be shown is that this differential treatment amounts to protection. The Appellate Body held that '[a]lthough it is true that the aim of a measure may not be easily ascertained, nevertheless, its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure.' While the 'magnitude of the dissimilar taxation' may be good evidence of protection, the Appellate Body laconically concluded that it is a matter of case-by-case analysis. A clear methodology is not given, and perhaps that would not have been easy to do. In light of the more recent direction taken by the case-law (with respect to the interpretation of the different concepts of 'likeness' and 'DCS' products), the Appellate Body's findings may be construed as hinting at the question of whether the tax differential affects *significantly* the competitive relationship between goods.[20]

The *Chile – Alcoholic Beverages* case shows the ambiguities of WTO law as applied to taxation. It is the Appellate Body's first application of its test. The Chilean tax system distinguished beverages according to their alcoholic content, applying progressively higher tax rates depending on such content. However, in practice, only two tax bands – the lowest (27%) and the highest (47%) – were relevant. While 95% of imported products paid the highest rate (versus 25% of the domestic products), domestic products largely paid the lowest rate (50%-75% of domestic production). Panel and Appellate Body concluded the very significant difference between the rates applicable to domestic and imported products was sufficient to show the system was discriminatory and protectionist.[21]

While Chile was not able to explain the steep progression in tax rates and, especially, that only the lowest and the highest were relevant, it interestingly argued that, if *volumes of sales* were considered, it was Chilean drinks that accounted for the major part of sales in the highest bracket. In other words, Chilean drinks paid most of the tax. Although the argument was not accepted,[22] it raises an important issue.[23] Are we sure that if Chile wanted to act in a protectionist way, it would have imposed such a high fiscal burden on its domestic products (volume-wise)? In other words, is the protection of the domestic industry the only plausible explanation of the Chilean scheme? Despite contrary *dicta*,[24] isn't in the end always an issue of exploring the 'objective intent' of the legislator, irrespective of whether this is 'stated' or not?[25] If so, what is the burden of proof claimants

[19]Equally complex has been to give shape to the concepts of 'like' or 'DSC' products. The Appellate Body eventually found that 'likeness' refers to intense competition and 'DSC' to any competitive relationship. See Appellate Body Report, *Philippines – Taxes on Distilled Spirits*, adopted 20 January 2012, WT/DS403/AB/R, at paras 120–122, 148.

[20]See Mavroidis, *The Regulation of International Trade* (n 3) 373.

[21]Appellate Body Report, *Chile – Alcoholic Beverages*, adopted 13 December 2000, WT/DS87/AB/R, WT/DS110/AB/R, at paras 64–66.

[22]Ibid., para 67.

[23]Mavroidis, *The Regulation of International Trade* (n 3) 375.

[24]Appellate Body Report, *Chile – Alcoholic Beverages*, adopted 13 December 2000, WT/DS87/AB/R, WT/DS110/AB/R, at para 62.

[25]According to R Hudec, *GATT/WTO Constraints on National Regulation: Requiem for an 'Aims and Effects' Test* (1998) 32 *International Lawyer*, 619: 'The quotation [of the Appellate Body's finding that the "protective application" of a measure can be discerned from its design, architecture, and revealing structure] makes a great deal more sense if one substitutes the word "purpose" for "application"' (631). See also GM Grossman, H Horn and P Mavroidis, 'National Treatment' in H Horn and P Mavroidis (eds.) *Legal and Economic Principles of World Trade Law* (Cambridge University Press, 2013) 205.

should satisfy, and the standard of persuasion panels should be satisfied with? Since direct evidence (i.e. statements of objectives) is likely to be rare, should indirect evidence become the standard, as happens in many other areas of the law?[26]

In conclusion, there is a *fil rouge* going through all these cases, which is the difficulty in crafting a legal rule – negotiated or judicially created – apt to distinguish the bad from the good, to capture those instances of differential tax treatment that cannot be justified other than by protectionist intent.[27] Only these cases should be regarded as discriminatory. The scenario is certainly different, and the determination easier, in those cases which involve *de jure* discrimination[28] or include explicit discriminatory elements such as local content requirements.[29]

5. Tax subsidy litigation: about norms and exceptions

Governments can subsidize business through taxation and, at least in the developed world, they increasingly do so.[30] The legal question with tax under subsidy disciplines is to determine whether a preferential tax treatment derogates from the relevant tax benchmark. The creation of an exception constitutes the essence of a tax subsidy. This test, recognized by the OECD[31] and generally accepted in the literature,[32] prevails in practice in the EU and the WTO.[33] This was true in the GATT era, and it is still true in the WTO, where the ASCM introduces a legal definition of subsidy: the commanding test is whether a 'government revenue that is otherwise due is foregone or not collected' (letter (ii) of Article 1.1(a)(1) ASCM).

