

The international tax policy in the context of integration and trade in Latin America

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1. Introduction

At the end of the 1980's Latin American countries started a process of liberalization through which the traditional scheme of "production towards domestic necessities" was left behind. In Latin America different reforms in areas such as tax law, financial (banking) law, foreign trade law and constitutional law were introduced. These reforms took place for these countries at a different pace and different emphasis was given in one or another area by the institutions of these countries. In general terms, the results of these reforms were the modernization of the institutions and the internationalization of the economy. From a perspective of trade, agreements at regional level took place. Examples of these trade agreements are, the Latin American Association Integration², Andean Community ("CAN")³, Mercosur-CAN⁴ and Group of Three⁵ amongst others. From a tax point of view, this process of liberalization aimed at removing obstacles for investment and reinforcing the capital market influencing the domestic and international tax policy. The strategies and instruments used to develop an international tax policy in accordance with this process of liberalization differ among Latin American countries. Examples of these instruments for international tax are unilateral rules, bilateral tax conventions or tax provisions in regional agreements.

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² Latin American Association Integration ("ALADI") created in 1980 (Montevideo Treaty) members of which are Argentina, Bolivia, Brazil, Colombia, Chile, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. The main objective is the reduction of intra-regional trade barriers and other non-trade measures with the aim to achieve a common market.

³ A multilateral agreement with Andean Community countries (Colombia, Bolivia, Ecuador and Peru) is currently in force. The purpose of this agreement is the economic and social integration towards a Common Market.

⁴ This agreement is in effect as of 1 July 2004. It aims to create a free-trade area through the reduction of trade tariffs and non-trade tariffs insofar as they affect trade. Mercosur consists of Argentina, Brasil, Paraguay, and Uruguay.

⁵ Group of three members are Colombia, Mexico and Venezuela. The main aim is to create a free-trade area with the removal of trade barriers in matters of intellectual property, taxation, investment and trade.

This paper aims to describe the different approaches from Latin American countries and in order to keep it comprehensive; Chile and Colombia have been selected as countries of study. Hypothesis is that the differences in the international tax policy in these countries have an influence in the processes of Latin American integration and trade.

In the past, the importance of coordination and convergence of tax policies in Latin America has been addressed. In this regard, the International Fiscal Association in its 2005 Congress addressed the issue of tax competition in an economically integrated area without internal frontiers.⁶ In this context, the second aim of this paper is to provide recommendations for a consistent, stable, and open tax policy that may result in investment flows to Latin American countries.

In order to analyze and provide recommendations to the trade and tax policy of Chile and Colombia, a general overview of the instruments for international trade is provided in Section 2 and for international taxation in Section 3. The main features of international trade and international taxation of the two countries of study are described, to wit: Chile in Section 4 and Colombia in Section 5. The relationship between trade and taxation up till the time of writing is analyzed in Section 6. More specifically, the influence of trade provisions such as most favoured nation clause and export subsidies in direct taxation is addressed. Finally, the suggested approach of this paper, that is, the importance of the development of an international tax policy in the context of integration and trade is analyzed in Section 7. It is worth to point out that this paper is a theoretical comparison of the tax and trade policy of Chile and Colombia. The approach in this paper is from a tax law perspective and more specifically deals with direct taxation (leaving outside value added tax issues). Hence, economic studies on whether bilateral tax treaties promote investment will not be dealt with in this paper.⁷

⁶ Coordination of taxes in economic unions/common markets: Seminar C. International Fiscal Association. 59 Annual Congress. Buenos Aires, Argentina.

⁷ B. Bloningen and R. Davies in “The Effects of Bilateral Tax Treaties on U.S. FDI Activity”, 2000 available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=445980 (the Social Science Research Network).

2. Instruments for international trade

2.1. Multilateral level: World Trade Organization

WTO (former GATT) is the international organization regulating international trade. WTO members are committed to the multilateral trade agreements listed in the annexes 1 through 3 of the WTO.⁸ In general terms, WTO agreements apply to trade in goods and services based on three main principles, to wit: the most favoured nation clause, the national treatment and the rules for export subsidies. These principles are defined below.

- **Most favoured nation clause** (“MFN”) requires that all benefits or trade concessions to third countries must be extended to all Members of the agreement.
- **National treatment** requires imported products to be given the same treatment as the one applicable for the products manufactured domestically with regard to taxes and domestic regulations. Thus, the protection of domestic products is not allowed and foreign and domestic products should be treated similarly. With regard to imports, this principle provides that the import of goods produced by foreign companies established in the region is subject to the same treatment as goods produced by national or mixed enterprises.
- **Export subsidies** are regulated in the provisions of the Subsidies and Countervailing Measures Agreement (“SCM”). Under the provisions of the SCM agreement, a subsidy exists insofar as two requirements are met being (i) the existence of a financial contribution and (ii) the benefit granted through the subsidy.⁹

⁸ Mainly with regard to the new GATT, GATS, TRIPS Agreement, Subsidies Code and Anti-Dumping Code, Customs Valuation Code, Agreement on Textiles and Clothing, Application of Sanitary and Phytosanitary Measures, Safeguards, Import Licensing Procedures, Technical Barriers to Trade, Pre-Shipment Inspection, Rules of Origin and the Dispute Settlement Understanding.

⁹ The SCM Agreement states: A subsidy shall be deemed to exist if:

- a)
- There is a **financial contribution** by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e. where:
 - (i) a government practice involves a direct transfer of funds (e.g. grants, loans and equity infusion), potential direct transfer of funds or liabilities (e.g. loan guarantees);
 - (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
 - (iii) a government provides goods or services other than general infrastructure or purchases goods, and
 - (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;
 - There is any form of income or price support in the sense of Art XVI of GATT 1994; AND
- b) A **benefit** is thereby conferred

2.2. Bilateral and regional level

The bilateral and regional trade agreements are regarded as trade agreements authorized under the MFN exception. These agreements are allowed under the GATT insofar as the two requirements as stated in Art XXIV GATT are met.¹⁰ The Committee on Regional Trade Agreements, established by the WTO to examine each agreement tries to reconcile the rules of the specific regional agreement with those governing multilateral trade agreements.¹¹ The following examples illustrate the type of regional and bilateral trade agreements that have been concluded up till the time of writing, to wit:

Regional trade agreements

Agreements on trade at regional level are for instance the European Union, European Free Trade Association (EFTA), Andean Community (CAN), South American Market (MERCOSUR), North American Free Trade Agreement (NAFTA), the Association of Southeast Asian Nations (ASEAN), and the Common Market of Easter and Southern Africa (COMESA).

