Potential WTO Claims in Response to Countermeasures under the OECD's Recommendations Applicable to Alleged Tax Havens

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1. Introduction

In 1998, the Organisation for Economic Co-operation and Development ("OECD") issued a report called *Harmful Tax Competition: An Emerging Global Issue* (the "1998 Report"). In the 1998 Report, the OECD made certain recommendations intended to counter the perceived harm caused by the operation of so-called "tax havens".[1] In 2000, the OECD followed up with its *Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs - Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices* (the "2000 Report"). The 2000 Report provided a list of tax havens and provided a range of "possible defensive measures" that could be imposed on the tax havens in order to remedy the "harmful" tax competition attributed to such havens.

In late June 2001, after objections from the United States, the OECD significantly scaled back its proposals relating to tax havens, generally limiting the approach to aspects of information exchange intended to facilitate greater scrutiny of accounts used to shelter fraud, abuse, money laundering and other criminal practices. The OECD's new position, however, does not in any way preclude individual countries from following the OECD's earlier recommendations and proceeding with defensive measures at the national level.

Apart from the OECD process, the challenge to tax havens has recently shown new momentum in the context of the global fight against terrorism. Following the terrorist attack on the United States on 11 September 2001, many governments are taking a closer look at ways to find and shut down terrorist financing, including new sanctions and enhanced rules on money laundering. The EU is also reportedly relying on the new anti-terrorism initiatives to inject new life into its fight against tax havens and so-called "harmful" tax competition. One EC official is quoted as saying, "Politically it is now going to be very difficult to defend the continuation of tax havens, no matter where they are in Europe."[2] Even in the current context, however, it remains obvious that a balanced approach is necessary in order to ensure an effective fight against terrorism, while respecting both legitimate tax policy of sovereign nations and international legal obligations.

This article provides a preliminary analysis of possible claims that alleged tax havens may have under the rules of the World Trade Organisation ("WTO") when another WTO Member

[1] The term "tax haven" is used in this article, although the more appropriate term would be "low tax jurisdiction," *i.e.*, countries that apply no or only nominal tax rates.
[2] "Brussels Sees Need To Focus on Tax Havens", The Financial Times, 25 September 2001.

imposes a particular countermeasure. The analysis will be limited to claims relating to financial services under the General Agreement on Trade in Services ("GATS"), which is the primary source for relevant WTO obligations. At present, it is unclear whether any particular OECD Member has imposed a specific countermeasure explicitly or implicitly in accordance with the OECD recommendations. The following overview of potential issues, therefore, remains necessarily abstract and to some extent speculative. However, it may nonetheless serve to highlight the specific issues that countries that consider imposing such measures may encounter. Without prejudice to individual circumstances in individual cases, this analysis demonstrates that following the OECD recommendations may lead to claims of WTO-inconsistency, especially if the measure is not carefully tailored to address legitimate objectives.

2. **Background**

The 1998 Report introduced certain factors to identify tax havens and harmful preferential tax regimes. This article is limited to issues relating to tax havens.

The definition of a "tax haven" has proven somewhat elusive in the past. As stated in the 1998 Report, the OECD had concluded in an earlier report in 1987 that "a good indicator that a country is playing a role of a tax haven is where the country or territory . . . is generally recognised as a tax haven." Thus, the OECD essentially concluded that a tax haven is defined as a tax haven. In its 1998 Report, the OECD moved on from this rather circular "reputation test" to a slightly more substantive definition, *i.e.*, that a tax haven was a country with no or nominal taxation usually coupled with a reduction in regulatory or administrative constraints.

The OECD's proposals are based on the claim that tax havens lead to harmful tax avoidance, because entities have incentives to migrate to jurisdictions with lower tax rates and less burdensome regulatory or administrative requirements. The OECD concludes that this migration has an adverse effect on the home country's tax base and contends that such tax-rate-based competition is unfair.

Apart from the philosophical and political question of whether this effect should be considered a detriment or a necessary consequence of desirable global competition, it is clear that when the Uruguay Round negotiations on the GATS concluded in 1994, the existence of tax havens was known to the negotiators and was considered a condition of competition in the market for financial services. Thus, WTO Member commitments both in 1994 and following the Financial Services negotiations in 1998 were conducted with the knowledge of the effect of tax havens on the financial services market.

3. **GATS Claims**

In assessing the possible WTO inconsistencies of specific countermeasures, it is important to recognise the fundamental point that only WTO Member countries are bound by WTO obligations. Moreover, only countries that are WTO Members have the right to challenge whether measures taken by other WTO Members are consistent with their WTO obligations. As an international organisation, the OECD itself is not subject to WTO rules, although its

individual Members are subject to WTO obligations in their capacity as WTO Member countries.