The issue is that it is not always easy to identify general norms and exceptions, and more specifically, to determine whether a differential tax treatment favouring the recipients is justified or 'discriminates' between economic operators that are in a similar situation.[34] This analysis requires to assess and distinguish between the *objectives* of the

The Appellate Body has, however, recently reiterated that policy considerations do not belong to GATT Article III:2. See Appellate Body Report, *Brazil – Certain Measures Concerning Taxation and Charges*, adopted 11 January 2019, WT/DS472/AB/R, para 5.27.

[26]H Horn and P Mavroidis, 'Still Hazy after All These Years: The Interpretation of National Treatment in the GATT/WTO Case-Law on Tax Discrimination' (2004) 5 *European J Int L* 39.

[27]The GATT negotiators were not happy with the ambiguous language of Article III. They, however, eventually settled for it, leaving to adjudicators the duty to 'complete the contract'. See Mavroidis, *The Regulation of International Trade* (n 3) 338–40.

[28]Panel Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (Mexico) (Article 21.5 – Mexico)*, adopted 3 December 2015, at para 7.65.

[29]There is a long line of cases. See, e.g. *Indonesia – Certain Measures Affecting the Automobile Industry* (DS54); *Canada – Renewable Energy* disputes (DS 412; DS426); *India – Certain Measures Relating to Solar Cells and Solar Modules* (DS456); *United States Certain Measures Relating to the Renewable Energy Sector* (DS510).

[30]For example, tax measures are the most common form of EU State aid, consistently amounting to 2/3 of the total of aid granted.

[31]A 'tax expenditure' is 'a departure from the generally accepted or benchmark tax structure, which produces a favourable tax treatment of particular types of activities or groups of taxpayers': OECD, *Tax Expenditures: A Review of the Issues and Country Practices*, Report by the Committee on Fiscal Affairs (1984) 7.

[32]See, e.g. L Rubini, *Definition of* Subsidy and State Aid: WTO Law and EC Law in Comparative Perspective (Oxford University Press, 2010), chapter 7; M Benitah, *The Law of Subsidies under the GATT/ WTO System* (KLI 2001) 188; M Daly, 'The Role of Tax Expenditure Reporting in a Global Economy' (1995) 12(1) *The World Economy* 87; Daly, *Is the WTO a World Tax Organization?* (n 8) 19.

[33]See Rubini (n 32); for EU law, see also K Bacon, *European Union Law and State Aid* (Oxford University Press, 2017) chapter 2.

[34]There is an important theoretical and practical overlap between the notion of subsidy and that of discrimination, as the carve-out in Article III:8(b) of the GATT recognizes.

tax. It is only through this enquiry that it is possible to determine whether the measure amounts to a subsidy.

A significant question focuses on the legal status of tax measures introduced to level the playing field and ensure the competitiveness of the relevant economy or sector. It is indeed inevitable that the diversity of tax systems benefits certain economies/sectors vis-à-vis others. Trade law is, however, not flexible enough to take these considerations into account. While from an economic viewpoint, it may well be true that these tax incentives do not distort but simply correct the market, the legal framework is more formal and carries out its 'derogation test' in isolation from many of the circumstances surrounding the measures or impacting the economy.

The most important jurisprudence to elucidate these issues is the DISC/FSC litigation that has spanned through various decades, from the 1970s up to the 1990s, through the GATT to the WTO era.[35]

The root of the conflict originated in the co-existence of two principles to tax income, on their different opportunities for tax avoidance, and, ultimately, on their impact on international competitiveness.[36] While countries normally levy tax only on the income earned (by residents and non-residents) inside the country (principle of territoriality), US tax law taxes also income earned outside the country if there is an effective connection with a trade or business in the US (principle of worldwide taxation).[37] The combination of the territorial limitation of the tax systems with the existence of off-shore jurisdictions and the manipulation of transfer pricing all lead to the conclusion that multinationals based in territorial systems are objectively advantaged vis-à-vis US-based multinationals, which cannot escape the broader reach of their tax system.