Bilateral trade agreements

The feature of bilateral of trade agreements results in different provisions negotiated between the countries. This change of provisions can be illustrated in the trade agreements being concluded by the United States and the European Union described below

Several trade agreements have been concluded by the United States since the introduction of the Trade Act of 2002.¹²

- In 2003 (Singapore and Chile);

¹⁰ These requirements are: (i) the agreement must lower trade barriers within the regional groups and (ii) the agreement cannot raise trade barriers for non-participating members.

¹¹ Most recently, on 10 July 2006, a new transparency mechanism for regional trade agreements ("RTA") was negotiated by members of the WTO. This mechanism provides for early announcement of any RTA and notification to the WTO. See information available at the website of the WTO: http://www.wto.org/english/news_e/news06_e/rt_a_july06_e.htm (Last visited July 2006).

¹² By means of the Free Trade Act of 2002, the Congress of the United States ("US") granted to the President a 'Trade Promotion Authority' to negotiate free trade agreements ("FTA"). Under this authority, the trade agreements concluded by the President are subject to up-or-down vote at the Congress. In other words, the Congress may accept or reject the FTA without any amendments. This authority has been and still is extensively used by the President. As a result, an unprecedented number of agreements have been concluded or are in the process of being concluded by the US with other countries. Public Law 107-210". R. Folsom. Chapter 21: Free Trade Agreements of the United States in International Business Transactions, 2 Ed, West Pub. Co. 2006.

- in 2004 (Morocco and Australia);
- in 2005 (Bahrain, Oman and Peru);
- in 2006 several trade agreements are being negotiated, to wit: United Arab Emirates, Thailand, Colombia, Panama and Ecuador.

The change of provisions in the trade agreements concluded by the United States is illustrated by Scott. This author rightly argues that one trade agreement differs from another one in accordance to the objectives of the parties when concluding these agreements.¹³ For Scott, if one example may illustrate this different approach is the Chile-US agreement. This agreement is regarded as comprehensive whereas other agreements may “simply reduce or eliminate tariffs, subject to extensive sectors or product exceptions; such pacts are the rule among developing countries. Some are notable for the volume of trade eligible for preferences; others apply to very little trade. Their trade impacts and implications for the world trading system vary accordingly”.¹⁴

At European Union level, several trade agreements with a different framework have been concluded described as follows:

- Association agreement with Chile;
- Economic Partnership agreement with Mexico (under revision); in negotiation: European Union and Mercosur¹⁵;
- Cooperation agreement with Mediterranean countries.

The contents of the agreements differ among countries. In this regard, Szepesi rightly argues that the two trade agreements concluded by the European Union with Mexico and Chile cover different issues such as market access to and national treatment for investors in foreign services sector.¹⁶ These benefits are not available in the trade agreements concluded by the European Union with Mediterranean countries (Algeria, Egypt, Israel, Jordan, Lebanon, etc). The main reason for these differences is

¹³ For a description of the contents of the FTAs see Free Trade Agreements: US Strategies and Priorities, J.S. Scott (ed.), International Institute of Economics, April 2004. In addition, R. Folsom. Chapter 21: Free Trade Agreements of the United States in International Business Transactions, 2 Ed, West Pub. Co. 2006

¹⁴ Chapter 1: Overview in Free Trade Agreements: US Strategies and Priorities, J.S. Scott (ed.), International Institute of Economics, April 2004, at 7.

¹⁵ Information available at the website of the European Commission in trade issues: See information available at http://ec.europa.eu/trade/index_en.htm (Last visited September 2006).

¹⁶ Szepesi, S. 2004. Comparing EU free trade agreements : Investment. (ECDPM InBrief 6D). Maastricht : ECDPM. Electronic version available at <http://www.eldis.org/static/DOC15643.htm> (Last visited September 2006).

according to Szepesi that the emphasis of these agreements is on coordination and cooperation rather than to promote investment.¹⁷

Summarizing, international trade is currently dealt with agreements of a multilateral, regional or bilateral level. Moreover, differences are found among the countries in the contents of the agreements that regulate more extensively, and/or favourable trade issues. In order to analyze the relationship between taxation and trade, a general overview of the type of instruments in international taxation is provided below.

3. Instruments for international direct taxation

In international taxation different types of instruments may be used with a bilateral or multilateral character¹⁸ with the aim to prevent amongst others international juridical double taxation¹⁹ and tax evasion. Accordingly, by means of bilateral instruments such as tax conventions, both states give up their taxation rights on a reciprocal basis. In this context, several bilateral tax conventions models exist among them the following:

- The model of the Organization for Economic Cooperation and Development (“OECD”) that applies to OECD members mostly developed countries (“OECD Model”);
- Models developed by countries such as the United States Model (versions 1977, 1981 and 1996) and the Dutch Standard Treaty (1987);
- The model for developing countries of the United Nations versions of 1980 and 2001.²⁰

The focus of this paper is on the OECD Model that is in general terms used worldwide including by developing countries.²¹ Accordingly, the 1963 first OECD Model has been subject of amendments in 1977 and 1992 and since that time this OECD Model has become a loose leaf (ambulatory) version with changes introduced

¹⁷ Ibid.

¹⁸ In addition, unilateral tax rules may also influence double taxation. For instance in the Netherlands, in cases where no double tax treaty has been concluded or where a tax treaty does not include a specific provision (to be applicable to the tax, taxpayer, income, property, estate or gift) the unilateral rules laid down in the Decree on the Avoidance of Double Taxation (*Bvdb*) are applicable.

¹⁹ Defined as “the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods”. OECD Commentary:Introduction, para. 1.

²⁰ One of the differences between the OECD Model and the UN Model that influences leasing is that the “the UN Model Treaty imposes fewer restrictions on the tax jurisdiction of the source country. For example, the UN Model Treaty does not contain specific limitations on the withholding tax rates on dividends, interest, and royalties imposed by the source country; instead, the withholding rate levels are left to bilateral negotiations of the Contracting States”. B.J.Arnold and M. J. McIntyre, *International Tax Primer*, Kluwer Law International, 1995, at 99.