For purposes of this analysis, consider the following scenario: a WTO Member country, relying on the OECD recommendations, imposes a countermeasure affecting an alleged "tax haven," which is also a WTO Member. The threshold question for a valid claim by the affected "tax haven" (the "Complainant") is whether the GATS applies to the particular countermeasure imposed by the other WTO Member (the "Defendant"). Assuming that the Defendant has applied a "measure" subject to the GATS, the next question is whether such measure (1) is inconsistent with the Defendant's WTO obligations, and/or (2) causes, or has caused, the nullification or impairment of benefits that could reasonably have been expected to accrue to Members based on the Defendant's relevant WTO obligations.

3.1 Jurisdictional Issues

The GATS, in principle, covers virtually all measures relevant to the international rendering of services. GATS Article I:1 provides that GATS "applies to measures by Members affecting trade in services." The drafters of the GATS clarified the meaning of this very broad statement by providing *inter alia* the following definitions:

- "trade in services" is defined to include the supply of a service through the four "modes" of supply. (GATS Article I:2) The analysis in this article is limited to the following "modes" of supply, which are the most relevant to possible GATS claims:
  - from the territory of one Member into the territory of any other Member ("cross-border supply" or Mode 1); and
  - in the territory of one Member to the service consumer of any other Member ("consumption abroad" or Mode 2).

- "measure" means "any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form." (GATS Article XXVIII:a)

- "measures by Members" means primarily measures taken by "central, regional or local governments and authorities." (GATS Article I:3(a))

The Panel in *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("*EC - Bananas*") removed any doubts about the broad coverage of GATS when it stated:

> "The scope of the GATS covers any measure of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services."[3]

The Appellate Body affirmed this finding of the Panel.[4]

[3] Report of the Panel, WT/DS27/R/USA, para. 7.285 (22 May 1997).
[4] Report of the Appellate Body, WT/DS27/R/AB, para. 220 (9 September 1997).

Thus, it is safe to conclude that virtually any government measure that affects a WTO Member's financial service providers is likely to fall within the scope of GATS disciplines.

3.1.1 Domestic countermeasures

The OECD identified the following "range of possible defensive measures" in its 2000 Report:

- To disallow deductions, exemptions, credits, or other allowances related to transactions with Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To require comprehensive information reporting rules for transactions involving Uncooperative Tax Havens or taking advantage of their harmful practices, supported by substantial penalties for inaccurate reporting or non-reporting of such transactions.
- For countries that do not have controlled foreign corporation or equivalent (CFC) rules, to consider adopting such rules, and for countries that have such rules, to ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices (Recommendation 1 of the 1998 Report).
- To deny any exceptions (*e.g.* reasonable cause) that may otherwise apply to the application of regular penalties in the case of transactions involving entities organised in Uncooperative Tax Havens or taking advantage of their harmful tax practices.
- To deny the availability of the foreign tax credit or the participation exemption with regard to distributions that are sourced from Uncooperative Tax Havens or to transactions taking advantage of their harmful practices.
- To impose withholding taxes on certain payments to residents of Uncooperative Tax Havens.
- To enhance audit and enforcement activities with respect to Uncooperative Tax Havens and transactions taking advantage of their harmful practices.
- To ensure that any existing and new domestic defensive measures against harmful tax practices are also applicable to transactions with Uncooperative Tax Havens and to transactions taking advantage of their harmful tax practices.
- Not to enter into any comprehensive income tax conventions with Uncooperative Tax Havens, and to consider terminating any such existing conventions unless certain conditions are met (Recommendation 12 of the 1998 Report).
- To deny deductions and cost recovery, to the extent otherwise allowable, for fees and expenses incurred in establishing or acquiring entities incorporated in Uncooperative Tax Havens.
- To impose "transactional" charges or levies on certain transactions involving Uncooperative Tax Havens.

The above "possible" countermeasures are phrased in very general terms. However, virtually all of these countermeasures when implemented in the domestic laws, regulations and/or practices of particular OECD Members would constitute measures to which the GATS would apply. In other words, consistent with the definitional provisions of the GATS cited above, they would constitute actions by central governments that affect trade in services, in particular financial services.

Notwithstanding broad GATS coverage in principle, the Complainant would need to be selective in choosing the specific measure(s) to challenge, as certain countermeasures (especially those with clear discriminatory aspects) are more likely to be inconsistent with WTO obligations.

3.1.2 OECD's recommendations

At present, only the OECD's recommendations are in effect, and no OECD country has (at least formally) imposed a countermeasure. Thus, the first issue is whether the GATS applies to the OECD's recommendations themselves.