In 1971 the US adopted the *Domestic International Sales Corporations (DISC)* legislation which provided for a tax exemption of a share of export income generated by specific companies. The EEC challenged the legislation. For several meetings, the US denied that the GATT had any jurisdiction in tax, and, only eventually, agreed that the matter be adjudicated but under one condition. Challenging three European tax schemes based on territoriality (of Belgium, France, the Netherlands), it highlighted that, *if* the DISC legislation were illegal, *then* so were these three territorial tax 'exemptions'.[38]

Four-panel reports were issued in 1977 which concluded that both the US DISC tax exemptions and the application of the European territorial systems constituted export subsidies. Crucially, on the basis of the agreed equivalence between the two claims, the US argued *a contrario* that 'if territorial tax exemptions were to be permitted, non-territorial countries must be permitted to grant an equivalent tax subsidy to their own exporters'.[39] The US was thus quite willing to reverse the panel ruling on this condition, which was not acceptable to the EEC. Lacking unanimity, the reports remained unadopted until a settlement was agreed with the Council's '1981 Understanding'. The parties accepted that 'economic processes located outside the territorial limits of the exporting country

[35]See, e.g. JH Jackson, 'The Jurisprudence of International Trade: The DISC Case in GATT' (1978) *American J Int L* 747; GC Hufbauer and J Shelton Erb, *Subsidies in International Trade* (MIT Press, 1984) 57–63; RE Hudec, '*Enforcing International Trade Law—The Evolution of the Modern GATT Legal System* (Lexis Law Publishing, 1993) 53–100.
[36]Chaisse and Mosquera, in this Asia Pacific Law Review special section 'The Future of International Tax Disputes' para 3.1.
[37]See GC Hufbauer and A Assa, *US—Taxation of Foreign Income* (Columbia University Press, 2007).
[38]See Hudec, 'Industrial Subsidies: Tax Treatment of 'Foreign Sales Corporations' in EU Petersmann and MA Pollack (eds), *Transatlantic Economic Disputes—The EU, the US, and the WTO* (Oxford University Press, 2003) 175, 177–78.
[39]Ibid., 178.

need not be subject to taxation by the exporting country and should not be regarded as export activities' (emphasis added). Two conditions had to be fulfilled, namely that the exemption be limited only to *foreign economic processes* (i.e. sales activities taking place outside the government's territory) and to *foreign-source income* (which would have been ensured by calculating the exempt income on the basis of arm's length pricing). Both the US and the EEC claimed victory. The US replaced the DISC legislation with the FSC legislation, which introduced an exemption from taxation on a portion of the 'foreign trade income' of certain companies established outside the US (*Foreign Sales Corporations*, FSC).

According to most observers, the FSC tax exemption did not meet the conditions of the 1981 Understanding.[40] That was the conviction prevailing in Brussels corridors too. Pending the Uruguay Round negotiations, no challenge was filed. After the advent of the WTO, the climate, however, changed. The US started to use the new dispute settlement system heavily, also against the EU. The EU felt a strong signal was necessary to discipline this aggressiveness and in 1997 challenged the FSC legislation claiming it amounted to an export subsidy prohibited under the new ASCM. Both the Panel and the Appellate Body concurred that the legislation was a subsidy, being a case where government revenue, 'otherwise due', had been foregone, and that, being contingent on exports, it was prohibited. Despite changes, also the new statute implementing the dispute settlement decisions, the *Extra-Territorial Income (ETI)* legislation, was found illegal.[41]

What is interesting is that the Panel and the Appellate Body, each called to examine US law twice, came out with four different approaches or tests to give meaning to the key 'otherwise due' expression:[42] from the simple use of a 'but for' test to its qualification, from a 'derogation test' in disguise up to a 'comparative test', the latter being the latest word of the Appellate Body on the point. In particular,