²¹ One exception is the multilateral agreement for the Andean Community introduced through the Decision 40 of 1971. This agreement contains two Annexes being (i) a double taxation convention (“DTC”) model to be applied within the Andean Community and (ii) a DTC model applicable to treaties concluded with third parties. Both models follow the UN Model Convention granting to the country of source almost entirely the right to taxation.

in 1995, 1997, 2000 and 2003.²² The OECD Model is not only the provisions but also the OECD commentary that intend to “illustrate or interpret” the OECD Model provisions.²³

The first aim of this paper is to examine the policy on trade and taxation of Chile and Colombia. This issue is dealt with in the following Sections, that is, for Chile Section 4 and for Colombia Section 5.

4. Chile

4.1. Background

Chile has a small economy that is highly dependant on foreign trade. Chile has carried out several steps in order to stimulate its economy and to promote domestic and foreign investment.²⁴ At domestic level, for instance by means of greater competitiveness, lower tariffs, increasing levels of foreign trade, and introduction of unilateral favourable Laws to promote investment (e.g. Foreign Investment Statute, Legislation for mining projects, tax incentives for investments, etc.).²⁵

At international, Chile has promoted extensively foreign investment by means of multilateral, bilateral and unilateral measures in the last decade. Examples of these measures are the following:

- membership of Chile to international organizations for trade (WTO);
- active participation in multilateral and regional forums of competition, trade and taxation;
- consistent open policy²⁶ on a reciprocal basis by means of trade agreements and bilateral tax treaties;

²² For an overview of the historical development of the OECD see I.J.J. Burgers, *Wegwijs in het internationale belastingrecht*. Burgers, I.J.J. (editor). Koninklijke Vermande. Second edition. The Hague. 2005. Third Edition, at 30.

²³ OECD Commentary: Introduction, para. 28.

²⁴ See for instance the introduction to why to negotiate FTA and bilateral tax treatments in the website of the Tax Administration of Chile. In the introduction, Chile is regarded as a small country (15 million inhabitants) with a small market. In order to achieve economic growth, trade needs to be strengthened for goods, services and investment. Given that double taxation is outside the trade issues dealt with by Chile, the government considers of importance to conclude bilateral tax treaties. The main aim is to promote investment flows to Chile by means of given certainty to the investors of the tax conditions of its investment in Chile. See information available in Spanish at <http://www.sii.cl/tlc/tlc.htm> (Last visited 2006).

²⁵ Information available at the website of Chile Foreign Investment Committee at www.foreigninvestment.cl (Last visited September 2006).

²⁶ In respect of trade this consistency has been reflected in the trade policy review of 2003 states in this regard that: “Chile has tried to maintain a certain coherence in its negotiations, which means that each

- unilateral measures to promote foreign investment and to guarantee stability to the foreign investor.

Due to all of the above, Chile is nowadays a strong economy with investment flows from its main trade partners: the European Union and the United States. For these reasons, Chile is regarded in this paper as an example of a successful approach towards liberalization providing an open and consistent trade and international tax policy. A detailed overview of the instruments for international trade and taxation in Chile is provided in the following Sections 4.2. and 4.3.

4.2. Instruments for international trade

4.2.1. Multilateral level: World Trade Organization

Chile is a founding member of former GATT. Since 1 January 1995, Chile is an active member of WTO. In the framework of its WTO commitments Chile applies the multilateral trade agreements listed in the annexes 1 through 3 of the WTO.²⁷ No review by the judiciary upon compatibility with the Constitution exists in Chile. Therefore, upon ratification by the Congress, WTO agreements receive the status of domestic (ordinary) law. These laws can be invoked before national courts.

The trade policy of Chile has been reviewed twice by the WTO in 1997 and 2003.²⁸ These reviews stated that Chile stimulates domestic and foreign investment with trade policies that are in accordance to the WTO principles and agreements. More specifically, the 2003 trade policy review of Chile stated that Chile has participated actively in the multilateral trading system and with a trade policy that follows WTO guidelines. It has been involved in cases under the WTO dispute settlement system but only few disputes have reached WTO panels.²⁹

new agreement negotiated must be consistent with those that already exist". In respect of taxation, Chile follows the OECD Model that results in a coherent approach towards negotiating bilateral tax treaties. Trade Policy Review: Chile. Press/TPRB/224. 4 December 2003.

²⁷ Mainly with regard to the new GATT, GATS, TRIPS Agreement, Subsidies Code and Anti-Dumping Code, Customs Valuation Code, Agreement on Textiles and Clothing, Application of Sanitary and Phytosanitary Measures, Safeguards, Import Licensing Procedures, Technical Barriers to Trade, Pre-Shipment Inspection, Rules of Origin and the Dispute Settlement Understanding.

²⁸ In 2003: WT/TPR/D/102 and in 1997 WT/TPR/D/13. See information available at the website of the World Trade Organization: Trade Policy Reviews http://www.wto.org/english/tratop_e/tpr_e/tpr_e.htm (Last visited September 2006).

²⁹ See the website of the WTO for further information on Chile's WTO policy at http://www.wto.org/english/thewto_e/countries_e/chile_e.htm (Last visited September 2006).

The main conclusion of Chile's trade policy is provided in the text of 2003 trade policy review stating as follows:

*“Chile opted for an outward orientation as a key tool for achieving sustainable economic recovery, both through its unilateral policy of openness and through trade negotiations at various levels. The choice was a successful one, which helped Chile to maintain its levels of stability and to continue along the path to growth”.*³⁰

This participation of Chile in a multilateral level is complemented by the development of trade policies at bilateral level. More recently by means of Decision 645 of 2006 (20 September), Chile received the status of associate member to the Andean Pact. Notwithstanding the participation of Chile in the Andean Pact (“CAN”), the effects of this status are not yet foreseen.³¹ Therefore, the following description will focus only on agreements concluded at bilateral level.

4.2.2. Bilateral level

In addition to the active participation at WTO level, Chile has also participated actively in trade negotiations with other countries. The agreements concluded are free trade agreements, preferential trade agreements, bilateral investment treaties, and agreements for cooperation and/or association. An overview of these agreements³² is provided herein below.