Based on the above definitions, an argument could be made that the OECD's recommendations constitute a "measure" because they (1) fall within the very broad definition of a "measure", including a measure "in any form", and (2) reflect a decision by the central governments of the individual OECD Members (*i.e.*, were formally adopted by OECD Governments). Moreover, these recommendations have likely "affected" trade in services, as evidenced by a likely decline in deposits or other effect on the demand for financial services by the Defendant's consumers from or within the affected tax havens.

While tax havens could attempt to direct pre-emptive actions against OECD Member countries based on the above argument, it will be difficult to sustain such a challenge in formal dispute settlement proceedings. Past practice under GATT and WTO panels generally provides that panels will not find that discretionary legislation, *i.e.*, legislation that the executive authority has the discretion whether to apply, is inconsistent with GATT or WTO obligations.[5] The same logic would likely apply here, given that the OECD Member governments are not obligated under international or domestic law to apply any counter or defensive measures whatsoever as a consequence of their decision to adopt the OECD's recommendations. The 2000 Report expressly states that "Member countries retain the right to apply, or not apply, defensive measures unilaterally to any jurisdiction." Thus, it would be very unlikely for a WTO panel to rule that the OECD recommendations must be applied by WTO Members that are also OECD Members (*i.e.*, that such measures are "mandatory") and thus that such recommendations themselves are measures that are inconsistent with relevant WTO obligations.

Notably, however, in *United States - Measures Treating Export Restraints as Subsidies* ("*U.S. - Export Restraints*"), adopted in August 2001, the Panel found that it was not precluded from first assessing whether particular "measures" were inconsistent with relevant WTO obligations and second determining whether the "measures" were mandatory or

[5] *See, e.g.*, Report of the Appellate Body, *United States - Anti-Dumping Act of 1916*, WT/DS136/AB/R-WT/DS162/AB/R, para. 88 (adopted 26 September 2000); Report of the Panel, *United States - Measures Treating Export Restraints as Subsidies*, WT/DS194, para. 8.9 (adopted 23 August 2001); *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, Panel Report, BISD 41S/131, para. 118 (adopted 4 October 1994).

discretionary.[6] In other words, the Panel found that it could issue findings on the substance of the matter without first answering the threshold question of whether the alleged measures were mandatory. In effect, the Panel determined that the "measure" at issue was inconsistent with WTO obligations if it were ever to be applied in the future, a quasi-conditional ruling that is in many respects similar to an advisory opinion.

Although a far more speculative case, given the absence of domestic legislative or regulatory actions implementing specific countermeasures, a similar approach could theoretically be used to challenge the OECD recommendations. If a WTO panel were to follow the same approach as the Panel in the *U.S. - Export Restraints* case, it could first assess whether the OECD's recommended countermeasures, or a carefully selected subset thereof, would violate relevant WTO obligations and then determine if such recommendations were "mandatory." Under this approach, the complaining WTO Member(s) could, theoretically, obtain findings that certain OECD recommended countermeasures could not be applied because they are WTO inconsistent. The absence of specific details of any particular countermeasure, however, would likely limit the ability to succeed under this approach, although this would not necessarily preclude achieving certain political and/or diplomatic objectives in highlighting the potential WTO implications for the future imposition of countermeasures.

It remains, however, highly unlikely that a panel would go so far to analyse the WTO consistency of such potential measures based solely on the existence of the OECD recommendations and the Defendant's OECD membership, in the absence of any further "hard evidence" (such as draft legislation or the like) indicating that the Defendant actually intends to act on these recommendations. The circumstances of the *U.S. - Export Restraints* case seem to mark the outer limits of panels' courage to venture into the field of speculation.

4. Violation Claims under GATS

The following is a discussion of potential GATS claims that a Complainant tax haven could raise to challenge a countermeasure. Given the broad scope of potential measures, this article only discusses possible claims in general terms as well as certain issues that will be critical to evaluate in order to support such claims.

For purposes of the discussion below, we have assumed that services suppliers in the Complainant's territory provide financial services to (1) Defendant's consumers in the Defendant's territory (cross-border supply) and (2) Defendant's consumers in the territory of the Complainant (consumption abroad). Substantial debate has taken place regarding how to differentiate financial services supplied under Mode 1 (cross-border supply) and services supplied under Mode 2 (consumption abroad).[7] This article does not address the precise distinctions between the two modes, because they are not necessarily relevant to the success of particular claims, especially where the same obligations apply to both modes. To facilitate the analysis, this article uses the example of the imposition of a countermeasure by France as a Member country of the European Union.

4.1 Article II - Most-Favoured-Nation Treatment

[6] *U.S. - Export Restraints*, at para. 8.14.
[7] *See, e.g.*, Technical Issues Concerning Financial Services Schedules, Note by the Secretariat, S/FIN/W/9 (29 July 1996).

