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Current Note

Tax and the UK/Japan Comprehensive Economic Partnership Agreement

The relationship between modern tax law and contemporary trade law is bound to be complex. Tax lawyers in a post-Brexit UK, have to address the relationship in a much more direct way than before. The issues which arise will no longer be subsumed into a broader debate about the relationship between EU law and national tax law.

As the Finance Act 2020 (FA 2020) recognised,[1] the conduct and resolution of international trade disputes not infrequently involves the imposition of duty. The interaction between tax and duty law and trade law is not material, however, only in the context of trade disputes. It is equally significant in relation to trade agreements. That is clearly demonstrated by the provisions concerned with tax in the new Comprehensive Economic Partnership Agreement between the UK and Japan (UK/Japan Agreement).[2]

Tax lawyers in the US have for some time been conscious of the impact of trade agreements on tax law.[3] On the one hand, the tax system may be seen as a particularly sensitive set of choices by democratically elected politicians and deserving, therefore, of exceptional treatment by trade law on occasions. On the other hand, a national tax system may be seen as just another vehicle for the advancement of protectionism and discrimination. As the Appellate Body has said in relation to provisions in Article III of the General Agreement on Tariffs and Trade 1994: "[T]here is no sharp distinction between fiscal regulation…and non-fiscal regulation…Both forms of regulation can often be used to achieve the same ends."[4]

The conflict arises not just in the context of bilateral agreements but also in relation to multilateral agreements. As is well known there were a series of significant decisions under the General Agreement on Tariffs and Trade in relation to direct tax.[5] The General Agreement on

[1] See FA 2020 s.97; T. Lyons, "Finance Act 2020 Notes: Section 97: international trade disputes" [2020] BTR 497.

[2] Agreement between the United Kingdom of Great Britain and Northern Ireland and Japan for a Comprehensive Economic Partnership: Tokyo, 23 October 2020 (Japan No.1 (2020), CP 311 Vol.1), not yet in force.

[3] See e.g. J. Slemrod and R.S. Avi-Yonah, "(How) Should Trade Agreements deal with Income Tax Issues" (2001–2002) 55 *Tax Law Review* 533; P.R. McDaniel, "Panel IV: The Pursuit of National Tax Policies in a Globalized Environment: Principal Paper: Trade and Taxation" (2000–2001) 26 *Brooklyn Journal of International Law* 1621; P.R. McDaniel, "The David R. Tillinghast Lecture, Trade Agreements and Income Taxation, Interactions Conflicts and Resolutions" (2003–2004) 57 *Tax Law Review* 275.

[4] See Report of the Appellate Body, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (2001, WT/DS135/AB/R), para.99.

[5] Panel Report, Tax Legislation — United States Tax Legislation (DISC), L/4422, adopted 7–8 December 1981, BISD 23S/98; Panel Report, Tax Legislation — Income Tax Practices Maintained By France, L/4423, adopted 7–8 December 1981, BISD 23S/114; Panel Report, Tax Legislation — Income Tax Practices Maintained By Belgium, L/4424, adopted 7–8 December 1981, BISD 23S/127; and Panel Report, Tax Legislation — Income Tax Practices Maintained By The Netherlands, L/4425, adopted 7–8 December 1981, BISD 23S/137. Some early discussion of these cases may be found in A. Prest, "GATT and Company Taxation" [1977] BTR 201. More recent cases include disputes concerning Foreign Sales Corporations, the FSC Repeal and Extraterritorial Income Exclusion Act 2000 of the US, Boeing and Airbus.

Trade in Services (GATS) contains certain exceptions relating to taxation in Article XIV.[6] Now that the UK is setting out to negotiate new trade agreements, however, it is in the context of bilateral treaties that the issues demand immediate consideration.

Given the fanfare with which the UK/Japan Agreement has been greeted, it is useful to consider briefly the issues in the context of that Agreement, although it is not, of course, the only UK agreement which confronts them.[7] In the UK/Japan Agreement, tax makes its first appearance in Chapter 1 ("General Provisions"). Article 1.4 is headed "Taxation". After a brief definition provision, Article 1.4.2. states:

> "This Agreement applies to taxation measures only in so far as such application is necessary to give effect to the provisions of this Agreement."[8]

It is a provision which appears to demonstrate that the advantages of brevity are not always accompanied by the benefits of clarity. That is of some importance given that the provision is seeking to delineate the boundaries of trade and tax law. The use of the word "necessary" may suggest the presence of a degree of objectivity which is, in fact, absent. What it is to "give effect to" is also a matter which is capable of dispute. The entire provision may be seen from one end of the telescope as a conditional exclusion of taxation but, from the other end, as a conditional inclusion.

The ambiguity of the provision is not removed by reason of the fact that the exact same wording is used in the Agreement between the EU and Japan. As it happens, it is Article 1.4.2 in that Agreement as well.[9] Indeed, the wording of the whole of Article 1.4 of the UK/Japan Agreement is similar to the wording of the Agreement between the EU and Japan.