> . . . we believe that panels should seek to compare the fiscal treatment of legitimately comparable income to determine whether the contested measure involves the foregoing of revenue which is 'otherwise due', in relation to the income in question.[43]

In the end, all these approaches are different ways of phrasing the same logical process, which essentially requires the search for exceptions and norms.[44] Why then not saying this clearly and avoid too many variations to the same theme? There are various reasons for this. Tax systems are complex. This complexity in tax translates into the complexity in the legal standard to assess it. It is natural that adjudicating bodies, called to 'complete the contract' by giving shape to the 'otherwise due' language, were particularly worried to set in stone a methodology that might result in Type-1 or Type-2 errors. At the

[40]The *FSC* legislation required very little genuine foreign economic activity and the pricing rules did not comply with the arm's length principle. See RE Hudec, *Enforcing International Trade Law* (n 35) 95–98, and Hudec, 'Industrial Subsidies' (n 38) 180.

[41]Eventually, after retaliation and second implementation proceedings, the US repealed the *ETI* legislation. Attempts to amend the US corporate tax system have followed, raising concerns about their WTO-compatibility. See, e.g. J Hillmann, 'Why the Ryan-Brady Tax Proposal will be Found to be Inconsistent with WTO Law' Institute of International Economic Law Issue Brief, 03/2017.

[42]For a full analysis, see L Rubini, *The Definition of Subsidy*, 265–74.

[43]Appellate Body Report, *US—FSC (Article 21.5 EC)*, para 91. Interestingly, the Court of Justice of the European Union has come out with a very similar test: Case C-143/99, *Adria-Wien Pipeline*, para 41.

[44]See Rubini, *The Definition of Subsidy* (n 42) 272–74.

same time, however, the paradox is that one cannot escape from the logical process to identify a tax subsidy outlined above. This is a delicate assessment, requiring a careful analysis and not always leading to a certain outcome.[45]

The key question was whether the need to ensure competitiveness is an objective which subsidy disciplines should accept with reference to an income tax system. The US' argument was once again about the alleged *economic equivalence* between the European tax exemptions for export income and the FSC tax exemption. The measure was not a subsidy because it was simply compensating a disadvantage. The Panel dismissed the argument. While the US was free to maintain whatever tax system it saw fit, it could not, after making its sovereign choice with respect to the fundamentals of the system, create specific exemptions claiming this was necessary to eliminate a disadvantage created by its tax system itself.[46]

This reasoning is correct in so far as it solves the issue formally, within the four corners of the law (a constraint economists do not face). If the US' logic were followed, where to draw the line between the endless objectives to tackle handicaps and market failures? That would inevitably require a comprehensive welfare analysis already at the preliminary level of the subsidy definition without letting the actual disciplines to do their job by sorting out subsidies' effects and objectives.

To be sure, the analysis of the tax objectives is central to determine whether a differential treatment is a subsidy. The issue is to distinguish. In the EU a distinction is made between objectives that are *internal* to the logic of the tax (e.g. carbon emissions reduction in a carbon tax) and those that are *external* (e.g. the need to alleviate the fiscal burden for energy-intensive industries in an energy tax system). Only the former should be considered when determining whether the measure is a subsidy. Competitiveness arguments go beyond this category.[47] This distinction seems equally applicable in the WTO context for *systemic* reasons.[48] There are specific transparency requirements for subsidies. Under-inclusion would then raise an additional element of concern because it could disable a special system of peer review.

After this case-law review, two conclusive remarks can be made on the relationship between trade law and taxation. First, the uncertainty in tax incentives should be combined with the fuzziness of the legal standards. Similar to what happens for NT, the result of the analysis of subsidy laws is sheer legal uncertainty. Secondly, and more crucially for the themes of the Symposium, despite adjudicating bodies always paying lips to the sovereign prerogatives of governments in tax matters, certain decisions have *de facto* significantly impacted on these by forcing governments to change fundamental tax principles.

[45]Using mathematical language, 'saying that an exemption amounts to "foregone revenue that is otherwise due" has no meaning if we do not have a universal reference set in which this exemption appears as a departure from the general regime': Benitah, *The Law of Subsidies under the GATT* (n 32) 188. The problem is that it is possible to identify different universal reference sets in any given case with the consequence that the assessment of the 'otherwise due' requirement may well lead to different results (*ibid*., 188 and 189).