The first likely line of challenge against countermeasures directed specifically against "tax havens" would be that the measures are inconsistent with the so-called most-favoured-nation, or "MFN," obligation. The MFN obligation under GATS is set forth in Article II:1 and provides that

> "each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."

This provision applies to all services covered by GATS, but does not cover services expressly listed as exempted by certain Members.

Accordingly, if the Defendant imposed a countermeasure that allowed a third country's financial services suppliers to provide financial services on a more favourable basis than the Complainant's suppliers, the Complainant could claim that the Defendant is violating its MFN obligation under GATS Article II. The general test is whether the particular measure creates less favourable conditions of competition between the Complainant's services suppliers and like suppliers of third countries.[8] Thus, if the Defendant (in its action against the tax haven) applies the same tax treatment both in law and in fact regardless of the origin of the financial services supplier, the Defendant would not violate its MFN obligation.

For example, assume that France has imposed a particular countermeasure that provides, either in law or in fact, more favourable treatment for its consumers depositing funds with financial services providers in Switzerland than it does for consumers depositing funds with financial services providers in the alleged tax haven, *i.e.*, the Complainant. Assuming that the French countermeasure created competitive conditions that were less favourable for the Complainant's financial services suppliers compared to Swiss suppliers, the French measure would appear to be inconsistent with France's MFN obligation. Many of the general countermeasures listed in the 2000 Report (see above) would likely change the competitive conditions under which financial services suppliers of tax havens operate in their dealings with clients from other WTO Members. Moreover, the services that are compared (*i.e.*, those offered to French consumers by the Complainant's suppliers and by the Swiss suppliers) would probably be considered "like" services and thus the subject of valid comparison in the MFN analysis.

However, the Complainant must be cautious in asserting an MFN-based claim, because significant exemptions may apply. For example, if the United States imposed the same countermeasure as France in the previous example, the finding of an inconsistency would be subject to a number of MFN exemptions relating to tax measures that the United States scheduled during negotiations. For example, the U.S. MFN exemptions include"[d]ifferential treatment under direct tax measures at the federal level" regarding:

> "measures permitting less favorable taxation for citizens, corporations or products of a foreign country based on discriminatory or extraterritorial taxes, more burdensome taxation, or other discriminatory conduct."[9]

[8] *See, e.g.*, Report of the Panel, *EC - Bananas*, W/DS27/R/P, para. 7.385 (22 May 1997); Report of the Appellate Body, *EC - Bananas*, para. 248 (9 September 1997).
[9] United States of America, Final List of Article II (MFN) Exemptions, GATS/EL/90 (15 April 1994).

Thus, to the extent that the countermeasure falls within the scope of one of the exemptions, a panel would not find that the United States acted inconsistently with its MFN obligation under GATS Article II.

Apart from such country-specific MFN exemptions, additional exceptions, both specific and general, may apply. The general, sector-specific and security exceptions under GATS are addressed further below. With regard to MFN obligations, GATS Article XIV(e) specifically provides:

> "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> * * * * *
>
> (e) inconsistent with Article II, provided 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."

Thus, if the relevant countermeasure falls within this exception relating to double taxation (and conforms to the other requirements for relying on a general exception discussed below), the Defendant may escape an adverse decision that it acted inconsistently with its WTO obligations. In most instances, however, this narrow exception could not be used to justify an MFN incompatible countermeasure targeting so-called "harmful" practices of alleged tax havens.

4.2 Specific Commitments

Part III of the GATS covers obligations of Members relating to market access and national treatment. Part III represents a "bottom-up" approach to services commitments, because WTO Members can voluntarily choose those sectors and sub-sectors to which the relevant obligations will apply and may schedule further limitations on the scope of such commitments.

By contrast, the Understanding on Commitments in Financial Services (the "Understanding") provides for a "top-down" approach to scheduling specific commitments in financial services. Under a "top-down" approach, Members commit to the application of obligations to all subsectors and under all circumstances, except where specific exemptions are scheduled. A number of WTO Members, including most OECD Members, agreed to schedule their financial services commitments in accordance with the Understanding.

The provisions of the Understanding apply on an MFN basis to all other Members. In other words, France must comply with its obligations under the Understanding equally with respect to other Members that use the Understanding and with respect to all other WTO Members, including alleged tax havens.

4.2.1 Market access

4.2.1.1 Cross-border trade

GATS Article XVI (Market Access) generally provides that Members are prohibited from imposing the restrictions listed in paragraph 2 for a particular service if they have scheduled a specific commitment not to do so and have not placed any relevant limitations on such commitment (either horizontal or sector-specific). The "specific commitments" are made by sector or sub-sector and by mode of supply.

