

WORLD TRADE ORGANISATION: BRICS AND DIRECT TAXATION¹

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In this paper I describe the impact which the WTO has had on corporate income taxation in the BRICS. It comes from the main Agreements which the WTO operates, their interpretation by Members and the methodology for settling disputes together. Also relevant is the increase in transparency which comes from notifications of their rules made by Members on accession and as part of the periodic review of their rules and procedures. All this evidence supports the conclusion that the WTO is involved in shaping the BRICS international tax policy.

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I. WHAT IS THE WTO

1.1 Background:

The WTO can trace its history to the end of World War II, when the United States and Allied Forces planned to establish a new world order through three international institutions designed to liberalize trade and payments.

The International Monetary Fund (IMF) was formed to facilitate international payments.

While Europe and Japan wished to rebuild their production capability, they accepted this would require substantial foreign capital and without an international order to facilitate it, the objective would be doomed. The International Bank for Reconstruction and Development (IBRD, now the World Bank) was born to deal with this.

To facilitate the free trade which was necessary to encourage the relocation of the assets needed in the reconstruction and then to export the manufactured goods, they planned to create an International Trade Organization (ITO) but the General Agreement on Tariffs and Trade (GATT)² evolved instead.

1.2 GATT and WTO

On 1 January 1995, GATT 1947 evolved into GATT 1994 and the WTO,³ and has been at the centre of global trading negotiations⁴ ever since.

In 1947, GATT had been formed as a multilateral agreement to assist in the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis". It was a provisional agreement entered into by the contracting parties with no legal enforcement power but the WTO was formed as a binding permanent agreement with Members.

1.3 Membership:

At formation in 1994, WTO admitted 75 of the former GATT 1947 Members together with the European Communities. The 52 remaining GATT 1947 Members re-joined the WTO in the following two years. At the time of writing, there are 159 WTO⁵ Members with Russia and Vanuatu acceding in 2012. There are 21 countries with Observer status.⁶ At a total complement of 159 and a potential of 180, this means most countries would be members.

²Gatt was established in 1948

³The 1947 GATT wording is still in effect but is now under the WTO framework, subject to the modifications of GATT 1994

⁴The BBC lists some of the more important milestones in the evolution of the GATT into the WTO and beyond at http://news.bbc.co.uk/1/hi/world/europe/country_profiles/2430089.stm

⁵As at 2 March 2013

⁶An Observer must start accession for membership within 5 years from commencing the Observer status, except for the Holy See

1.4 Functions:

One of the main differences between GATT and the WTO is that while GATT 1947 was a body of rules agreed upon by nations, the WTO is an institution. This change of form led to a change of functions with the WTO now dealing not only with the management of international trading of goods but also with international services⁷, agriculture and intellectual property.⁸

At the core is the requirement to ensure that domestic and international businesses are treated equally with respect to export production and for nationals of one country to be given no less favourable treatment than that given to nationals of another country.

Although GATT 1994 gave rise to multilateral agreements as the means of binding its Members, some plurilateral agreements⁹ were formed,¹⁰ but because this led to selective trading two of the four plurilateral agreements have been repealed. This is not to say though that plurilateral agreements are dead as some leading commentators suggest.¹¹

1.5 Purpose:

The WTO's purpose is liberalizing world trade through Member States negotiating trade agreements with other Member States which provide the legal ground-rules for international commerce. The trade agreements are contracts which bind the Member States to keep their trade policies within agreed limits. The Agreements, through transparency and predictability, help producers of goods and services, exporters and importers to conduct their business within the rules while simultaneously allowing Governments to meet social and environmental objectives.

1.6 Dispute Settlement:

Conflict arises when a Member adopts a different interpretation of a provision in one of the Agreements to that adopted by another Member. Consultations based on legal principles and an agreed timetable take place and where they do not lead to a voluntary resolution, the Complainant (sometimes joined by other Member States) can request a Panel be established¹² by the Dispute Settlement Body (DSB).¹³

⁷ General Agreement of Trade in Services

⁸ The Trade Related Aspects of Intellectual Rights Agreement

⁹ The 4 plurilateral agreements covered trade in civil aircraft, government procurement, dairy products and bovine meat. The bovine meat and dairy agreements were terminated in 1997 and not all Members were members of each

¹⁰ They were principally established in the Tokyo Round

¹¹ Baldwin Richard in "Bilateralism and plurilateralism: Rethinking trade integration for the 21st century"

Graduate Institute, Geneva, Wilton Park 7 February 2012

¹² Panels normally consist of three people having relevant background and experience from Members independent to the dispute.

¹³ As an alternative, the parties may follow an alternative dispute settlement procedure including conciliation, mediation and arbitration

The Panel¹⁴ should complete its report within six months or, when there is urgency, within three months (but these times can be extended) and the DSB then takes a decision no later than 20 days later. Not more than 60 days after issuance, the report is adopted by the DSB unless either the DSB decides not to adopt it or a Member notifies an intention to appeal.

The Appellate Body (AB) consists of seven members with three serving on any one case and with Members being able to nominate persons for AB membership. The appeal is limited to the issues of law and assumptions covered in the Panel's report and it must be concluded not more than 60 days from the date the Member formally notifies its decision to appeal.

The AB's report is adopted by the DSB and unconditionally accepted by the Members in the dispute within 30 days following its issuance, unless the DSB fails to accept the report. Assuming the AB's report has been adopted by the DSB, the complained to Member must advise the complainant how it proposes to implement the recommendations. If it is impracticable to comply immediately with any or all of the requirements, the Member will be granted reasonable grace but the DSB will keep the matter under constant surveillance. Should the Member not implement the settlement then a further hearing can take place.

II. WTO AND DIRECT TAXES

2.1 Compatibility of the WTO and Double tax relief:

The similarity between the driving forces behind the WTO and the international tax governance organisations (principally the OECD and UN) are not superficially apparent to most except when considering how each seeks to reduce the barriers to international trade.

The WTO requires Members to reduce indirect taxes, subsidies and non-tax matters (known as non-tariff barriers-NTB) which impede the free movement of goods and services (i.e. tariffs)¹⁵ which sovereign states reduce the incidence of double taxation because they believe it is a barrier to international trade concerning production profits, finance and capital¹⁶.

The reduction of tariffs and NTB are dealt with multilaterally by GATT and the other Agreements. The avoidance of double taxation on finance, capital and production profits takes place unilaterally when a country reduces its taxes¹⁷ by amending its own laws, or bi-laterally, through Double Tax Conventions (DTC's) based on one of the OECD¹⁸ or UN¹⁹ Models or on one of a growing number of other Models²⁰ depending on country's geographical location and socio-political grouping.

14The Panel members are normally jointly selected by the Parties but should compromise not be reached then the DSB makes the choice

15 Daly M, The WTO and Direct Taxation, Discussion Paper No 9, Geneva, Switzerland, 2005

16Para 1 and 2 of the Introduction to the Commentary to the OECD Model 2012

17By granting unilateral foreign tax credits, tax sparing or exemption

18 OECD Model Tax Convention on Income and Capital 2010-2012

19 United Nations Model Double Taxation Convention 2011

20 United States, Russia, Netherlands amongst others

Negotiators of bi-lateral DTC's identified long ago that double taxation represented a serious obstacle to maximising import substituting foreign direct investment. This realisation led to a proliferation of DTC's to reduce the source country withholding taxes on payments made to a non-resident, on capital gains and the like as well as avoiding double taxation.

All this means there is substantial similarity in the fundamental objective of the OECD and UN as evidenced in the Model Double Tax Conventions and the Commentaries²¹ and the WTO objective. While the DTC's focus on juridical double taxation (i.e. taxation on the same entity's income or capital in two countries), the OECD Commentary tells us about the "harmful effects on the exchange of goods and services and the movement of capital, technology, and persons and it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries."