[46]Panel Report, *US – FSC*, para. 7.122.

[47]See Case C-173/74 *Italy* v *Commission* [1974] ECR 709.

[48]For a recognition of the relevance of the objectives see Appellate Body Report, *US –Large Civil Aircraft*, WT/DS353/AB/R, adopted 23 March 2012, para 815.

6. Border tax adjustments and their distinctions: encroaching on tax sovereignty?

In the previous section, we have analysed the long tax controversy between the US and the EU on the different principles informing their income tax systems. The *Working Party on Border Tax Adjustments* was set up following a request from the US, concerned about the impact of European indirect taxes, such as VAT, on international trade.[49] While the US system was based on direct taxation (e.g. income tax), European countries opted for indirect taxation (e.g. consumption taxes).[50] Due to its nature as a 'negative integration' contract, the GATT was obviously neutral on such general tax decisions.

Changes effected early on after the GATT came into force in 1947 seemed to express the preference of the world trading system. In 1955 the crucial provision on subsidies (Article XVI), which initially only provided for a notification requirement and for consultations in case of allegations of serious prejudice, was amended substantially through the introduction of new prohibitions for export subsidies and a norm regulating exemptions or remissions of indirect taxes (i.e. taxes on products). In particular, a note *ad Article XVI* reads:

> The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued shall not be deemed to be a subsidy.[51]

This note explicitly acknowledges the destination principle for indirect taxes, thus confirming the US concerns about the competitiveness of European exports: only indirect taxes – and not direct taxes – could be rebated at the border. A rebate of a direct tax (irrespective of its amount) would have amounted to a subsidy and, more specifically, to an export subsidy (which was subject to a stricter discipline than purely domestic subsidies).

Through an illustrative list of prohibited export subsidies, the 1960 *Working Party on Subsidies* reinforced this discipline: while clearly permitting proportional exemptions or rebates on indirect taxes when goods were destined for export markets, any remission on 'direct taxes, or social welfare charges on industrial or commercial enterprises' was strictly prohibited.[52]

While indirect taxes were thus fully subject to the 'destination principle' (taxation should be appropriately levied in the country of destination), direct taxes were subject to the 'origin principle' (the proper jurisdiction to tax income is the country where the said income is generated).[53]

The 1970 *Working Party on Border Tax Adjustments* was the opportunity to re-discuss the legal status and rationale of these two principles. The outcome essentially confirmed the previous position, though important points (for example, on 'taxes occultes' and property taxes) were elaborated. The principles of the *Working Party* are incorporated in certain items of *Annex I – Illustrative List of Export Subsidies*, attached to the WTO ASCM. For the purposes of this Symposium, only a few items are relevant.

[49]Mavroidis, *The Regulation* (n 27) 353 *et seq*.
[50]Ibid., 354.
[51]This note is reproduced in the first footnote of ASCM Article 1 thus clarifying the newly introduced definition of subsidy.
[52]See item (c) and (d).
[53]The economic rationality of the different treatments between direct and indirect taxes has been criticized. See, e.g. GC Hufbauer and J Shelton Erb, *Subsidies in International Trade* (n 35) 10–11; 51 *et seq*.

The case-law focused on the interpretation of the fifth sentence of one footnote to item (e), which prohibits the exemption, remission or deferral of direct taxes. Footnote 59 reads that 'item (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member.'[54]

Finally, it is important to focus on the proposal for a carbon border adjustment mechanism ('CBAM') published by the EU Commission on 14th July 2021.[55] In essence, the system provides that importers must purchase certificates to cover both direct and indirect emissions embedded in certain products imported into the EU (particularly, steel, iron, cement, fertilizers, aluminium and electricity). The scheme, which is essentially an extension of the EU Emissions Trading Scheme ('ETS'), is aimed at tackling carbon leakage. The Proposed Regulation includes provisions for calculating the embedded submissions (Article 7) and for taking into account the carbon price paid in the country of origin (Article 9). This innovative mechanism, which should enter into force in 2026, has attracted interest and analysis about its WTO law compliance, which largely focus on potential discriminatory elements of the scheme, which may well constitute the basis for WTO legal claims.[56] While a breach of the principle of NT is almost inevitable (since what would be taxed is the process of production and not the products' characteristics), the legal focus would shift to the application of the general exceptions under GATT Article XX, and in particular its *chapeau* which essentially calls for the measure to be even-handed in its application.[57] To ensure legal compliance, the key for any carbon pricing system is 'to structure any accompanying border measure as a straightforward extension of the domestic climate policy to imports'.[58] Assuming the soundness of the basic economic and legal principles underlying the scheme, Robert Howse observed that seminal schemes such as this one might benefit from, and improve on, their practical application, so that any element of illegality in the implementation of the scheme may eventually be eliminated.[59] The EU proposal has been harshly received by certain countries, such as Russia,[60] but has also generated debate in other countries, such as the US, about adopting similar measures.[61]