The Understanding, however, takes a supplemental approach and, in certain instances, more or less fully opens the markets of those Members using the Understanding. Paragraph B.3 states, in relevant part:

> "Each Member shall permit non-resident suppliers of financial services to supply, as a principal, through an intermediary or as an intermediary, and under terms and conditions that accord national treatment, the following services:
> * * * * *
> (c) . . . advisory and other auxiliary services, excluding intermediation, relating to banking and other financial services as referred to in subparagraph 5(a)(xvi) of the Annex."

For consumption abroad, paragraph B.4 of the Understanding states:

> "Each Member shall permit its residents to purchase in the territory of any other Member the financial services indicated in:
> (a) subparagraph 3(a);
> (b) subparagraph 3(b); and
> (c) subparagraphs 5(a)(v) to (xvi) of the Annex."

The services listed in subparagraph 5 of the GATS Annex on Financial Services (the "Annex") include a wide range of generally-defined financial services, including accepting deposits, lending of all types, financial leasing, payment and money transmission services, trading, money brokering, asset management, and settlement and clearing services.

Thus, rather than narrowly preventing limitations on the number of financial service suppliers or the type of legal entity as provided under GATS Articles XVI:2(a) and (e), paragraph B.4 of the Understanding provides much broader obligations, especially regarding consumption abroad, *i.e.*, that the relevant Member "shall permit the purchase in the territory of any other Member" of the wide range of services identified in the Annex.

Consider again the example of a proposed French countermeasure. The EC's schedule of specific commitments, which applies to France, states the following:

> "1. The Communities and their Member States undertake commitments on Financial Services in accordance with the provision of the 'Understanding on Commitments in Financial Services' (the Understanding).
> 2. These commitments are subject to the limitations on market access and national treatment in the 'all sectors' section of this schedule and to those relating to the subsectors listed below.
> 3. The market access commitments in respect of modes (1) [cross-border supply] and (2) [consumption abroad] apply only to the transactions

indicated in paragraphs B.3 and B.4 of the market access section of the Understanding respectively."

If the French measure does not permit French residents to, for example, purchase financial services involving the making of deposits in banks within the territory of the Complainant tax haven, France would appear to act inconsistently with its WTO obligations as reflected in the Understanding. Notably, France has not scheduled (through the EC) any other limitations on market access that would limit its obligations under the Understanding. Thus, a countermeasure may be especially susceptible to attack under this provision of the Understanding, depending on the circumstances.

4.2.1.2 Non-discriminatory measures

In addition to the general GATS obligations and standard market access commitments, the Understanding contains additional specific market access obligations relating to measures that are not discriminatory, but nevertheless have an adverse effect on market access for financial services. Paragraph B.10 of the Understanding states:

> "Each Member shall endeavour to remove or to limit any significant adverse effects on financial service suppliers of any other Member of:
>
> (a) non-discriminatory measures that prevent financial service suppliers from offering in the Member's territory, in the form determined by the Member, all financial services permitted by the Member;
> (b) non-discriminatory measures that limit the expansion of the activities of financial service suppliers into the entire territory of the Member;
> (c) measures of a Member, when such a Member applies the same measures to the supply of both banking and securities services, and a financial service supplier of any other Member concentrates its activities in the provision of securities services; and
> (d) other measures that, although respecting the provisions of the Agreement, affect adversely the ability of financial service suppliers of any other Member to operate, compete or enter the Member's market."

Depending on the facts, a particular countermeasure could readily fall within the above categories. Although the *chapeau* language "shall endeavour to remove" limits the effectiveness of this provision, it may still be used to establish the context under which specific commitments were made and to support a claim that measures adversely affecting the ability of other Members' financial services suppliers to compete should not be maintained.

4.2.2 GATS Article XVII - National Treatment

Article XVII of GATS applies the national treatment principle to trade in services, stating that "each Member shall accord to services and services suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and services suppliers."[10] The national treatment

[10] The national treatment provisions in the Understanding only address national treatment with respect to financial services suppliers established in the territory of the relevant Member, *i.e.*, mode 3 of supply covering commercial presence. This mode of supply is not covered within the scope of this article.

obligation, however, only applies when a Member has scheduled a specific commitment in the relevant services subsector and when any scheduled limitations do not apply. Thus, to establish a violation, the Complainant must demonstrate that the Defendant (1) has treated the Complainant's service suppliers less favourably than its own "like" suppliers, (2) has made specific commitments in the relevant sector, and (3) has not scheduled relevant national treatment limitations.