- Free trade agreements with Canada, Central America, the European Free Trade Association, Mexico, South Korea and the United States;
- Association agreements with the European Union and Transpacific Strategic Economic Partnership (P4 New Zealand, Singapore, Brunei Darussalam and Chile);
- Complementary agreements with Argentina, Bolivia, Colombia, Ecuador, MERCOSUR, Peru, Venezuela;
- Investment promotion and protection agreements: Germany, Austria, Belgium, Croatia, Denmark, Spain, Finland, France, Greece, Italy, Norway, Poland, Portugal, United Kingdom and Northern Ireland, Czech Republic, Romania, Sweden, Switzerland, Ukraine, Australia, China, South Korea, Malaysia, Philippines, Argentina, Bolivia, Costa Rica, Cuba, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Paraguay,

³⁰ Trade Policy Review: Chile. Press/TPRB/224. 4 December 2003.

³¹ A commission will be set up within the next 180 days to evaluate the effects and participation of Chile in the Andean Pact.

³² Source General Direction for International Economic Affairs (DIRECON) at www.direcon.cl and Foreign Trade Information System SICE www.sice.org (Last visited September 2006).

Peru, Uruguay and Venezuela. All of these agreements but Germany (1977) have been signed between 1990 and 2006.

Another feature of trade in Chile is that the Free Trade Agreement with the United States and the Association Agreement with the European Union are examples of agreements with a comprehensive and satisfactory measure that benefit Chile. The focus of these agreements is on market access and on institutional matters that contribute to transparency and better conditions of competition that will benefit Chile and its trade with other countries. If one example may illustrate this are the contents of the Association Agreement with the European Union. This Agreement provides for an economic, financial and technical cooperation in issues such as industrial cooperation, cooperation on small and medium-sized enterprises, cooperation on services, promoting investment, cooperation on energy, customs cooperation, consumer protection, etc.³³

Finally, the active participation of Chile is due to the interest of achieving more rapidly substantial results with its main partners in Latin-America, North America, Central America and Europe. Recently, Chile is also focusing on Asian Markets (e.g. Malaysia, Philippines, and South Korea) and in the Pacific Trade (P4 New Zealand, Singapore, and Brunei Darussalam). The result is Chile having links with all trade markets that result in more investment with Chile as a link between Latin-American markets and other markets around the world.

4.2.3. Unilateral instruments

One of the features of the process of trade openness in Chile is the importance given by law-makers to unilateral measures to promote foreign investment. For this purpose, several statutory provisions³⁴ have been introduced such as the foreign regulations of the Central Bank³⁵ and the Foreign Investment Statute. Given the focus of this paper on promotion of investment only the favourable rules of the Statute will be described below.

³³ The text of the Association Agreement is available at the website of the European Union in trade issues at http://ec.europa.eu/trade/index_en.htm (Last visited September 2006).

³⁴ Other Laws of importance for investment are the Investment Platform Law (Law 19.840 of 23 November 2003), Law for mining projects (Law 20.026 of June 16 2005). See information available at the website of the Foreign Investment Committee at www.foreigninvestment.cl (Last visited September 2006).

³⁵ Chapter XIV of the Central Bank's Compendium of Foreign Exchange Regulations at www.bcentral.cl/eng/norms/ (Last visited September 2006).

The Foreign Investment Statute (“Statute”) was introduced by means of Decree Law 600 of 1974, amended on 16 December 1993. This Statute is a special voluntary investment regime and therefore, foreign investors have the choice between the foreign regulations of the Central Bank and the provisions of the Statute. This Statute provides national treatment to investors without discrimination in all sectors upon approval by the Foreign Investment Committee. The result is the foreign investor being subject to domestic rules on investment (art. 9). Under the terms of this Statute, foreign investors conclude a contract (*contrato de inversión*) with Chile, which authorizes and protects the transfer of capital for the investment. This contract is indefinite in duration and can be modified with the consent of both parties.³⁶ Finally, another important feature of this Statute is the choice for foreign investors to opt for a system of invariable direct taxation (art. 7). This system consists of the application of the provisions for direct taxation at the time the contract is concluded. Once the choice is made, the foreign investor may only once, waive it, so domestic tax laws at the time of application of the contract will be made applicable. The invariable system of taxation is applicable for a maximum period of ten years.

4.3. Instruments for international direct taxation

Initially, Chile signed international tax agreements in respect of direct tax issues in air and maritime transportation³⁷ as follows:

- Air transportation: Germany, the United States, France, Panama, Paraguay and Uruguay;
- Maritime transportation: Singapore;
- Air and maritime transportation: Colombia and Venezuela.

These agreements were mostly concluded in 1978 (Germany, Colombia, France) and in 1990’s (the United States, Paraguay, Singapore, Uruguay, Venezuela) and in 2001 (Panama). Thus, one may argue that given the dates, these agreements were initially receiving the attention of the tax administration and the Chilean government and only in a later stage the bilateral tax treaties received such attention.

³⁶ In order to enforce this contract, specific provisions have been introduced. For instance, the FTA between Chile and the United States in the Annex (10F) that: “ if Chile has breached the tax provisions of the contract concluded under the Foreign Investment Statute, the investor may, only have recourse to the dispute settlement provisions of the investment contract of the dispute settlement provisions of this FTA relevant to taxation measures”.

Agreement available at the website of the Foreign Investment Committee and at the Website of the US Trade: http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html (Last visited September 2006).

³⁷ See the website of the Tax Administration in Chile available in Spanish at <http://www.sii.cl/tlc/tlc.htm> (Last visited 2006).

Chile has started an active process in international taxation by means of negotiating bilateral tax treaties³⁸. In Chile, all bilateral tax treaties but Argentina (1986) have been concluded since the end of 1990's. The status and number of bilateral tax treaties at the time of writing are described as follows³⁹:

- In force: Argentina, Canada, Brazil, Norway, South Korea, Ecuador, Peru, Spain, Poland;
- Subscribed; Denmark, Croatia, United Kingdom, New Zealand, Sweden, France;
- Negotiation concluded: Malaysia and Russia;
- In negotiation: Finland, Cuba, Hungary, the Netherlands, Paraguay, Switzerland, United States, Venezuela, Italy, Czech Republic, China and Ireland.