Not unexpectedly, Members react to the loss of revenue from the reduction of tariffs by creating tax revenue another way. One such instance discussed by Slemrod, is the Irish situation where after removing tariffs, adjustments were made to direct taxation and incentives.²²

1.3 Uruguay Round

The 1993 Uruguay Round brought into existence a number of Agreements to support GATT containing countervailing measures to financially penalise a Member which had granted a specific subsidy to encourage domestic production of goods and services at the expense of imported goods and services. In an extremely important concession to Member sovereignty, the Subsidies and Countervailing Measures Agreement²³ excluded from the subsidy definition, any setting or change in a generally applicable tax rate.

This carve out was generally thought to mean that the WTO had no relevance or impact on direct taxation but in 2005 Daley wrote that the international community now understood the WTO's role in reducing the impact of direct taxation in inhibiting the international movement of goods, services, capital, persons and technology was not just about tax rates, but was about the principles and procedures behind those rates.

These provisions meant that a country's Sovereign right to amend its own tax laws was fettered by the WTO where there was inconsistency between the Member's internal taxation laws and the WTO's requirements.²⁴ This happened from the settlement terms adopted by Members, or where agreement was not possible, from the terms of the Reports issued by the Panel or the Appellate Body.

21 OECD Commentary on the Model Conventions of 1977 and 1992, incorporating changes from 1994 to 2012

22 Slemrod, JB, 1995. "Free Trade Taxation and Protectionist Taxation", *International Tax and Public Finance*, pp 471-489

23 Article 2(2) of Agreement on Subsidies and Countervailing Measures

24 Daley, M, WTO and Direct Taxation, *ibid*, p2

The nature of a Member's taxation policies was now regularly and closely monitored by the WTO Trade Policy Review Mechanism and this sharing of information with other Members led to transparency. Prior to joining, each new member notified its taxation (direct and indirect) provisions and other laws which potentially could breach the SCM so this provided a volume of information for Members to study.

2.3 Major WTO Agreements:

The WTO Agreements for which direct taxation is relevant are:

GATT (1994):

Law

Article III is relevant to direct taxation (National Treatment on Internal Taxation and Regulation) because each of sub-paragraphs (1) (2) and (4) qualify the WTO rules by reference to "internal taxation". Under these provisions, internal taxes and charges are not to be applied to imported or domestic products in a manner which protects domestic production (sub 1) while the products of any territory are not to be subject directly or indirectly to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products (sub 2). Additionally, products of a Member are to be given treatment which is no less favourable than that accorded to like products of national origin in respect of taxes, regulations and requirements affecting their internal sale, offering for sale, transportation, distribution or use (4).

While none of these provisions specifically uses the words "direct taxation", they each ensure that when a good is imported into a Member State that the good must be no less favourably treated in relation to internal taxes in comparison to a good produced in that Member State.

The importance of the direct taxation input generally went unnoticed until the FSC/ETI dispute.²⁵ This case concerned a complaint by the EEC against corporate income tax incentives made available to Boeing by the US Congress because the incentive reduced US taxation on earnings from the export of Boeing aircraft.

Before this case, it had been believed that GATT did not apply to direct taxation because corporate income taxes did not apply to products but only to profits. The Panel swept away this misunderstanding by clarifying that "nothing in the plain language of Article 111(4) specifically excluded the requirements of conditioning access to income tax measures from the scope of application of Article 111."²⁶ Since the Boeing tax concession was applied to profits and not production, this was clear.

²⁵This involved the provision by the US of a taxation exemption for export sales earned by the Boeing Corporation.

²⁶Panel Report, United States, "Tax Treatment for Foreign Sales Corporations". Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body report, WT/DS108/AB/RW, paragraphs 8.142-8.143

The Panel also resolved that Article 111(4) “applies to measures conditioning access to income tax advantages in respect of certain products” because a reduction to the amount of direct tax on export income was economically equivalent to an export subsidy, while tariffs or consumption taxes refund were not.

The US responded to the FSC Complaint by the EEC with its own complaint about the territorial tax systems in use by Belgium, France and The Netherlands. They argued each of the three was in breach of GATT because they reduced direct tax on foreign source income.

An Understanding was reached and as part of the resolution of the 4 disputes, 4 Panel Reports issued. The first Report concluded that an exemption from direction taxation on income arising in export sales was discriminatory (i.e. Boeing and FSC) but concluded in the latter 3, that a territorial tax system did not breach GATT . This was a critical decision because it ensured that the territorial systems in place then and some which have been reintroduced in more recent years²⁷, do not breach GATT.

The DTC rules set out how to calculate the income of an establishment which a Member²⁸ has in another Member and the importance of the arm’s length method cannot be understated. The Panel Reports confirm that for WTO purposes, the arm’s length pricing method must be applied when allocating income between the related firms in the different Member states.²⁹ With both relying on the arm’s length method, this confirms the interdependency between the WTO and direct taxation rules as described in the OECD and UN Model DTC’s.

The Panel also held that GATT did not prevent a Member’s direct taxation provisions preventing double taxation on foreign source income and these provisions are central to Members unilateral tax credit provisions as well as the double tax credit provisions to be found in a DTC. Again the nexus between direct taxation and WTO is clear.

2.3.1.2 Conclusion

This section of this Article confirms the importance of direct corporate income tax when working out if Article 111 of GATT had been breached in relation to foreign source income. If the 4 Panels had found the Belgium, France and the Netherlands territorial tax systems breached GATT then this should have led to the illegality of foreign tax credit systems with double taxation resulting. Since this would have led to a disastrous impact on the free flow of goods cross borders it was both politically and commercially unacceptable.

²⁷Section 18A to UK CTA 2010 which provides an exemption for income of a non UK PE

²⁸Article 9 and Article 7 of the OECD Model DTC

²⁹This means that the Understanding is consistent with the transfer pricing rules in members own tax laws and in bi-lateral DTC

2.3.2 Agreement on Subsidies and Countervailing Measures (SCM):

2.3.2.1 Introduction

This section discusses the importance and relevance of direct corporate taxation to measures in the SCM and shows the interdependency of the WTO and bi-lateral DTC's.

The SCM describes the multilateral disciplines³⁰ which regulate the provision of subsidies, and how the countervailing measures³¹ are used to offset the financial injury arising from specific subsidies. The SCM is also designed to prohibit Members granting specific subsidies³² contingent on export performance or on local content.³³

Subsidies may be specific or non-specific and where the subsidy relates to an enterprise or to an industry or group of enterprises or industries³⁴ alone, then it will be specific. This direct targeting can be seen to confer an advantage and is the reason for the prohibition.

Subsidies are either prohibited, actionable³⁵ or non-actionable³⁶ and all are subject to transitional rules. Non actionable subsidies³⁷ include those granted for research, environmental and economically disadvantaged areas but are subject to detailed terms and conditions.

The time period for a developed country member to phase out a prohibited subsidy is three years from the date on which for it (this allows for Accession's), the SCM Agreement entered into force providing it notified the WTO of the subsidy within 90 days from becoming a Member. Members in transformation to a market economy are granted a seven-year phase out period for prohibited subsidies providing they were notified within two years from becoming a Member.

The SCM defines developing country members to mean least-developed members ("LDCs"), members with a GNP per capita less than \$1000 per year³⁸ and other developing countries. The lower a Member's level of development, the longer the transition period.

30 These are the rules which govern whether a subsidy may be provided by a Member and how that governance is enforced through the WTO dispute settlement mechanism

31 These constitute the unilateral instruments available for application by a Member at the conclusion of an investigation by that Member

32 Defined by Article 1 as "a financial contribution by a member of the WTO or by a public body within the Territory of a Member which confers a benefit. Such contributions include revenue foregone as a consequence of tax incentives." A subsidy will also include payments made as grants, loans, equity or the provision of goods or services (excluding infrastructure); purchases of goods and price support but any duty or indirect tax refunds or remissions on exported goods are excluded.