Using the example of France again, the first step is to determine whether the countermeasure violates national treatment. If France imposes a countermeasure that accords less favourable tax treatment to the use of financial services supplied from the territory of the Complainant tax haven compared to the tax treatment applied to the same financial services supplied by French providers, France's countermeasure may violate the national treatment provision under Article XVII.

To sustain this violation, however, the Complainant must also show that France made a specific commitment in the relevant financial service and that no limitations apply to the relevant mode of supply. In the case of France, the EC made specific commitments in the financial services sector and entered "None" (*i.e.*, no limitations to the application of national treatment in the sector) under modes 1 and 2 in its schedule. The EC's schedule also does not contain any relevant horizontal limitations, *i.e.*, limitations applicable to all sectors.

Even assuming that a panel were to find that the Defendant acted inconsistently with its WTO obligations under GATS Article XVII, however, the Complainant's case must still survive the potential assertion of a general, sector-specific and security exceptions under GATS. The less specific exceptions will be discussed below, however, the general exception under Article XIV(d) specifically addresses national treatment and taxation. It allows for measures:

> "inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective [footnote omitted] imposition or collection of direct taxes in respect of services or services suppliers of other Members"

Footnote 6 of GATS defines the scope of (d) very broadly and includes measures that, for example:

- Apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- Apply 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.

Given the broad language of this exception, it is clear that a significant array of measures may be justified, including countermeasures against tax havens as suggested by the OECD, provided that additional requirements applicable to "general exceptions" (see below) are met.

4.3 General, Sector-Specific and Security Exceptions

The obligations contained in the GATS are subject to the general exceptions under GATS Article XIV. In addition, paragraph 2(a) of the GATS Annex on Financial Services (the "Annex") establishes a sector-specific exception applicable to financial services regulation,

the so-called "prudential carve-out." Finally, GATS Article XIV *bis* provides certain security-related justifications for measures that would otherwise be inconsistent with WTO obligations.

If one of these exceptions applies, a panel will not find that the Defendant has violated its WTO obligations in imposing the countermeasure. Importantly, however, the Defendant has the burden of proof to demonstrate to the panel that an exception applies. The final question addressed below is whether these exceptions are applicable to measures that are inconsistent with the obligations in the Understanding.

4.3.1 General exceptions

Based on practice under GATT Article XX applicable to goods, analysis of the general exceptions involves a two-step process. First, the Defendant must demonstrate that one of the subparagraphs of GATS Article XIV applies. Second, the Defendant must demonstrate that the *chapeau*, or introductory section, of Article XIV would not otherwise preclude reliance on the exception.

The specific exceptions to Article II, the most-favoured-nation obligation, and Article XVII, the national treatment obligation, under Articles XIV (e) and (d) were addressed above. Provided that their specific requirements apply, a measure would also have to meet the requirements of the *chapeau.*

The other potentially relevant subparagraph within Article XIV for this analysis seems to be subparagraph (c), which allows for measures:

> "necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of this Agreement including those relating to:
> (i) the prevention of deceptive and fraudulent practices"

The *chapeau* of Article XIV provides that the relevant measures must not be

> "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services."

The Defendant (France in the ongoing example) would need to demonstrate that the relevant countermeasure directed against the Complainant tax haven falls within (c) and meets the test in the *chapeau* of Article XIV. Depending on the measure, the "necessity" test under (c) is often difficult to overcome because it must be shown that no other less trade-restrictive measure was reasonably available to achieve the objective. Moreover, in this case, depending on the justifications used for the measure, it may be difficult for the Defendant to argue that it meets the relevant standard, *i.e.*, is intended to secure compliance with laws relating to deceptive and fraudulent practices, especially given that the OECD reports focus more on avoiding "harm" from tax competition rather than on providing a remedy for fraud of any kind.

Provided one of the subparagraphs applies, the question whether the countermeasure contravenes the *chapeau* would depend on the facts of the case. An "honest" and open

countermeasure directed against tax havens is likely to pass the test of not being a disguised restriction on trade. However, whether such a targeted measure would pass the requirement of non-discrimination between "countries where like conditions prevail" is an open question that, ultimately, will have to be decided by a panel and the Appellate Body based *inter alia* on the parameters taken into account to establish "likeness."

4.3.2 Paragraph 2(a) of the Annex on Financial Services - Prudential Measures

The Annex applies to measures affecting the supply of financial services. Paragraph 2(a) of the Annex states:

> "[n]otwithstanding any other provision of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement."

Due to its prominence and broad coverage, this "prudential carve out" is likely to be asserted as an affirmative defence to any claim regarding a particular countermeasure specifically affecting trade in financial services. However, the Defendant will again have the burden to demonstrate that the particular countermeasure is a prudential measure within the meaning of the provision and is not being used as a means of avoiding its commitments or obligations.