The change of approach towards an active role in bilateral tax treaties have been discussed by Morales. This author states that until the later 1990's, Chile was a country with capital import neutrality stating that "for Chileans, double taxation almost did not exist. It was a problem only for foreign companies doing business in Chile, and it was solved in their home countries by obtaining relief for the taxes paid abroad".⁴⁰ Later on, this approach changed towards capital export neutrality that results in almost all tax treaties following the credit relief mechanism to avoid double taxation. The only treaty based on the Andean Pact with a source based and capital import neutrality approach is the treaty with Argentina concluded in 1986. In general terms, the other tax treaties are based on the OECD Model even though at the time of writing Chile is not a member of the OECD.⁴¹ Finally, one may argue that the openness of economy in trade stimulates the openness in taxation that favours consistent rules in respect of topics of interest for foreign investors. Examples are for instance the approach towards clarifying permanent establishment and business profits issues and specific rates of withholding in passive income (i.e. interest, royalties and dividends). All of these provisions resulted in more certainty and

³⁸ In this regard, Morales rightly describes the expansion of bilateral tax treaties stating that: "Chile began enlarging its income tax treaty network in the 1990s. To prepare the country for the new policy, internal tax laws were modified in 1993 to provide double taxation relief, while special relief provisions for treaty situations (following the tax credit mechanism) were introduced in 1997. The same tax reform introduced transfer pricing legislation. In the late 1990s, Chile entered into three double taxation conventions (DTCs), and in 2000, the Chilean treaty network began its real expansion. O. Morales. *International Tax Policy in Chile*. *Journal of International Taxation*, Issue 24, March 2004.

³⁹ Information available at the website of the Foreign Investment Committee and at the website of the (Last visited September 2006).

⁴⁰ O. Morales. *International Tax Policy in Chile*. *Journal of International Taxation*, Issue 24, March 2004.

⁴¹ For an analysis of the double tax treaties concluded by Chile see O. Morales. *International Tax Policy in Chile*. *Journal of International Taxation*, Issue 24, March 2004.

stability to foreign investors in Chile. The analysis of the provisions of the bilateral tax treaties is outside the scope of this paper.⁴²

5. Colombia

5.1. Background

In 1990, Colombia started a process of liberalization through which the traditional scheme of “production towards domestic necessities” was left behind. In consequence, reforms in the tax, financial, foreign trade and constitutional systems took place.⁴³ These reforms aimed at removing obstacles for investment and reinforcing the capital market influencing the domestic and international tax policy in Colombia. In addition, taxation is influenced by the regional agreements of which Colombia is member, taking into account the Latin American process of integration. According to Art 227 of the Constitution, Colombia can become a member of international organizations that are empowered to introduce mandatory provisions for the country members.

5.2. Instruments for international trade

5.2.1. Multilateral level: World Trade Organization

Colombia joined the GATT through Law of 1981 and the WTO through Law of 1994 (Law 170). In accordance with the requirement stated in Art 241 (10) of the 1991 Constitution, the Law of 1994 required review by the Constitutional Court with regard to the ratification procedure of an international agreement and the test of the Law as to its compatibility with the Constitution. Following this review, approval by the Constitutional Court was given on 28 March 1995.⁴⁴ Colombia placed its instrument of ratification on March 31 becoming a member as of 30 April 1995.

Through the Law of 1994 Colombia became a Party to all of the agreements that are listed in the former annexes 1 through 3.⁴⁵ The WTO Agreements have the status of

⁴² See for a description of the tax treaties concluded by Chile and other Latin American countries. N. del Castillo, J. Gross, et al. Taking advantage of tax treaties in Latin America. *International Tax Review*. Vol 14 (2003), no. 3. London, at 28-32.

⁴³ For instance, the introduction of a Constitutional Chart, the draft of new principles in order to promote exports and imports and the creation of new institutions in financial and foreign trade sector.

⁴⁴ Judgment of the Constitutional Court C-137 of 1995.

⁴⁵ Mainly with regard to the new GATT, GATS, TRIPS Agreement, Subsidies Code and Anti-Dumping Code, Customs Valuation Code, Agreement on Textiles and Clothing, Application of Sanitary and

an international treaty. In Colombia, the WTO Agreements as international treaties have to be integrated into domestic law by means of legislative provisions (“Laws”). In this regard, Art 224 of the Constitution states that for the validity of the international treaty, approval of the implementing Law by the Congress is required. Nevertheless, the same Art 224 states that given the economic character of these agreements, the President is empowered to give temporary effect to economic and commercial treaties before approval by the Congress is granted.

Finally, since the accession to the GATT in 1981, Colombia has been object of two claims from Thailand and Panama. These two claims have been recently initiated, that is, 2006. Prior, Colombia’s participation in Dispute Settlement Proceedings has been limited to its role as a third party in 1992 and 1993 regarding controversies concerning the EU banana import regime. In 1992, Colombia participated as a third party in the panel brought against the United States regarding restrictions on tuna imports.⁴⁶ In 1993 it was one of the claimants in a procedure against the United States for measures which affected the import of tobacco.

5.2.2. Regional trade agreements

At the time of writing, Colombia is member of several regional agreements. The main agreements affecting trade and taxation are summarized in the table below.⁴⁷ Moreover, a short description of the most favoured nation clause, national treatment and the provisions on international taxation are provided for each regional agreement.

- Latin American Association Integration (“ALADI”) created in 1980 (Montevideo Treaty) members of which are Argentina, Bolivia, Brazil, Colombia, Chile, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. The main objective is the reduction of

Phytosanitary Measures, Safeguards, Import Licensing Procedures, Technical Barriers to Trade, Pre-shipment Inspection, Rules of Origin and the Dispute Settlement Understanding.

⁴⁶ Colombia: Trade Policy Review 1996. Government Report available at www.wto.org. (February 2004).

⁴⁷ Although not specifically a regional agreement, the US Andean Trade Preference Act (ATPA) is worth mentioning. This unilateral trade programme implemented by the US aims to “encourage economic development in the beneficiary countries being Colombia, Bolivia, Ecuador and Peru. Its purpose is to expand access to the US market for a number of products from the region and by providing an incentive to private foreign investment in the form of an exemption from custom duties to help diversify Andean exports”. Source Colombian Government Trade Bureau (COLTRADE). Electronic version available at www.coltrade.org. (January 2004).

intra-regional trade barriers and other non-trade measures with the aim to achieve a common market.