33 There are two types of prohibited subsidies, the first being subsidies contingent on one of several conditions, on export performance ("export subsidies") while the second is contingent on one of several other conditions, upon the use of domestic over imported goods ("local content subsidies") and are both prohibited because they are designed to directly affect trade. Under the SCM the two prohibited subsidiaries are extended to developing country Members subject to specified transition rules. A local content subsidy involves inducing customers to purchase domestically manufactured goods instead of imported goods

34 Article 2(1) of SCM

35 Most subsidies, such as production subsidies, fall in the "actionable" category. Actionable subsidies are not prohibited but are subject to challenge, either through multilateral dispute settlement or through countervailing action, in the event that they cause adverse effects to the interests of another Member.

36 A non actionable subsidy is not specific in terms of Article 8 of SCM

37 Article 8(2) of SCM

38 These are listed in Annex VII to the SCM Agreement

LDCs and Members with a GNP per capita of less than \$1000 per year are totally exempt from the prohibition on export subsidies while the country continues as a member of those categories. Other developing country members have an eight-year transition out of their export subsidies. This means that because the subsidies may continue for many years the injury to other member should be monitored to ensure it does not become substantial.

The semi-annual notification is at the heart of the transparency. The procedure allows Members to receive early warning of another Member's potential breaches and actions it has taken to rectify them.

Notification also involves all Members must notifying any countervailing duty laws, regulations and all countervailing actions and preliminary and final countervailing actions at the time they are taken.

2.3.2.2 Does direct tax play a role in calculating a subsidy?

A subsidy is a financial contribution³⁹ paid by a Government or by any public body within the Member's territory. Some examples include grants, loans and equity infusion; loan guarantees and fiscal incentives such as tax credits and revenue foregone.

Whether revenue foregone is a subsidy for an exported good is addressed by Footnote 1 to section 1.1(a)(1)(ii) SCM. The Article prescribes⁴⁰ that an exemption 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, is not a subsidy.

To be prohibited or actionable, the subsidy must be specific.⁴¹ The SCM provides that the setting or changing of generally applicable tax rates (i.e. at any level of government) is not a specific subsidy⁴² and therefore not prohibited. From this, it had been rightly assumed that revenue foregone because of a deduction or an exemption when calculating corporate taxes was not a specific subsidy if it arose from the setting or change of rates, but if the subsidy amount arose because of a deduction or exemption referable to the base, then the carve out would not apply and the subsidiary would be specific.

2.3.2.3 Direct taxation

The importance of "direct taxation" to export subsidies in the SCM is clear. Examples of export subsidies⁴³ listed in the SCM Annex include the full or partial exemption remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises and the allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

³⁹Article 1 of SCM

⁴⁰In accordance with Article XVI of GATT 1994 (Note to Article XVI) and Annexes I through III of SCM

⁴¹Article 3 of SCM

⁴²Article 2(2) of SCM

⁴³Included in Annex 1 to the SCM and in paras (e) and (f)

These examples support the argument that there will be a subsidy where a Government provides a deduction for more than 100% of the expenditure incurred, as is not unusual for research and development expenses.

Footnotes to the SCM examples define direct taxes to be taxes on wages, profits (i.e. corporate income tax), interest, rents, royalties (which includes withholding taxes in the source country on each of the three) and all other forms of income and taxes on the ownership of real property⁴⁴ (which covers taxes on rent and on capital gains in the source country). From this it is clear that while tax rates may be a carve out, base setting is not a carve out.

2.3.2.4 Interrelationship between SCM and bi-lateral double tax conventions

As further evidence of the interrelationship, (see SCM footnote 59) the Members confirm that arm's length pricing is required for goods sold between parties under the same or common control where one exports and the other imports and that if non arm's length prices are used the rules allow a member to draw the other member's attention to the contravening pricing. This is especially the case if the transfer pricing has led to a significant direct tax saving on export transactions. The footnote confirms the interrelationship between SCM and the DTC's in the following manner:

"In such circumstances the Members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultation created in the preceding sentence"

2.3.2.5 Significance of the tax costs

Many members are not required to remove their subsidies at all, or if they are there is a very long transition period potentially leaving the impact from the subsidies to linger for many years. In that case, the direct taxation incentives giving rise to the specific subsidy would be extremely relevant for SCM purposes.

2.3.2.6 Conclusion

The evidence in this section confirms that direct taxation is a very relevant factor in determining whether a specific subsidy has been granted and if so, in calculating the amount of that subsidy. It also confirms that while a simple change or setting of rates will not give rise to a specific subsidy, exemptions or deductions which leave the base changed most likely will.

⁴⁴ Footnote 58 to SCM Agreement

2.3.3 Agreement on Agriculture (AonA):

2.3.3.1 Introduction

Under the AonA, the domestic support and export subsidy commitments in Part IV of each Member's Schedule are commitments which limit the GATT 1994 subsidy. The rules prevent a Member providing any support⁴⁵ to domestic producers which is greater than the commitment nominated in the budget outlays.⁴⁶

2.3.3.2 Does direct tax play a role in Agriculture subsidies

Direct taxation is relevant because budget outlays includes revenue foregone⁴⁷ and revenue foregone takes into account the direct taxation amount which but for the concession would have been received by the Member.

Other AonA provisions with tax relevance include the formula for calculating the financial amount of Domestic Support⁴⁸ because that formula also allows for revenue foregone by Governments and their agents.

2.3.3.3 Conclusion

The significance of direct taxation to the AonA is much less than for the SCM but nevertheless it is a component in the budget outlays which finance the domestic support.

2.3.4 General Agreement on Trade in Services (GATS):

2.3.4.1 Introduction

Trade in services is defined,⁴⁹ broadly, to mean the supply cross border (either directly or through its own physical presence in the other member) of a service or the supply of a service within the one border to a customer of another Member.

Under the GATS, each Member is obligated to provide to a Member's service supplier, immediately and unconditionally, all treatment⁵⁰ which is no less favourable than that which it provides to like services and service suppliers of any other country.

A Member is not prevented from maintaining a measure inconsistent with the most favoured nation policy providing the measure is listed in, and meets the Exemptions conditions.⁵¹

⁴⁵ Article 6 of the AonA

⁴⁶ Article 9(2)(a) of the AonA

⁴⁷ Article 1 (c) of the A onA

⁴⁸ In Annex 3 to AonA

⁴⁹ Article 1(2) GATS

⁵⁰ Part 11, Article 11(1,2 and 3) GATS

⁵¹ Annex on Article II

GATS also does not prevent any Member from conferring an advantage on a next door country in order to facilitate supplies of services in those contiguous frontier zones, which are both locally produced and consumed. This means that services supplied through or in a special economic zone on a border can be on a basis different to that offered to other persons in the remainder of the Member's territory.

2.3.4.2 Does direct tax play a role in GATS

The simple answer is that it does. Under the General Exceptions,⁵² providing a measure is not applied arbitrarily or in a manner causing unjustifiable discrimination, GATS does not prevent the adoption or enforcement by any Member of measures inconsistent with national treatment, providing the new measure is aimed at ensuring the equitable or effective imposition or collection of direct taxes⁵³ on services or service suppliers of other Members. To work out the meaning of “ensuring the equitable or effective imposition or collection of direct taxes” we turn to Footnote 6 to Article IV(d) of GATS because it describes relevant Measures as those:

1. applying to non-resident service suppliers in recognition of the fact that the tax obligation of the non-resident is determined with respect to taxable items sourced or located in the Member's territory (*This means that a source base system is acceptable*⁵⁴); or
2. applying to non-residents in order to ensure the imposition or collection of taxes in the Member's territory (*This means that a withholding tax collection procedure is acceptable*); or
3. applying to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures (*This means transfer pricing, specific anti-avoidance and general anti-avoidance provisions are acceptable*); or
4. applying to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory (*This means a withholding tax system on consumers is acceptable*); or

⁵²Article IV

⁵³Direct taxes is defined in Article XXV111(o) of GATS to comprise” all taxes on total income (eg withholding taxes), on total capital or on elements of income or of capital (eg capital taxes), including taxes on gains from the alienation of property (eg capital gains tax), taxes on estates, inheritances and gifts (eg inheritance, wealth and gift duties), and taxes on the total amounts of wages or salaries paid by enterprises (eg national insurance charges, payroll taxes), as well as taxes on capital appreciation (eg wealth taxes)

⁵⁴The words in the parentheses and italics in points 1-6 represent my understanding of the measures which a Member can legitimately adopt without a Member of another country being legitimately able to complain

5. distinguishing service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them (*This means that a foreign tax system or controlled foreign corporation rules will be acceptable*); or
6. determining, allocating or apportioning income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base (*This means that transfer pricing and separate enterprise calculations are acceptable*).