Depending on the facts, the Complainant could argue that such provision is irrelevant to the consumption of financial services in the consumption abroad mode of supply, *i.e.*, outside the territory of the defendant. This could be supported with reference to the heading of paragraph 2, which indicates that it applies to "domestic regulation." It also appears illogical for prudential measures, which generally apply to domestic supervision and licensing, to apply to purchases from foreign services providers, especially outside the territory of the regulating Member. However, the reference to ensuring "the integrity and stability of the financial system" in paragraph 2(a) could be used to justify measures with extraterritorial effect. Regardless, the Defendant must still demonstrate, based on specific information and evidence, that it imposed the countermeasure for these legitimate reasons, and not simply to address conditions of competition known at the time that its financial services obligations were negotiated.

4.3.3 Security Exceptions

While the general exceptions and the prudential carve-out for financial services regulation are relevant for possible justifications of restrictive measures based on the political and economic rationale of the OECD recommendations, measures motivated by the present "war against terrorism" may find a basis in the GATS security exceptions, embodied in Article XIV *bis.* The provision reads in relevant part:

> "1. Nothing in this Agreement shall be construed:
>
> (…)

(b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:

(…)

(iii) taken in time of war or other emergency in international relations (…)"

This provision is modelled quasi-*verbatim* on GATT Article XXI, and thus related case law would seem to provide helpful interpretative guidance. However, despite its 54 years of existence, GATT Article XXI has only been invoked in a handful of cases, none of which has been allowed to proceed to clear panel pronouncements on the substance of the provision. Moreover, Members have been very reluctant to discuss security matters in a trade forum, demonstrated most recently by an agreement between the United States and the European Communities to suspend their WTO dispute over the U.S. imposition of sanctions on Cuba. Therefore, while measures affecting trade in services and violating WTO obligations may be justified on national security grounds, it is important to bear in mind that WTO Members involved in a dispute over security measures are likely to seek solutions outside the formal WTO dispute settlement system.

The GATS security exception provides a wide degree of discretion to WTO Members. A Member relying on the exception would only need to demonstrate that (1) the measure was taken during a war or "other emergency in international relations", (2) the measure was an action to protect "essential security interests", and (3) it considered the measure necessary to protect such interests.

First, the present situation involving the "war on terrorism" may qualify as a "war" in the sense of classical definitions of international law. In any case, however, an "other emergency in international relations" clearly exists. Taking a speculative look into the future, however, this requirement may be harder to fulfil once a reasonable degree of peace and security has been restored, *i.e.*, once the actual use of military force is discontinued and no terrorist attacks have been carried out for a reasonable period of time. In any event, Members would appear to have substantial discretion to assess whether a "war" or "other emergency" exists and the duration of such a situation.

Second, the Defendant will enjoy a significant margin of discretion in defining its own "essential security interests", considering the subjective nature of such interests. At the same time, however, the Defendant is not entirely free to identify any interest as an essential security interest. Economic interests, for instance, would not qualify.

Third, the Defendant must demonstrate that it "consider[ed]" that the measure was "necessary" to protect its essential security interests. The language again accords the Defendant a wide margin of discretion in "considering" for itself whether the measure is necessary, although such discretion is not limitless. Just as in the case of general exceptions, a determination that a countermeasure is "necessary" would require the absence of less trade restrictive measures that are equally effective at protecting the legitimate security interests. However, as the language ("considers") suggests, a Member is not required to take significant risks and may choose stronger measures if they provide more security, provided a certain degree of "reasonableness" is respected.

If a Member attempted to justify a countermeasure against a tax haven based on the national security exception, such countermeasure would probably need to bear a clear relation to the fight against terrorism and would have to be at least to some degree demonstrably efficient in this regard. Moreover, the measures taken under this subparagraph of GATS Article XIV *bis* are considered "emergency" measures, which would suggest that the provision does not justify the imposition of such measures for an indefinite period of time, absent continuous relevant circumstances. Thus, to counter the use of the security exception, tax havens could argue that the countermeasures imposed must have a direct relationship to the fight against terrorism, for example, money laundering and terrorist financing rather than "harmful" tax competition). In addition, tax havens affected by countermeasures may, even if forced to accept them under the present circumstances, may be able to secure their removal when and if conditions improve.

4.3.4 Would the exceptions apply to the Understanding?

An interesting interpretative question is whether the general exceptions in GATS Article XIV, the prudential exception in the Annex, and the security exception in GATS Article XIV *bis* would apply to the obligations in the Understanding.