[54]The *US – FSC* dispute made it clear various issues such as the scope of the provision, the degree of discretion of Members to avoid double taxation, the relationship of the measures to target 'foreign-source income', the notion of 'foreign-source income' and the use of international tax law as a tool of interpretation.

[55]A good exposè of the negotiating positions of the Council and the European Parliament are set out, alongside the key elements of the Commission's proposal, in Van Bael and Bellis, 'The EU Carbon Border Adjustment Mechanism (CBAM): What's at stake for the trilogue?' (12 July 2022) <https://www.vbb.com/insights/trade-and-customs/the-eu-carbon-border-adjustment-mechanism-cbam-whats-at-stake-for-the-trilogue>.

[56]See, e.g. V Crochet, 'CBAM enters with a BANG: The European Commission Puts Forth Its Carbon Border Adjustment Mechanism Proposal' International Economic Law and Policy Blog, <www.worldtradelaw.net> accessed 14 July 2021.

[57]For an analysis see L Rubini and I Jegou, 'Who'll stop the rain? Allocating Emissions Allowances for Free: Environmental Policy, Economics, and WTO Subsidy Law' (2012) 1 *Transnational Environmental Law* 325. If the scheme is considered a 'technical regulation', the legal analysis would also focus on the 'legitimate regulatory distinction' test in Article 2.1 of the TBT Agreement.

[58]J Hillman, 'Changing Climate for Carbon Taxes – Who's Afraid of the WTO?' The German Marshall Fund of the US, Climate and Energy Paper Series 2013, 1.

[59]R Howse, 'How to Begin to Think about the WTO Compatibility of the EU CBAM' International Economic Law and Policy Blog <www.worldtradelaw.net> accessed 14 July 2021.

[60]L Hook, M Seddon and N Astrasheuskaya, 'EU Plan for World's First Carbon Border Tax Provokes Trading Partners' *The Financial Times* (16 July 2021).

[61]L Fedor and A Williams, 'Democrats Eye Carbon Border Tax to Help Fund $3.5tn Spending Package' *The Financial Times* (15 July 2021).

As the examination of subsidy laws highlighted, the question arising from the analysis of BTAs, which goes to the core of the Symposium, is whether, and to what degree, trade laws encroach on tax sovereignty.

7. The frontier: tax avoidance

Linked to the narratives on a level playing-field and competitiveness, significant developments are taking place with respect to the use of trade law to tackle tax avoidance. This refers to all those practices carried out by multinational companies to exploit the differences across domestic tax laws to reduce their overall tax burden. It is important to distinguish between measures of tax avoidance and measures adopted to tackle tax avoidance. This paragraph will assess the impact of trade law on both.

Strictly speaking, tax avoidance scenarios are different from those where governments themselves introduce favourable treatment for certain enterprises or sectors. We have already addressed the seminal DISC/FSC litigation where legislation was under review. More recently, the administrative practise of tax rulings adopted by domestic tax authorities to determine the tax treatment of multinational enterprises in advance has been subject to investigation and litigation in the EU (but not in the WTO). The current focus of the fight of tax avoidance mostly concentrates on the services sector and, in particular, the taxation of services in the digital economy.[62] Several countries have thus recently adopted digital services taxes to subject to tax the activity of multinational enterprises operating in the digital sectors. These unilateral measures have been very controversial and subject to trade investigations in the United States.[63]

As noted, the GATS is deferential not only towards direct domestic taxation but also towards international tax law, explicitly giving way to the application of tax treaties for double taxation avoidance in cases where a NT claim could be filed. Importantly, the possibility of using trade law to tackle unwarranted tax practices is limited in another significant respect. The GATS does not include any substantial discipline on subsidies.[64] In sum, the possibility to discipline any tax differential treatment is severely limited either because there are no NT commitments (or there are specific tax treaties on double taxation) or because the system does not provide any significant regulation of subsidies in the services sector.