GATS is a creation of the Uruguay Round which commenced in 1986 and concluded in 1994. The integrated OECD Model Commentary was firstly published in 1997 and then in 1992 and frequently since then. It would seem an extraordinary co-incidence for there to have been no co-ordination in the development of the language used in both when the concept similarities are stark.

Additional evidence of the convergence of GATS and direct taxation and international tax law, is that GATS provides that “tax terms or concepts discussed above are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure, providing that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound”. The comparability with the wording in Article 3(2) of the OECD Model DTC is clear. Consideration for another day includes the relevance of Tax information exchange agreements and other similar agreements.

2.4.3.3 Conclusion

Direct taxation is clearly relevant when working out if and how a Member's measures are in breach of GATS. While the examples of exceptions in footnote 6 are extensive they unfortunately do not provide clear guidance for use when working out how complaints can be resolved because the footnote provides the Member being complained to, with the right to use its own definitional rules when working out whether a law has only been used in assisting in imposing or collecting taxes.

2.3.5 Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS):

2.3.5.1 Introduction

Each Member⁵⁵ is required to provide to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property.

According to Note 3 to Article 3, the “protection” is to include matters affecting the availability, acquisition, scope, maintenance and enforcement of IP rights as well as those matters specifically affecting the use of intellectual property rights.

2.3.5.2 Does direct tax play a role in TRIPS

Nowhere in TRIPS are the words “direct taxes” to be found but I believe they are implicit because by their imposition on an IP supplier, that person may choose not to make the IP available to a Member in another State if that State imposes a tax which is not creditable in the residence country.

Agreement on Trade Related Investment Measures(TRIMS):

⁵⁵ Article 3 of TRIPS which provides exceptions for the provisions set out in the Paris Convention (1967), the Berne Convention (1971), the Rome Convention or the Treaty on Intellectual Property in Respect of Integrated Circuits

Introduction

TRIMS specifies that⁵⁶ (without prejudice to other rights and obligations under GATT 1994) no Member is permitted to apply a TRIM which is inconsistent with the provisions of Article III⁵⁷ or Article XI⁵⁸ of GATT 1994, essentially the requirement to provide equal treatment for locally produced and imported products. Inconsistent TRIMs include those for which compliance is mandatory or domestically legally or administratively required such as the purchase or use by an enterprise of products of domestic origin or from any domestic source⁵⁹, or a requirement for an enterprise's purchases or use of imported products be limited⁶⁰ in relation to locally produced goods for export.

Does direct tax play a role in TRIMS

Not directly but indirectly through the national treatment provisions in GATT.

Conclusion

Before firstly reading the GATT Agreements, one would expect a very low level of involvement of direct taxation in the rules and regulation. However, GATS' interrelationship with bi-lateral DTC is clear and broad and this leaves one with the impression that the opportunity for the WTO to become an important participant in global direct tax regulation is there for it to grasp. The dispute settlement body could evolve into the international regulator needed to resolved intra Government disputes on harmful tax practices, at least in the services sector.

⁵⁶Article 2(1) of TRIMS

⁵⁷Article III(1) states that "The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production"

⁵⁸Article XI states that "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting part"

⁵⁹The specification can be made by reference to the volume or value of specific products, or by reference to a not less than proportion of volume or value of locally produced goods

⁶⁰The limitation is calculated by reference to an amount of volume or value of local products

III. ACCESSION AGREEMENTS IMPACT ON BRICS CORPORATE TAX LAW

3.1 Introduction

I can now progress to discuss the impact the WTO Agreements have on BRICS corporate income taxation. As part of the Accession procedure, a country is required to enter into an Accession Protocol and an essential element is the disclosure and notification to other members of measures, provisions or subsidies which are, or may be in breach of the agreements. Sometimes the disclosures quickly become the subject of a complaint which is either resisted by the new member or a change is made.

If the member is a developing country or a country in transformation then the breach may subsist for an extended period before change must become effective.

In this Article, I consider the Russian and China Accession Protocols.

3.2 Russia:

3.2.1 Direct taxes

Direct tax provisions of the Russian legislation,⁶¹ including laws on the Taxation of Profits of Entities and Organizations,⁶² on the Taxation of Profits and Incomes of Foreign Legal Entities⁶³ and on the Tax Rates for Certain Income are referred to in the Protocol. The Russian agreements on the avoidance of Double Taxation⁶⁴ are also listed. With this information available it improved transparency for Members.

Anticipating Members raising concerns about Russia's special economic zones (SEZ), the Russian Government⁶⁵ stated that except for subsidies referred to in the Working Party Report,⁶⁶ its laws⁶⁷ did not grant any subsidy which is prohibited under Article 3, SCM.⁶⁸ It further wrote⁶⁹ that except as otherwise provided for in the Working Party Report, it would eliminate all subsidy programmes falling within the scope of Article 3, SCM or would modify them so that any subsidy would no longer be contingent upon exportation or use of domestic over imported goods. This is evidence of a direct effect by the WTO on Russian taxation law.

Where a country provides a SEZ, Members examine the rules in detail because the nature of the provisions giving rise to the revenue foregone in an SEZ, can lead to a conclusion that a prohibited subsidy has been made available.

61 TRADE WT/ACC/RUS/12 4, June 1996

62 No.2116-1, 21 December 1996

63 Instruction No.34

64 Letter No. YUU-6-06/308 of 31 May 1995

65 Para 678 of the Accession Agreement WT/ACC/RUS/70 WT/MIN(11)/2 17 November 2011

66 WT/ACC/RUS/70 WT/MIN(11)/2, dated 17 November 2011, Report of the Working Party on the Accession of the Russian Federation to the World Trade organization

67 As provided by any level of government in the Russian Federation

68 Prohibited subsidies are those contingent upon export performance or contingent upon the use of domestic over imported goods.

69 Para 698 of the Accession Agreement

In response to a Member who used the Russian notification to question whether Russia's SEZs,⁷⁰ were compliant, Russia⁷¹ explained that all its SEZ's were primarily directed to the growth of high technology industries (generally an acceptable SEZ purpose) so that expanding the zones was consistent with Russia's WTO obligations.

Russia also argued that its SEZ's were compliant because none was established under any special regime applicable solely for foreign investment. Accordingly, Russian residents and foreign invested firms (irrespective of the percentage of foreign participation) could both become SEZ resident.

3.2.2 Conclusion

The Russian Government was required through accession to notify Members of its laws and to review and justify certain tax concessions. This transparency confirms that accession spotlights the tax laws and presents information for Members to determine if they should request changes.

3.3 China:

3.3.1 Introduction

China has had a chequered GATT Membership history in that while it was a founding (one of twenty three) member (on 21 May 1948), its membership ceased on 5 May 1950 when the Kuomintang Government relocated to Taiwan. In 1982, China was granted Observer status and requested its Membership be resumed on the grounds that the Kuomintang's withdrawal was void. In May 1987, GATT established a Working Party to assess China's Status and in December 2001 it resumed WTO Membership.

3.3.1 Direct taxes in the Accession Protocol

The Accession Protocol listed many references to direct taxation in China. Some required immediate change while the notification on others merely fulfilled China's transparency obligations.