Article 1.4.3 of the UK/Japan Agreement goes on to make clear that: "Nothing in this Agreement shall affect the rights and obligations of a Party under any tax agreement." The tax agreement is said to prevail "to the extent of the inconsistency". The existence of an "inconsistency" is to be determined jointly by the relevant competent authorities.[10] That is a provision which may be thought to reflect a somewhat other-worldly optimism in relation both to semantics and bureaucratic activity.

[6] General Agreement on Trade in Services, Annex 1B to the Marrakesh Agreement establishing the World Trade Organization. For some discussion of direct tax and WTO matters, see M. Daly, "WTO Report" in IFA, *Cahiers de droit fiscal international* (2008), Vol.93a and M. Daly, *Is the WTO a World Tax Organization: A primer on WTO rules for policymakers* (2016), available at: *https://www.imf.org/external/pubs/ft/tnm/2016/tnm1602.pdf* [Accessed 24 November 2020].

[7] Reference may be made, for example, to the free trade agreement between the UK and the Republic of Korea: Korea (No.1) 2019, London 22 August 2019, CP 167 (UK/Korea Free Trade Agreement) which is not considered in this note.

[8] UK/Japan Agreement, above fn.2, Art.1.4.2.

[9] Agreement between the EU and Japan for an Economic Partnership which entered into force on 1 February 2019, available at: *https://trade.ec.europa.eu/doclib/press/index.cfm?id=1684* [Accessed 16 November 2020]. There is similar wording in the Free trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part [2011] OJ L127/6 Art.15.7.

[10] UK/Japan Agreement, above fn.2, Art.1.4.3.

Provisions concerning the inapplicability of any most favoured nation provision to tax[11] and concerning dispute settlement[12] provide further protection for tax systems. So does Article 1.4.6. This states that nothing in the Agreement is to be construed so as to prevent the

> "adoption, maintenance or enforcement by a Party of any taxation measure aimed at ensuring the equitable or effective imposition or collection of taxes such as measures:
> (a) distinguishing between taxpayers who are not in the same situation, in particular with regard to their place of residence or the place where their capital is invested; or
> (b) preventing the avoidance or evasion of taxes pursuant to the provisions of any tax agreement or domestic tax legislation".[13]

Following a common formula, however, that protection is not absolute. It is:

> "Subject to the requirement that taxation measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between the Parties where like conditions prevail, or a disguised restriction on trade and investment…."[14]

The restriction may be in a common form, but it would seem to offer plenty of scope for debate as to its applicability.

Further provisions dealing with taxation exist in relation to the import and export of goods and services. Services are dealt with in Chapter 8, "Trade in Services, Investment Liberalisation and Electronic Commerce". Article 8.3 contains "General exceptions". Tax is particularly important for Article 8.3.2(d) which ensures that, subject always to the absence of arbitrary or unjustifiable discrimination or a disguised restriction, a Party is not prevented from acting inconsistently with the national treatment provisions in Articles 8.8.1, 8.8.2 and 8.16

> "provided that the difference in treatment is aimed at ensuring the equitable or effective[1] imposition or collection of direct taxes in respect of economic activities, entrepreneurs, services or service suppliers of the other Party"[15] (footnote omitted).

Footnote 1 in Article 8.3.2(d) seeks to elucidate in six sub-paragraphs, (a) to (f), the concept of equitable or effective imposition or collection. The first of these refers to measures which

> "apply to non-resident entrepreneurs and service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Party's territory".[16]

[11] UK/Japan Agreement, above fn.2, Art.1.4.4.
[12] UK/Japan Agreement, above fn.2, Art.1.4.5.
[13] UK/Japan Agreement, above fn.2, Art.1.4.6.
[14] UK/Japan Agreement, above fn.2, Art.1.4.6.
[15] UK/Japan Agreement, above fn.2, Art.8.3.2(d).
[16] UK/Japan Agreement, above fn.2, Art.8.3.2(d), fn.1 (a). Reference may also be made to the UK/Korea Free Trade Agreement, above fn.7, Art.7.50(f) fn.40.

The negotiators spared themselves the trouble of drafting a long footnote from scratch by adopting the terms of footnote 1 in Article 8.3.2(d) of the Agreement between the EU and Japan. At least in this area of tax policy, the EU and the UK seem to have something in common.[17]

In relation to services as in relation to goods, the provisions of the Article on most favoured nation treatment are limited so as not to encompass an international agreement for the avoidance of double taxation or another international agreement or arrangement relating wholly or mainly to taxation.[18]

Finally, another provision of note affecting taxation is included in Chapter 12 on subsidies. One example of a subsidy is said to be a "tax concession".[19]

The tax provisions in the UK/Japan Agreement show that the negotiators understand the existence of a tension between trade and tax law. They have certainly attempted to resolve it. The extent to which they have succeeded is a matter which may well be tested in the future.

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[17] The footnote draws very substantially on footnote 6 in GATS Art.XIV(d).
[18] UK/Japan Agreement, above fn.2, Arts 8.9.3(a) and 8.17.2(a).
[19] UK/Japan Agreement, above fn.2, Art.12.6.2.(b).

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