Article XIV states that "nothing in this Agreement" shall preclude the adoption or enforcement of measures under certain circumstances. Paragraph 2(a) of the Annex states that "[n]otwithstanding any other provisions of the Agreement." Article XIV *bis* states "[n]othing in this Agreement shall be construed." There is no reference to the Understanding in the GATS or the Annex. Moreover, the Understanding appears to represent the plurilateral equivalent of other "understandings" that apply to Members and clarify certain provisions of GATT, such as the Understanding on the Interpretation of Article XVII of GATT 1994 (state trading enterprises). In this instance, the Understanding supplements Part III of GATS.

The text of the preamble to the Understanding refers to the GATS, suggesting that the GATS is indeed a separate "Agreement" from the Understanding. Moreover, the preamble provides that its provisions are applicable only to the extent that they do not conflict with the GATS, again re-emphasising that the Understanding is separate from the "Agreement" (*i.e.*, the GATS) as the term "Agreement" is used in the exceptions. There is also no direct conflict between the GATS and the Understanding, *i.e.*, both the GATS and the Understanding can be given full effect without reading the exceptions to apply to the Understanding. Finally, there is no indication in the text itself that any provisions of the GATS, including the general, prudential and security exceptions, are explicitly or implicitly intended to apply to the provisions of the Understanding. Thus, notwithstanding the possible policy arguments, a strict legal interpretation of the relevant provisions could lead to the conclusion that the GATS general, prudential and security exceptions do not apply to measures found inconsistent with obligations under the Understanding.

An alternative interpretation, however, could be based on GATS Article XX:3, which states that "[s]chedules of specific commitments shall be annexed to this Agreement and shall form an integral part thereof." The Understanding is intended to replace or supplement the approach from Part III of GATS. Thus, when a Member expressly states in its schedule that it is making specific commitments in accordance with the Understanding, an argument could be made that it effectively includes the obligations in the Understanding as an integral part of its GATS schedule and as a replacement for the approach in Part III of GATS. Under such an interpretation, the general, prudential and security exceptions would apply to the

Understanding in the same manner as they apply to other scheduled commitments under Part III of GATS.

Notwithstanding the lack of legal and textual clarity, it would be highly unlikely for a panel or the Appellate Body to find that the general, prudential and security exceptions would not be available for measures that are inconsistent with provisions in the Understanding. Rather, the object and purpose of the exceptions, together with the unique relationship between the GATS and the Understanding, would likely accord panellists sufficient flexibility to find that the exceptions would apply. However, any Member seeking to rely on those exceptions to justify a countermeasure against a tax haven would still need to demonstrate that it has satisfied the requirements of such exceptions.

5. Non-Violation Claims under Article XXIII:3 of GATS

Under GATS Article XXIII:3, the Complainant could also assert that the application of the relevant countermeasure nullifies or impairs benefits that it could reasonably have expected to accrue to it under the Defendant's specific commitments, even though the measure does not conflict with the provisions of the GATS. If successful under this so-called "non-violation" claim, the Complainant could be entitled to modification or revocation of the measure.

Using Article XX:III:1(b) of GATT 1994 as a guide, three elements must be satisfied:

(i) the existence of a governmental measure;

(ii) nullification or impairment of a benefit accruing to the Member that could not have been reasonably anticipated by it at the time when the relevant specific commitment was negotiated; and

(iii) an upsetting of the competitive relationship between foreign and like domestic services or service suppliers.[11]

Although experience suggests that succeeding with a non-violation claim is difficult, whether the Complainant could satisfy these elements will ultimately depend on the specific facts surrounding the countermeasure imposed.

6. Conclusion

OECD Members have developed a series of recommendations involving tax havens, including proposed countermeasures to remedy "harmful" tax competition. Although the OECD's initiatives now appear more focussed on information exchange, alleged tax havens must be vigilant against the imposition (either directly or indirectly) of countermeasures by activist OECD Members seeking to improve their own tax competitiveness outside the context of further formal activity by the OECD.

[11] *See* Werner Zdouc, *WTO Dispute Settlement Practice Relating to the GATS*, 1999 J. Int'l Econ. L. 295, 302-308.

The above discussion shows that the imposition of such countermeasures could result in claims that the particular OECD Member is acting inconsistently with its WTO obligations, in particular, its financial services obligations under GATS. If a Member decides to impose countermeasures, it should verify conformity with its WTO obligations, as the victims of such measures are likely to scrutinise them carefully and will be prepared to vindicate their WTO rights if the circumstances warrant.

The recent terrorist attacks have generated a well-justified call for tighter oversight over possible sources and avenues of terrorist funding, including a renewed effort to examine the role of alleged tax havens. The initiatives aimed at terrorist financing, however, can and should be carefully balanced to ensure that they are developed in a manner that is both effective in achieving their important goals and consistent with international legal rights and obligations, including those of the WTO.