Panama – Argentina is the only dispute so far that has dealt with the WTO compatibility of measures to tackle tax avoidance. Argentina had adopted various measures, both tax and regulatory, to combat problems such as tax evasion, tax avoidance, fraud and money laundering enabled by certain 'tax haven' countries. In particular, Argentina discriminated against those foreign services suppliers in a jurisdiction refusing to share information to permit it to determine whether its nationals engaged in tax evasion. Panama claimed that these measures breached the MFN and NT obligations because they provided for less favourable treatment for 'non-cooperative' countries.

[62]See P Mavroidis, 'And you Put the Load Right on Me. Digital Taxes, Tax Discrimination and Trade in Services' (2020) 12 *Trade, Law and Development* 75; GC Hufbauer and Z Lu, 'The European Union's Proposed Digital Services Tax: A De Facto Tariff' PIIE Policy Brief (2018) 18–15.

[63]The USTR's website includes information on all Section 301 investigations <https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes>.

[64]With the exception of the possible application of NT commitments if the relevant Member has accepted any.

Here, we mostly focus on the tax measures at issue.[65] The Panel found that, while all measures breached MFN, three tax measures did not violate Argentina's NT commitment. In its defence, Argentina argued that most of the measures (including the four tax measures) were justified because they were necessary to secure compliance with laws or regulations which are not inconsistent with the GATS under GATS Article XIV(c). The Panel concurred but eventually found that the exception did not apply because the measures' application constituted arbitrary and unjustifiable discrimination within the meaning of the *chapeau*.[66] On appeal, the Appellate Body reversed the Panel's findings on the breach of MFN and NT. The case is significant because the Appellate Body made it clear that services (and service suppliers) from jurisdictions that share financial tax information may be different from services (and service suppliers) from jurisdictions that do not cooperate in supplying such information.[67]

We have already highlighted the difficulties posed by the assessment of 'likeness' above. Arguably, the differential approach towards 'non-cooperative' jurisdiction did not depend on 'origin' only but on their lack of adoption of international standards. This was a regulatory distinction based on the lack of cooperation in tax transparency. The important legal issue is whether these regulatory distinctions are relevant when it comes to determining whether two 'service suppliers' are like. Probably not. Competitiveness seems to be the key criterion (though the Appellate Body further muddled the waters). As argued above, the most appropriate place to consider *policy objectives* is the determination of whether the measure affords 'less favourable treatment'. In sum: were Argentina's measures protectionist or not? The Panel came to the conclusion that certain measures did not breach this standard by noting the anchorage to internationally agreed standards (which implemented Argentina's objective of tax transparency).[68]

Assuming a breach of trade law, both Panel and Appellate Body considered Argentina's claim based on GATS Article XIV, item (c). While accepting the necessity of the measures to secure compliance with Argentina's laws, the Panel found certain unjustified inconsistencies in their application between different countries and thus rejected the defence. Although Argentina had not (surprisingly) appealed the Panel's finding on the defence, the Appellate Body analysed the issue and essentially confirmed, through the traditional balancing exercise, that the measures were designed and necessary to secure compliance with Argentina's laws.

The broader lesson of the *Panama – Argentina* case is a confirmation of the difficulty of using domestic measures to solve problems outside a country's jurisdiction.

Tax avoidance is a frontier issue. Not only is it so because of the insufficiency of the current laws (including trade law) to tackle it efficiently but also because the only real

[65]For further discussion, see the contribution by Tony Marzal and Ricardo Garcia Anton.

[66]It is important to note that the measures at issue were essentially following 'international standards' on transparency. See, in particular, the Global Forum on Transparency and Exchange of Information for Tax Purposes and the Financial Action Task Force ('FATF') established by the OECD.