3.3.1.1 Eliminations

Accession required a number of changes to be made. The immediate amendments included adjustments to certain of its taxes and charges on imports⁷² in order for them to conform to GATT 1994. These taxes and charges included customs fees and internal taxes and charges, including value-added taxes, levied by all levels of Government.

⁷⁰Para 1091 of the Accession Agreement

⁷¹Russia explained its 4 SEZ's in pages 281 to 292 of the Working Party Report

⁷²Point 11, Page 7 ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA Decision, 10 November 2001, published as WT/L/432, 23 November 2001

China was also required to eliminate all taxes and charges applied to exports unless they were covered by Annex 6⁷³ to the Accession Protocol (duties) or unless they were applied in conformity with the duty rates listed in Article VIII of the GATT 1994.⁷⁴

Also, all foreign individuals and enterprises and foreign-funded enterprises were to be accorded treatment no less favourable than that given to other individuals and enterprises in respect of border tax adjustments. This applied from Accession day.

China also accepted that from Accession, its SEZ's, economic and technical development zones ("special economic areas")⁷⁵ for which special regimes for tariffs, taxes and regulations had been established, would be subject to the WTO rules.

Additionally, all subsidy programmes covered by Article 3⁷⁶ SCM and export subsidies on agricultural products⁷⁷ were to be eliminated.

3.3.1.2 Notifications

China was required to update the WTO⁷⁸ by way of notification,⁷⁹ of its laws, regulations and other measures relating to the special economic areas, listing the areas by name and their geographic boundaries. It was also required to notify other members of any subsidy⁸⁰ granted or maintained in its territory, in terms of the definition in Article 3⁸¹ of the SCM.

The Accession Protocol also stipulated that subsidies provided to China's state-owned enterprises (SOE's) would be specific (which made them prohibited) if, the SOE was the predominant recipient of the subsidy or if it received disproportionately the large amounts of the subsidies.

73 Annex 6 listed the duty rate and the products subject to export duty

74 Article VIII stipulates that fees and charges (other than import and export duties and other than taxes within the purview of Article III, see below) imposed by a Member on or in connection with importation or exportation shall not exceed the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes. Article III requires the Members recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production

75 Article 2A(1) of the Accession Protocol

76 Article 3 SCM *ibid*

77 Article 12(1) of the Accession Protocol

78 Article 2B(1) of the Accession Protocol

79 Notification (which was required to be prompt i.e. not more than 60 days) of full zone details including any additions or modifications together with the laws, regulations and other measures

80 A subsidy is defined by Article 1 of SCM to include a financial contribution by a government or any public body within the territory i.e. a government practice of direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)

81 An Article 3 subsidy is (except as provided in the Agreement on Agriculture) when within the meaning of Article 1 SCM, shall be prohibited subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I5 or subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

Further notifications⁸² (20 pages) were contained in Annex 5A of the Accession Protocol under the SCM. The wide range covered items as diverse as the application of preferential income tax rates and exemptions from income tax for businesses conducted in SEZ's to businesses involved with economic and technology development areas, foreign invested enterprises high-tech companies, companies utilizing waste and businesses in poverty stricken areas or businesses transferring technology.

Benefits to the SOE's were also notified and in Annex 5B, the subsidies to the SOE's⁸³ to be phased out were listed.

The WTO ability to cause China to amend its tax laws meant that the WTO had become a significant influence on China corporate income taxation.

3.3.1.3 Tax Law Changes

One of the most important notifications was in respect of the preferential policies for foreign invested enterprises⁸⁴ firstly introduced by China in 1985 which continued to apply on Accession in December 2001. The notification included a statement that the policy objective and/or purpose of the subsidy was to encourage FDI for economic expansion and cooperation. This entire law (permitting the preferential rates) was replaced on 1 January 2008 by the Enterprise Income Tax Law of the People's Republic of China.⁸⁵

3.3.1.4 Conclusion

The impact of Accession on China's corporate tax system was profound, from immediate eliminations, to deferrals and to notifications. Through this transparency, the world had become familiar with the domestic and international tax rules used by China and thereafter had been armed with information to lodge complaints to the Dispute Settlement Body.

While there is no clear written evidence available to me linking the repeal of the foreign enterprises tax law and the notification little more than 6 years earlier, it seems unlikely to be coincidental that with China not being an Annex VII(b) SCM country, it is required to remove specific subsidies, as a Member in transformation to a market economy, within a seven-year period.

⁸²Under SCM 25.1, a member agrees that, without prejudice to the provisions of paragraph 1 of Article XVI of GATT 1994, to notify its subsidies not later than 30 June of each year and the form of the notification needs to conform to the provisions of paragraphs 2 through 6

⁸³Including grants and the forgiving of tax liabilities

⁸⁴Before 1991, the benefits were provide by the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Equity Joint Ventures and Income Tax Law of the People's Republic of China for Foreign Enterprises and since 1991, they were provided by the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises

⁸⁵The law was adopted at the 5th Session of the 10th National People's Congress of the People's Republic of China on March 16, 2007, and came into force as of January 1, 2008

VI. TRADE POLICY REVIEW MECHANISM

4.1 Introduction:

Contributing to the transparency of subsidies, countervailing measures and notification amongst Members is the Trade Policy Review Mechanism (“TPRM”). This involves Members policies being summarised by the WTO and then available for comment by the Member concerned. With this information to hand other Members are able to consider whether to lodge a complaint.

The transparency arising under the TPRM, promotes Member adherence to the rules, disciplines and commitments by encouraging greater understanding of a country’s trade policies and practices, which includes tax measures. Transparency involves describing the tax measures with the applicable rationale and then estimating the measure’s cost in terms of revenue foregone and assessing its economic effectiveness.

All this is achieved through periodic reviews and so far as the BRICS are concerned, China is reviewed every two years with Brazil, Russia, India and South Africa, every four or six years as appropriate.

4.2 Brazil:

4.2.1 The 2013 notification

The 2013 TPRM review⁸⁶ disclosed that incentives and assistance⁸⁷ have been provided by both Federal and sub-federal Governments. It tells us that the incentives have been directed at encouraging research, or targeting specific sectors with most seeking to promote entrepreneurship, technological and infrastructure upgrades, innovation, exports energy efficiency, and regional development.

Brazil’s incentives and assistance have been provided as loans, tax incentives, non-repayable financial contributions, long-term and equity financing, accelerated depreciation, guarantees, grants, advisory services and credit insurance. This listing does raise questions as to whether prohibited subsidies are being provided.

The notification every four years of Brazil’s tax incentives brings them sharply into focus. In order for Brazil to fulfil its SCM obligations, it is required to regularly validate the effectiveness of the incentives as a proper response to a market failure which might otherwise prevent Brazil achieving its development objectives.

The 2013 notification referenced 11 federal subsidy programmes⁸⁸ operational in 2009 and 2010 including tax credits, accelerated depreciation, tax exemptions and reductions.

⁸⁶Trade Policy Review Body, Trade Policy Review, Report by the Secretariat on Brazil, dated 17 May 2013 and published at http://www.wto.org/english/tratop_e/tpr_e/s283_e.pdf

⁸⁷2013 Review on Brazil’s Trade Mechanism’s Page 84

⁸⁸Covering the pharmaceutical productive chain-capacity building and competitiveness enhancement in IT; industrial technology and agricultural/cattle breeding technology development programmes; Productive development policy for the Regional Amazon Development

4.2.2 Member Information request

Following the 2013 notification, the EU, Canada and Japan requested Brazil provide additional information on industrial and R&D incentives.⁸⁹ At the date of writing, there is no evidence of either these countries requesting consultations with Brazil over any of the provisions or the establishment of a Panel.

4.3 Russia:

Russia joined the WTO in 2012. Therefore its trade policies are yet to be investigated under the TPRM. Since a large number of notifications were made by Russia as part of the Accession process, that is a de facto review.