With regard to the national treatment, Art 46 of the Montevideo Treaty contains such clause applicable to taxes, contributions and other internal taxes.

- Andean Community (“CAN”): A multilateral agreement with Andean Community countries (Colombia, Bolivia, Ecuador and Peru) is currently in force. The purpose of this agreement is the economic and social integration towards a Common Market.⁴⁸ As a result, more attention has been directed towards double taxation and tax harmonization mainly with regard to indirect taxes. Following the WTO provisions, in the Constitutive Treaty⁴⁹ reference has been made to the most favoured nation clause (Art 139).

In matters of international taxation, a multilateral agreement was introduced through the Decision 40 of 1971. This agreement contains two Annexes being (i) a double taxation convention (“DTC”) model to be applied within the Andean Community and (ii) a DTC model applicable to treaties concluded with third parties. Both DTC models differ from the OECD/UN Model Convention granting to the country of source almost entirely the right to taxation. Most recently, Annex 1 of this Decision 40 has been amended through Decision 578 of 2004 (May 4).⁵⁰ Furthermore, through Decision 292 of 1991 a special tax regime has been introduced for multinational enterprises with domicile in the Andean Community (Art 1).

- MERCOSUR⁵¹-CAN Agreement in effect as of 1 July 2004. It aims to create a free-trade area through the reduction of trade tariffs and non-trade tariffs insofar as they affect trade. Art 13 of the Agreement states the reference to national treatment rules of Art III GATT and Art 46 of the Montevideo Treaty (“ALADI”). Moreover, with regard to double taxation it refers in Art 31 to the possibility to conclude new DTCs.
- Group of Three (“G-3”) which members are Colombia, Mexico and Venezuela. The main aim is to create a free-trade area with the removal of trade barriers in matters of intellectual property, taxation, investment and trade. Art 3-03 states the reference to national treatment rules of Art III GATT and its incorporation in the Treaty. Moreover, in matters of taxation, Art 3-04 contains the removal of taxes upon importation among other measures.

⁴⁸ Stated by the Andean Council of 27 May 1999.

⁴⁹ Decision 563 of 2003 that replaced Decision 406 of 1997 (25 June).

⁵⁰ This Decision will enter into force as of the first day of the next tax year following the year of publication (Official Gazette 1063 of 2004). In Colombia, the tax year, for instance, goes from January to December, thus, the date of entry into force will be 1 January 2005.

⁵¹ Argentina, Brasil, Paraguay, and Uruguay.

5.2.3. Bilateral trade agreements

At bilateral level, Colombia is currently active on negotiating and concluding trade agreements. These agreements have a different scope being economic complementation, political and cooperation agreement, free trade agreement, and partial scope agreements. The description of the agreements concluded by Colombia on a single basis or as a member of a regional organization (e.g. Andean Pact) is provided below⁵²:

- Economic complementation agreement with Chile, Cuba, Nicaragua, Mexico and Venezuela. As member of the Andean Pact (CAN) with Argentina, Brazil and Mercosur;
- Partial scope agreements with Costa Rica, El Salvador, Guatemala, Honduras, Panama;
- Preferential agreements with CARICOM;
- Free Trade Agreement with the United States: Negotiation concluded;
- Political Dialogue and Cooperation Agreement: Andean Community and European Union;
- Bilateral investment treaties with Chile and Peru.

5.2.4. Unilateral instruments

As in Chile, Colombia has also introduced an invariability clause in the investment contracts. This clause was introduced in the Law of Stability for foreign investors enacted on 2003 (Law 963). However, by contrast to Chile, this is not a Statute to regulate all foreign investment. The scope of this Law is to regulate investment contracts to be concluded with the foreign investor and Colombia to promote investment. The invariability clause in an investment contract results in the tax provisions in force at the time that the contract is concluded to be applicable to the foreign investor. The Constitutional Court held in Decision of April 2006⁵³ that the invariability clause is incompatible with the Constitution.⁵⁴ The Court also held that the investors have the judiciary proceedings if they want to claim compensation for changes in the tax provisions upon which the investment contract was subject to.

In this context, one may argue that regardless of the good intentions of the Colombian government and the Legislative to promote investment and to provide clear and stable rules to the investors, the Constitutional Court did not see appropriate for the Colombian government to guarantee to the investors that future

⁵² Information available at the Ministry of Commerce at www.mincomercio.gov.co (Spanish) and at the Foreign Trade Information System SICE www.sice.org (Last visited September 2006).

⁵³ Constitutional Court Judgment C-320 of 24 April 2006.

⁵⁴ This review of Laws takes place against compatibility with the Constitution by the Constitutional Court in accordance to art. 241(7) Constitution.

changes in tax provisions will not be applicable. The traditional approach of the Constitutional Court was also illustrated in Decision of 2005 that declared incompatible with the Constitution a provision regulating low or tax haven jurisdictions introduced by means of Law 788 of 2002. This Law introduced the transfer pricing regulations in Colombia. Accordingly, entities carrying out transactions affecting transfer pricing in low-tax or tax haven jurisdictions are deemed to have carried out their transaction regardless of the arm's length principles⁵⁵. In order to define these jurisdictions reference was made by the Legislative in the Law 788 of 2002 to the areas considered as such by the OECD. The Constitutional Court held the incompatibility given that Colombia is not a member of the OECD and therefore its provisions cannot be applicable in Colombia⁵⁶. The main conclusion is the traditional approach and the empowerment of the Constitutional Court to review of constitutionality of Legislative provisions. Therefore the risk may exist for foreign investors to have Legislative provisions that may be only valid for one year or less until the Constitutional Court declares them unconstitutional.

5.3. Instruments for international direct taxation

At the time of writing, Colombia follows the capital import neutrality. In addition, the territoriality principle provides for a source based approach, that is, income is taxed where it is earned. In addition until recently (2005) Colombia was reluctant to conclude or negotiate bilateral tax treaties. Various reasons might be given for this situation, among them the lack of certainty with regard to the cost versus benefit for the existence of tax treaties and the importance to collect revenue for instance through the 2002 and 2003 tax reforms.⁵⁷ At the time of writing, Colombia has only concluded a bilateral tax treaty with Spain.⁵⁸ This treaty was recently ratified (July

⁵⁵ For the explanation of the provisions for Transfer Pricing see I.J. Mosquera Valderrama. *International: What the Colombian Tax Reform Means*. International Tax Review. September 2003.