[67]It has been argued that the Appellate Body reached this correct conclusion but on the basis of wrong legal arguments. See P Delimatsis and B Hoekman, 'National Tax Regulation, Voluntary International Standards, and the GATS: Argentina Financial Services' (2018) 17 *World Trade Review* 265.

[68]Panel Report, *Argentina – Financial Services*, para 7.589 *et seq*. By contrast, the Appellate Body (at paras 6.107–115) opined that the most appropriate place to consider objectives is the exceptions, unless the defendant is able to prove an impact of the regulatory aspects on the 'conditions of competition'. Delimatsis and Hoekman, National Tax Regulation, Voluntary International Standards' (n 66) 285–86, that the best place to assess regulatory objectives is GATS Article XIV.

solution to a problem which is rooted in the loopholes generated by the existence of different tax jurisdictions can only be an international solution. In other words, what is needed is to go beyond the paradigm of domestic sovereignty towards a globally efficient tax compact that harmonizes tax laws, at least to some degree.[69]

8. Conclusions: trade law as inherently partial solution

This article speaks of the inevitable but uneasy relationship between tax and trade law. The emerging picture is mixed. Certainly, trade law introduces significant constraints on governments' tax powers – and this is testified by the burgeoning litigation on tax measures. That said, it looks like certain disciplines are likely to be more intrusive than others. While NT disputes seem to affirm a basic legal commandment – do not discriminate – and leave significant freedom on countries' ability to shape their domestic tax laws, other disciplines, like subsidy ones, can, at least in principle, bite. This especially happens when the facts make the country realize that its prevailing 'normal treatment' is not economically sound and, in a globalized context, puts its economy at a disadvantage as compared to other countries. Tax amendments thus attempt to adjust this normal treatment to rectify this handicap. Though from an economic standpoint, this conduct may not raise any concern, the formality of trade laws does not tolerate exceptions to self-created norms. From a political point of view, the salient issue is that the broad statements that governments would be 'sovereign' with respect to tax decisions are often lessened when specific tax measures, with their specific design and policy goals, are subject to the scrutiny of specific trade rules those governments have signed up to. Thus, often following a negative ruling of the dispute settlement mechanism, a government may be forced to amend the prevailing general tax norm itself (maybe built around principles going back decades or centuries) and shape it so that it fully complies with the requirements of trade law. The same scenario may take place with border tax adjustments.

The second red line going through almost every page of the article is complexity –at various levels. The case-law should thus be seen as a continuous effort to clarify the law and its standards, to untie the Gordian knot. Sometimes, adjudicatory bodies have been successful in doing so, in other cases less so. On the one hand, *tax* may be complex – because of how it is created and amended (forming, in some cases, almost geological stratifications), because of the variety of objectives it may pursue (competitiveness, carbon leakage, environmental protection, tax avoidance, domestic industry protection, revenue-raising). Lacking global harmonization, what inevitably comes out is the diversity of national preferences in the types of and standards in tax. At the same time, the impact of tax measures on international trade is not always easy to assess. Finally, the fragmentation of tax powers (and preferences) creates loopholes enabling tax avoidance. On the other hand, *trade law* may become particularly uncertain when it applies to tax. In the large majority of cases, the issue boils down to designing legal standards to identify, distinguish and assess policy objectives to determine whether a measure is legitimate. Very often easier said than done.

[69]Various initiatives are taking place in this respect. See Chaisse and Mosquera in this Asia Pacific Law Review special section 'The Future of International Tax Disputes'.

What does the WTO-tax story tell us about the broader discussion between public international law and taxation?

Trade law is often the only regulation that disciplines tax internationally and mostly does so in a negative way: the main concern is to avoid state measures distorting trade. This stands in stark contrast to the national nature of tax systems (each with its own history, goals, and characteristics) and to the multinational companies' exploitation of different tax systems to minimize tax liability. Trade law and its dispute settlement can only offer a partial solution to tackle specific instances of distortion, favouritism and protectionism. Due to its 'negative integration' character, it cannot offer globally harmonized standards which are at the core of the BEPS project. What remains to be seen is whether it will be left as the only guardian to ensure, perhaps inefficiently, a minimum level of fairness, or whether governments might eventually decide to relinquish part of their sovereignty and craft themselves international tax rules based on principles that suit them and society in the XXI century. There are signals that this might be one of the next big developments in international law.

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