4.4 India:

4.4.1 2011 Review

In 2011 the Indian review⁹⁰ was published. It did not report any notifications to the WTO⁹¹ regarding export subsidies on agricultural products but reported many tax incentives under SCM (dating from 2010⁹²) which potentially were subsidies, including free trade zones (SEZ)⁹³ and qualifying business entities which are exempt from income tax,⁹⁴ central sales tax, minimum alternate tax, dividend distribution tax, service tax, and from a series of state taxes.

The quantum of associated taxes forgone on the special economic zones more than doubled between 2007/08 and 2009/10⁹⁵ and this is indicative of the importance to India of the incentives.

Authority and North-East Region Development Authority; investment funds for the Amazon, the north-east regions and the State of Espírito Santo ; constitutional funds for financing the north-east, the north and the mid-west regions; development funds for the Amazon and the north-east regions; regional development and promotion of R&D and technological innovation programme

89 WTO documents G/SCM/Q2/BRA/35 and G/SCM/Q2/BRA/36 of 2 October 2012 and WTO document G/SCM/Q2/BRA/37 of 24 October 2012 including R&D and industrial incentives

90 Trade Policy Review Report, prepared by the Secretariat on India, 10 August 2011, the Summary of which was published at http://www.wto.org/english/tratop_e/tpr_e/s249_sum_e.pdf

91 India's most recent notification on export subsidy commitments dates from 2002 and covers 1996-97 to 2000-01 (WTO document G/AG/N/IND/3, 1 March 2002).

92 WTO documents G/SCM/N/186/IND, 18 October 2010; and G/SCM/N/155/IND and G/SCM/N/123/IND, 29 October 2010

93 SEZ's may be set up by the central or state governments or by private developers (including foreigners) as joint ventures with the State or fully private

94 This works as follows: 100% for the first five years, 50% for the next five years, and 50% of the reinvested export profit for the next five years

95 Rs 18bn to Rs 39.9bn

Other important 2010 notifications included a five year tax holiday⁹⁶ for export oriented units (“EOU”)⁹⁷ with the exporter being entitled to a 50% corporate income tax deduction on its profits. The 50% deduction was calculated by reference to the turnover of exported (a prohibited feature, normally) goods and merchandise sold to non-Indian purchasers where turnover is receivable in convertible foreign exchange. In recognition of the deduction being prohibited, it was phased out⁹⁸ with deductions not available from 2005/06.⁹⁹

India notified its export promotion tax schemes but it continues to use them because of its unlimited right to do so as an Annex VII (b) Member of SCM.¹⁰⁰ While India’s per capita GNP is less than US\$1,000 in constant 1990¹⁰¹ US\$ for three consecutive years, it continues to qualify for this exception.

In recognition of the need to phase out incentives which are likely to breach the WTO, India has terminated profit linked tax deductions provided to companies carrying on scientific research and development (2006/07) and profit linked tax deductions in connection with laying and operating a cross country natural gas distribution network, including pipelines and storage facilities (2009/10).

The minor changes made by India confirms that it will adapt slowly to the SCM rules while continuing to benefit from the exception available to it as an Annex VII(b) Member. This is then evidence of the importance of the WTO is shaping elements of India’s corporate income tax law.

4.5 China:

4.5.1 2012 Notification

During January 2010 to February 2012, China submitted 482 notifications including those for agriculture, services, technical regulations, regional trade agreements and intellectual property legislation. Its notification of subsidies (109 pages) applying during the 2005-2008 period¹⁰² included references to both direct and indirect tax subsidies, their commencement and termination dates and the justification for the tax preference. Some examples of the more important direct tax incentives included in that notification were:

96The CIT holiday phased out on 31 March 2011

97EOUs are similar to SEZs but may be located anywhere in the country and which initially concentrated in manufacturing but have extended to agriculture and service entities

98WTO document G/SCM/N/71/IND, 18 October 2001.

99Income Tax Act 1961, Section 80HHC (Deduction in respect of profits retained for export business

100An Article VII Member is excused from the provisions of Article 3 which prohibit subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance

101In the period 2006 to 2008, India’s gross national income (GNI) remained below US\$1,000 in constant 1990 dollars

102WTO , G/SCM/N/155/CHN G/SCM/N/186/CHN published on 21 October 2011, is China’s full notification of information on programmes granted or maintained at the central government level during the period from 2005 to 2008. China maintains the publication is a transparency obligation and therefore includes programmes which arguably are not subsidies or specific subsidies subject to the notification obligation within the meaning of the SCM Agreement.

4.5.2 Preferential tax policies

The benefits available for foreign-invested enterprises designed to encourage FDI were issued under the authority of the Ministry of Finance (MOF), State Administration of Taxation (SAT), Ministry of Commerce (MOFCOM).¹⁰³ A summary of the five incentives on offer is:

4.5.2.1 A 100% exemption for an enterprise with foreign investment involved in China manufacture which proposed to carry on business for not less than 10 years. There was a 100% exemption from the enterprise income tax in the first and second years of trading with a 50% exemption in the following three years. This incentive applied from 1991 to the end of 2007 including for enterprises registered before 16 March 2007;

4.5.2.2 A 40% refund of already paid income tax to a foreign investor in a foreign investment enterprise which directly reinvested its profit share into that enterprise as registered capital, or which invested the profit as capital into another enterprise which would carry on business for not less than 5 years. This incentive was available from 1991 to 2007;

4.5.2.3 Refund of previously paid tax where a foreign investor participated in the establishment or expansion of an export-oriented or advanced technology enterprise and reinvesting profits.

4.5.2.4 A 10% income tax rate from 1 January 2000 for any foreign enterprise without a China establishment or business place but which derived profit, interest, rental, royalty or other income from China sources, or which had a China establishment but derived the income not in an effectively connected manner. Foreign investors were exempted from income tax on the profit made from that foreign invested enterprise until 2007 when the concession was withdrawn.

4.5.2.5 Income tax was levied at 10% on a royalty for technical know-how in scientific research, exploitation of energy resources, development of communications and transportation industries, agricultural, forestry and animal husbandry production, and the development of important technologies. Where the technology supplied was advanced or the terms were favourable, the income was to be exempted from China tax.

¹⁰³Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991); Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprise (1991); State Council Circular Guo Fa No.37 of 2000; Law of the People's Republic of China on Enterprise Income Tax (2007); Regulations for the Implementation of Law of the People's Republic of China on Enterprise Income Tax (2007); State Council Circular Guo Fa No. 39 of 2007; MOF Circular Cai Shui No. 1 of 2008.

4.5.3 Preferential tax policies designed to encourage FDI, available for foreign-invested export enterprises, were issued under the authority of MOF, SAT, MOFCOM.¹⁰⁴ The tax rate for these businesses was reduced to 50% of the normal tax rate specified in the Income Tax Law for an export-oriented foreign-invested enterprise i.e. where 70% or more of the total export value was exported. If an enterprise which met the 70% turnover test was located in an SEZ (or in an economic and technological development zone) then the already 15% enterprise income tax rate, would be further reduce to 10%.

These concessions were available from 1991 to 2007.

Preferential tax policies were also available for foreign invested advanced technology enterprises designed to encourage high and new technology industrial development and also to enhance the technology progress. The concessions were issued under the authority of MOF,¹⁰⁵ SAT, MOFCOM, Ministry of Science and Technology (MOST).

Qualifying enterprises were entitled to an additional three year exemption or reduction extension but the reduction was limited to a 50% reduction and applied for the period 1991 to the end of 2007.

4.5.5 Summary

From these examples, the WTO impact in shaping China's corporate income tax is evident with the notified concessions being reduced/withdrawn within the 7 year transformation period.

Annex V11(b) Membership

China is not an Annex VII (b) Member of the SCM. This means that it is required to phase them over the prescribed period. While it is unclear whether each of the notified preferences were breaches of the Agreements, China notified the WTO Secretariat and removed the majority by 1 January 2008 when it merged its domestic and foreign tax laws.