⁵⁶ Constitutional Court Judgment c-690 of 12 August 2003.

⁵⁷ In this regard Jaime Vargas Cifuentes has argued that: "Colombian companies, Colombian national residents and foreign individuals that have lived in Colombia for four complete years are subject to Colombian income tax on their worldwide income. Foreign companies with no presence in Colombia, branches of foreign companies and foreign individuals that have not remained in Colombia for more than four years are taxed only on their Colombian-source income. As a general rule inside Colombia, or from the transfer of any kind of assets that are located inside the country at the time the transfer takes place, or from the exploitation of assets located inside the country. Perhaps due to the fact that at least until very recently Colombia was not a capital exporter it does not have a sophisticated foreign tax credit mechanism or a significant double taxation treaty network". National reporter: Vargas Cifuentes, Jaime A. *Trends in company/shareholder taxation : single or double taxation? Cahiers de droit fiscal international*. International Fiscal Association (IFA) Volume LXXXVIIIa; Kluwer, 2003, at 293.

⁵⁸ This international treaty was ratified by means of the Law 1082 of 31 July 2006.

2006) and the review of constitutionality will be soon carried out by the Constitutional Court. In addition, the Decision 40 of 1971, Decision 578 of 2004 and Decision 292 of 1991 of the Andean Community are applicable in matters of double taxation. This Decision provides for a source based approach based on the territoriality principle.

Finally, in order to avoid double taxation Colombia with regard to air and maritime transportation has signed some international tax agreements. For instance, Venezuela and Colombia have signed a bilateral agreement regarding taxation of state investment and the taxation of international transportation companies. Bilateral agreements on air and/or maritime transportation have also been signed as follows:

- Between 1970-1980: Argentina), Chile, Germany, the United States and Venezuela;
- Between 1981-1990: France;
- Since 1990: Brazil.

6. Relationship between international trade and taxation

The following paragraph deal with the relationship between trade and taxation addressed in the past. The description of the way that export subsidies and the MFN clause influence taxation is provided in this Section.

6.1. Influence of the World Trade Organization in taxation

This section focuses on the influence of trade agreements in taxation for instance by means of the rules for export subsidies and the application of the MFN clause.⁵⁹ In this context, the WTO last decade dispute in US export subsidies triggered the attention towards the influence of international trade in taxation. More recently, some countries have introduced the MFN clause in their bilateral tax treaties.⁶⁰ These two issues and its influence in taxation are addressed in the following paragraphs.

⁵⁹ The description of WTO and taxation was initiated by the Colombian National Report prepared for the 2004 Annual EU High Scientific Committee Conference, entitled “the WTO and Direct Taxation”, in Rust, Austria, July 2004. This author as the Colombian reporter is indebted to the Vienna University of Economics and Business Administration and the European Commission, High-Level Scientific Conferences for their support. See for further opinions of this author in this regard, the Colombian report for WTO and Direct Taxation. I.J. Mosquera, Valderrama Colombia in WTO and Direct Taxation. Lang, M. et al (eds). Linde Verlag Austria and Kluwer Law International, 2005.

⁶⁰ The influence of national treatment in taxation in the United States has been analyzed by Brauner. See Y. Brauner. “International Trade and Tax Agreements may be coordinated, but not reconciled”. Virginia Tax Review, Issue 25, Summer 2005, at 273.

Export subsidies

The WTO has been actively involved in taxation through the application of the definition of subsidy contained in the Subsidy and Countervailing Measure (“SCM”) Agreement. In this context, one example is the reports of the Panel and Appellate body concerning the tax treatment of Foreign Sales Corporations (“FSC”).⁶¹ A FSC is a corporation⁶² located for tax purposes and with presence outside the United States.⁶³ This FSC receives a United States tax exemption “on a portion of its earnings (foreign trade income), which means the gross income of a FSC attributable to “foreign trading gross receipts”. Foreign trading gross receipts mean the gross receipts of any FSC which are generated by qualifying transactions, which generally involve the sale or lease of “export property”.⁶⁴ The portion of the foreign trade income that benefits from this tax exemption is deemed “to be “foreign source income not effectively connected with a trade or business in the United States”. The remaining portion is taxable to the FSC.⁶⁵ In these reports it was said that the FSC regime was in violation of WTO rules and more specifically of the SCM Agreement.⁶⁶ As a result of the Panel and Appellate body concerning the tax treatment of Foreign Sales Corporations (“FSC”) and the judgment against United States the FSC regime was repealed. Later on, the American Jobs Creation Act of 2004 was enacted. This Act introduces new corporate tax incentives such as deduction for domestic manufacturing income (9% phased-in). Notwithstanding the change in law, the question with regard to the compatibility of the provisions of this Act with the WTO Agreements including the SCM Agreement still remains.

⁶¹ Report of the Panel WT/DS108/R.08, 8 October 1999; Report of the Appellate Body, WT/DS108/AB/R, 24. Feb 00; Report of the Panel, WT/DS108/RW, 20. Aug 01 and, Report of the Appellate Body, WT/DS108/AB/RW, 14. Jan 02.

⁶² A FSC is a corporation created, organised, and maintained in a qualified foreign country or US possession outside the customs territory of the United States under the specific requirements of Sections 921-927 of the US Internal Revenue Code. Report of the Panel WT/DS108/R.08 on *United States – Tax Treatment for “Foreign Sales Corporations* at 2.