4.7 South Africa:

4.7.1 Background

SA's interrelationship with the WTO is different from that of other BRICS in that while it is a WTO member in its own right the TPRM focusses on it as a member of SACU.¹⁰⁶

¹⁰⁴Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991); Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991); Law of the People's Republic of China on Enterprise Income Tax (2007); Regulations for the Implementation of Law of the People's Republic of China on Enterprise Income Tax (2007); MOF Circular Cai Shui No. 1 of 2008.

¹⁰⁵Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprise (1991); Regulations for the Implementation of Law of the People's Republic of China on Enterprise Income Tax (2007).

¹⁰⁶Southern African Customs Union, which has as members Botswana, Lesotho, Swaziland, Namibia and South Africa

4.7.2 Notifications

SA has confirmed its incentives are a key policy instrument.¹⁰⁷ It offers duty and tax exemptions to attract FDI and to direct the trading pattern of its resident businesses. The incentives continue to promote industrialization, develop export-oriented industries, and to assist SMEs and the formerly disadvantaged population. Some incentives are subject to local-content requirements and are contingent on export performance.

SA has notified the Committee on Agriculture that it provided no export subsidies during the period 2002-2005¹⁰⁸ and in 2003, notified the WTO that it did not maintain any specific subsidies or any subsidy which increased exports or aimed to reduce imports.¹⁰⁹

Conclusion

The significance to the BRICS corporate tax systems of their notifications is clear. From Brazil's accelerated depreciation and tax credits, to China which notified its foreign tax law in 2001 and then repealed it in 2008 and onto Russia which notified significant tax laws and its SEZ's at Accession in 2012 to India which while making some notifications has relied upon its status of being an Appendix VII(b) country to avoid having to change its law to remove the subsidies. All this information has shone a light on the subsidies and is giving rise to changes in the taxation system.

V. DISPUTES

5.1 Introduction

Other than China, the BRICS have not been subject to requests for consultations under any of the WTO Agreements in connection with direct taxation. They have however joined other disputes as a third party against, or in support of another country.

This does not mean that they have a good record of avoiding WTO breaches but it more likely means they are still substantially benefitting from transitional period relief, or in the case of Russia, accession was only complete in 2012.

The individual BRICS' positions in disputes are:

¹⁰⁷SACU-South Africa WT/TPR/S/222/ZAF/Rev.1 Page 295

¹⁰⁸G/AG/N/ZAF/66, 8 September 2008

¹⁰⁹G/SCM/N/95/ZAF, 12 August 2003

5.2 Brazil:

5.2.1 Disputes

Brazil has lodged 26 complaints against other countries and is a respondent in 14 cases and has joined as a third party in 76 cases. While Brazil has not received any request for consultations in connection with any breach traceable to a direct tax problem, it has joined two direct tax disputes against the US, the first where US¹¹⁰ provided a “foreign sales corporation” (“FSC”) relief to Boeing and the second where State, Local and Federal tax incentives and other financial contributions were provided to Boeing on the production of a new aircraft. Brazil is also likely to join as a third party in a dispute between Panama and the Argentine.¹¹¹

5.2.2 The EC complaints against the US which Brazil¹¹² Joined

In November 1997, the EC complained that the US imported products were treated less favourably than the US originated products because the FSC provisions were in breach of the US’s obligations under GATT 1994 (i.e. Article XVI) and also under the SCM (Article 3(1)(a)).

Specifically, the EC argued the US had granted Boeing exemptions from US corporate income tax on both the portion of income arising from exports earned by a US subsidiary of Boeing and also on the dividends distributed to the United States parent company from that income.

Brazil benefitted from joining as a third party because it became entitled to receive copies of all submissions made to the Panel by the Parties upto the first meeting of the Panel¹¹³ and also a right to be heard in the Consultations. At the Panel meeting on 17 May 2006, the US reported that on 11 May 2006, the US Congress had repealed the “grandfather” provisions of the American Jobs Creation Act settling that part of the dispute but the ETI Act continued to be subject to compliance proceedings.

110DISPUTE DS108 and Brazil intervening might have been due to Canada’s request for consultation with Brazil over an interest financing benefit provided by Brazil to non-residents purchasing Brazil manufactured aircraft, See WTO WT/DS46/1 G/SCM/D3/1, 21 June 1996

111WT/DS453/1, G/L/1019 and S/L/396 published on 19 December 2012

112Brazil joined the first Boeing dispute in 20 July 2005

113WTO Appellate Body, Reports and Awards, 1995-2010, Fourth Edition, Compiled by the Appellate Body Secretariat, published Cambridge University Press, p 1034/5

The provision of benefits to a US large scale aircraft manufacturer was again raised in 2004¹¹⁴ by the EC and once again Brazil joined as a third party. Unlike the earlier case, this time the taxes were Federal, State and City and the EU argued the US had breached the SCM. The EC complained about¹¹⁵ many taxes and benefits including the incentives package provided Washington State for the Boeing 7E7 production; the financial incentive package, including preferential bond financing, for the Boeing 7E7 production provided by the State of Kansas; the tax incentives, relocation assistance, development grant, rental-free headquarters for Boeing corporate and a relocation allowance granted by the State of Illinois and City of Chicago and the FSC/ETI subsidies which had previously been held a specific subsidy by the Panel and Appellate bodies and finally the research and experimentation tax credits.

The EC considered these measures to be inconsistent with the obligations of the US because in each instance there was a financial contribution by the US, State or Local government.

The complaint was heard by a Panel which found partly for the US and partly for the EU with both Members appealing the matter was heard by an Appellate Body which reported in March 2011. With both Members appealing that report a further appeal was heard with a decision tabled in March 2012 and the US notified the decision to accept in April 2012. The US failed to implement the decision so the EU commenced Compliance proceedings with the Panel advising its expected date of the decision in the first half of 2014.¹¹⁶

5.2.3 The Complaint by Canada against Brazil

Brazil provided low cost financing to purchasers of Brazilian made aircraft. On 18 June 1996, Canada requested consultations¹¹⁷ with Brazil in respect of Article 4 of SCM and under Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, regarding the export subsidies granted under the Brazilian PROEX financing scheme for foreign purchasers of Brazil's Embraer aircraft.

PROEX was an interest rate scheme for foreign purchasers of Embraer aircraft where interest rate subsidies between 3.5 and 3.8% pa for ten years were made available to reduce the cost of borrowing. With the subsidy, the foreign purchaser's credit cost was less than would be levied commercial lenders or by export credit agencies.

The Panel concluded¹¹⁸ that the PROEX payments were subsidies within the meaning of Article 1 of the SCM Agreement and because they were contingent upon export performance within the meaning of Article 3.1(a) of that Agreement they were prohibited.

114WTO WT/DS317/1 G/L/698 G/SCM/D63/1 12 October 2004, Dispute DS317 which merged into Dispute DS353

115Articles 3.1 (a) and (b) and 3.2 of the SCM Agreement;(2) Article 5 (a) and (c) of the SCM Agreement; (3) Article 6.3(a), (b), and (c) of the SCM Agreement; (4) Article III:4 of the GATT 1994

116WT/DS353/23

117WT/DS46/1, G/SCM/D3/1, 21 June 1996

118Para 7.14 of the Panel Decision number WT/DS46/R, 14 April 1999

5.2.4 Panamanian Dispute against Argentina which Brazil may joined

Panama sought consultations¹¹⁹ with Argentina because it believed the Argentine was in breach of the GATT 1994 and GATS with respect to measures applying to trade conducted with specified countries listed in Decree 1037/00¹²⁰ but not to others. Panama is included in the specified countries listing. The measures included the discriminatory assessment of profits tax¹²¹ depending upon the origin or the place of residence of the foreign services supplier.

At the time of writing, it is understood Brazil is considering intervening to support Argentina. Perhaps this is because Brazil does not wish for a precedent to be established which prevents a source country imposing differential rates of tax depending upon whether the lender or services supplier is resident in a low tax jurisdiction.

If Argentine should be required to amend its law then other countries with similar provisions (perhaps black lists¹²²) may be very concerned as to whether they too will be required to amend their law.

5.3 Russia:

5.3.1 Disputes

Russia has not complained against any Member but has received 2 complaints and has joined in 8 cases as a third party. None of these cases has any direct tax relevance. The existence of such a small number of complaints is explained by Russia's recent (2012) WTO Accession.

5.4 India:

5.4.1 Disputes

While India has been the complainant in 21 cases and the respondent in 22 cases, none has a direct taxation feature. India has been a third party in 90 cases one of which was the 1996 EC/FSC dispute.¹²³

5.5 China:

5.5.1 Disputes

China has been the complainant in 11 cases and the respondent in 31 cases, with perhaps the most important of the cases¹²⁴ being associated with the repeal of the China tax law for foreign corporations and its replacement with a law which does not contain the prohibited subsidies.

119WT/DS453/1, G/L/1019 and S/L/396 published on 19 December 2012

120Regulations to the Income/profits Tax Law (ley de Impuesto a las Ganancias)

121Different presumed net profit percentages apply when interest or supplies were paid to foreign creditors based on their country of residence

122Article 110(10) of the Italian income Taxes Consolidated Code

123DISPUTE DS108

124DISPUTE DS358 WT/DS358/1 G/L/813 G/SCM/D74/1 G/TRIMS/D/25

5.5.1.1 Complaint from the US over “measures”

In February 2007, the US complained of “measures”¹²⁵ which appeared to provide refunds, reductions or exemptions to China enterprises from taxes and other payments on the condition that those enterprises purchase domestic over imported goods, or on the condition those enterprises meet certain export performance criteria”. These would be inconsistent with both Article 3 of SCM and Article III:4 of GATT 1994 and Article 2 of TRIMs . The US also complained the measures were inconsistent with China's obligations under its Accession Protocol.

Due to the importance of this case for this Paper, the detail is set out in Annex 1 but in summary and by way of illustration of the breadth of the complaint relevant to direct taxation, the measures were contained in SAT Circulars, Circulars from the MOF and SAT, Rules for the Implementation of the Income Tax Law on Enterprises with Foreign Investment and Foreign Enterprises, in Articles of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, in the Catalogue for the Guidance of Foreign Investment, in Provisions of the State Council on the Encouragement of Foreign Investment and the Catalogue for the Guidance of Foreign Investment Industries.

The US argued for the establishment of a Panel¹²⁶ but in December 2007, China and the US informed the DSB they had agreed a Memorandum of Understanding¹²⁷ to settle the dispute. The request for a Panel was seen by leading China WTO officials¹²⁸ as a tactic only because by that time China was preparing for the implementation of its new Foreign Enterprise Income tax law and there was no legal or commercial advantage to be obtained by the US in pursuing the Panel.

The interdependency of the decision to repeal the law and the settlement of the dispute is further evidence of the importance of the WTO in shaping China's corporate income tax laws.

With days of the US launching its complaint against China, Mexico also joined as a third party¹²⁹ and substantially copied the US reasons for the request for consultations.¹³⁰ The DSB established a Panel but on 7 February 2008, China and Mexico reached a settlement similar to that reached by China and the US.

125 Described in more detail in the request for further consultations by the United States published on 2 May 2007 in WT/DS358/1/Add.1, G/L/813/Add.1, G/SCM/D74/1/Add.1, G/TRIMS/D/25/Add.1

126 WT/DS358/13 13 July 2007

127 WT/DS358/14, date 4 January 2008

128 Wenhua JI and Cui HUANG, “China's Experience in Dealing with WTO Dispute Settlement: A Chinese Perspective, published in *Journal of World Trade* 45, no. 1 (2011): 1–37

129 Dispute DS359

130 WT/DS359/1 G/L/814 G/SCM/D75/1 G/TRIMS/D/26

5.5.1.2 Guatemala Measure

A third dispute¹³¹ (currently in consultation) with a potential direct taxation¹³² resonance commenced on 19 January 2009 when Guatemala complained that China had offered grants, loans and other incentives to enterprises in China because in its opinion, the grants, loans and other incentives reflected measures relating to the China World Top Brand Programme and the Chinese Famous Export Brand Programme.

Guatemala argued those grants, loans, and other incentives were contingent upon export performance and so were inconsistent with Article 3 of SCM and with China's obligations under its Accession Protocol. The parties have not yet published an understanding of how to resolve the dispute.

5.6 South Africa:

5.6.1 Disputes

No Member has complained about SA measures but SA has been the respondent in 4 cases, none directly covering a direct taxation matter.

¹³¹Dispute DS390

¹³²On page 8 of the complaint under L-5 there is a reference to an Instrument issued by the Bureau of State tax WT/DS390/1 G/L/882 G/SCM/D83/1 G/AG/GEN/82 22 January 2009

VI. CONCLUSION:

The additional Agreements and the formal dispute settlement procedure which became part of the WTO when it evolved out of GATT, gave little indication of the likely extent to which they could impact a country's corporate income tax rules or the relevance of corporate tax provisions to determining whether a breach had occurred. There also was little understanding of the impact which both notifications and the TPRM would have on transparency and the knowledge which a Member could use to base complaints against another Member.

An analysis of the Russian and Chinese Accession Agreements, and the range of complaints which the BRICS have become party to shows the ever growing importance of direct taxation to the creation of a level playing field in world trade, not just for goods, but also for services and intellectual property. The speed of those changes is in part determined by the length of the phase out period which itself is determined by whether the country is in transformation or covered by the Appendix VII exemption.

The disputes taken up by the DSB or by a Panel, evidence the growing significance which direct taxation has when a country is considering whether it should complain against another member.

Given the evolution of world trade and the interrelationship of the WTO and the OECD/UN objectives in freeing up world trade it seems most likely there will be an upward trend in the number of disputes with more obvious direct tax relevance in the future. Some may argue this will be exacerbated by the BEPS¹³³ project but only time will tell if that is to be the case.

¹³³Under the auspices of the G20/OECD with an Action Plan to be implemented by 2015

VII. ANNEX 1-

The Measures in China's Tax Law which the United States argued were inconsistent with China's WTO Obligations and its Accession Protocol.

1. SAT Circular Concerning Transmitting the Interim Measure for the Administration of Tax Refunds to Enterprises with Foreign Investment for Their Domestic Equipment Purchases.
2. MOF Circular and the SAT Concerning the Issue of Tax Credit for Business Income Tax for Homemade Equipment Purchased by Enterprises with Foreign Investment and Foreign Enterprises, read in conjunction with the SAT Circular on Printing and Distributing the Measures Concerning Business Income and Tax Credit on the Investment of Enterprises with Foreign Investment and Foreign Enterprises by Way of Purchasing Homemade Equipment as detailed in GuoShiFa [1999] No. 171 (20 August 1999); CaiShuiZi [2000] No. 49 (14 January 2000) and GuoShuiFa [2000] No. 90 (18 May 2000).
3. Circular on Distribution of Interim Measures Concerning Reduction and Exemption of Enterprise Income Tax for Investment in Domestically Made Equipment for Technological Renovation.
4. Articles 75(7) and 75(8) of the Rules for Implementation of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, read in conjunction with Articles 8 and 9 of the Provisions of the State Council on the Encouragement of Foreign Investment and Articles 6 and 8 of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises.
5. Article 73(6) of the Rules for Implementation of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, read in conjunction with Articles 6 and 7 of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises and Section XIII of the Catalogue for the Guidance of Foreign Investment.
6. Article 81 of the Rules for Implementation of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, read in conjunction with Articles 6 and 10 of the Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises and Article 10 of the Provisions of the State Council on the Encouragement of Foreign Investment.
7. Article 3 of the Provisions of the State Council on the Encouragement of Foreign Investment.
8. Circular of the State Council Concerning the Adjustment in the Taxation Policy of Imported Equipment, read in conjunction with Section XIII of the Catalogue for the Guidance of Foreign Investment Industries.