⁶³ A FSC must meet certain requirements of foreign presence. For example, a FSC must maintain an office outside the customs territory of the United States. That office must be equipped to transact the FSC's business. Also, in order for a FSC, other than a small FSC, to be treated as having foreign trading gross receipts for the taxable year, the management of the corporation during the taxable year must take place outside the United States, and the corporation can have foreign trading gross receipts from any transaction only if economic processes with respect to the transaction take place outside the United States. *Ibid.*

⁶⁴ *Ibid.*

⁶⁵ Moreover, dividends paid by the FSC out of exempt and non-exempt income to the shareholder (ordinarily, the “related supplier”) generally qualify for a full dividends-received deduction. *Ibid.*

⁶⁶ In this regard, Paul McDaniel when analyzing the Panel Report dated 8 October 1999 (Report of the Panel WT/DS108/R.08.) stated that “given the ‘domestic content’ rules and the fact that the tax exemption is available only for export activities, the Panel’s decision was not surprising”. P. McDaniel, *The Impact of Trade Agreements on Tax Systems. Intertax*, Volume 30, Issue 5. Kluwer Law International 2002, at 168.

Given that differences in taxation may also influence or distort international trade, discussions regarding the harmonization of direct taxation mainly corporate income tax through the WTO Agreements have taken place. Nonetheless, attention should be drawn to the fact that the influence of the WTO Agreements and the decisions of the Panel and Appellate Body are restricted to direct taxation insofar as the measure is considered as a subsidy under the terms of the SCM Agreement.

In respect of the method used to prevent double taxation one may argue that any measure to avoid double taxation introduced by a country does not constitute a prohibited subsidy under the SCM Agreement. In this regard, a country has freedom to provide structure in its tax system in a way it considers appropriate following a specific international tax policy. The grant of an exemption, tax sparing, matching credit does not constitute a subsidy insofar as this method is applied without discrimination. In this case, it might be possible to imagine a situation where the exemption is only granted to certain types of companies creating a restriction without any justification.⁶⁷

Most favoured nation treatment

Bilateral tax treaties may include the Most Favoured Nation (MFN) clause.⁶⁸ By this means, the application of the favourable tax treaty can be extended to other tax treaty signed by the country of the taxpayer. In the United States, the description of the application of MFN has been addressed by Brauner.⁶⁹ This author provides one example of the MFN found in the US-Canada bilateral tax treaty.⁷⁰ This treaty includes a MFN-type provision under the non-discrimination article (art. 25).⁷¹

⁶⁷ See for further opinions of this author in this regard, the Colombian report for WTO and Direct Taxation. I.J Mosquera, Valderrama, Colombia in WTO and Direct Taxation. Lang, M. et al (eds). Vander Linden Austria, 2005.

⁶⁸ Members of the World Trade Organization are entitled to the rights stipulated in the MFN clause (ie all benefits or trade concessions to third countries must be extended to all members of the agreement). In general, the WTO mandates that each member grants MFN status to all other WTO members. However, it allows an exception for regional agreements (e.g. Andean Pact) that may extend different terms of trade to countries concluding these regional agreements.

⁶⁹ Y. Brauner. "International Trade and Tax Agreements may be coordinated, but not reconciled". Virginia Tax Review, Issue 25, Summer 2005, at 267.

⁷⁰ The text of the US-Canada bilateral tax treaty (in force since 16th August 1984) and the technical explanation is available at the website of the International Tax Dialogue at <http://www.itdweb.org/Pages/Search.aspx?lang=3&country1=188&country2=36> (Last visited July 2006)

⁷¹ "Citizens of a Contracting State, who are not residents of the other Contracting State, shall not be subjected in that other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which citizens of any third State in

Notwithstanding this provision, Brauner rightly argues that neither the text of the bilateral tax treaty nor the technical explanation includes explicitly the term MFN.

Another approach to MFN clause may be found in the bilateral tax treaties concluded by France but not in the US. In this context, some bilateral tax treaties (Estonia, Latvia, Mexico, India and Kazakhstan) concluded by France contain in the protocol to the article of royalties, a MFN-type provision. The provision states that if the party that concludes the tax treaty with France also concludes a double tax treaty with another country (OECD Member) where a reduced percentage, a restricted definition of royalties and/or scope of application, the percentage, or definition will be applicable automatically to the double tax treaty concluded by France. In other words, by means of the MFN type-provisions, the application of a percentage or definition introduced by France in the bilateral tax treaty with Latvia can be applied to another bilateral tax treaty concluded by France with for instance the Netherlands (OECD Member). The scope of application of MFN is limited to OECD countries. Finally, it is submitted that as in the US, France does neither use explicitly the term MFN in the text of the treaty nor in the protocol.⁷²

At a European level the MFN has been also dealt with by the European Court of Justice in respect of the case of 'D' vs. tax administration of the Netherlands in the light of the free movement of capital and non-discrimination. This decision has been issued in 2005.⁷³ The main issue was whether in the light of the non-discrimination and the MFN clause, the situation of "D" non-resident is compared to the situation of another non-resident who receives a special treatment under a DTC. In this case, the application of the benefits to non-Dutch tax residents under the DTC between Belgium and the Netherlands was claimed by a German (non-Dutch tax resident) in

the same circumstances (including State of residence) are or may be subjected". (Art. 25(2) US-Canada Tax Treaty).

⁷² For instance in the tax treaty concluded by France and India the following provision has been included :*"En ce qui concerne les articles 11, 12 et 13, si, en vertu d'une convention, d'un accord ou d'un avenant signés après le 1^{er} septembre 1989 entre l'Inde et un Etat tiers qui est membre de l'OCDE, l'Inde limite son droit d'imposer à la source les dividendes, les intérêts, les redevances, les rémunérations pour services techniques, ou les rémunérations pour l'usage d'un équipement, en convenant de taux d'imposition plus faibles ou de champs d'application plus restreints que ceux qui sont prévus par la présente Convention en ce qui concerne les mêmes éléments de revenus, les mêmes taux ou champs d'application prévus par cette Convention, accord ou avenant pour lesdits éléments de revenus s'appliqueront également dans le cadre de la présente Convention et prendront effet à la date d'entrée en vigueur de la Convention, accord ou avenant concernés conclus par l'Inde, ou à la date d'entrée en vigueur de la présente Convention si elle est plus tardive ».*

⁷³ Case C-376/2003 dated 5 July 2005. This discussion has been object of attention by legal scholarship see for example, O. Thoemmes, EC Tax Scene in Intertax vol. 33 issue 1. 2005, at. 44; M. Guilluy,; E. Centi and V. Marquis, MFN concept threatens tax treaty network. International Tax Review. Jul/Aug 2005. Vol 16, Issue 7.

respect of the application of the double tax treaty between Germany and the Netherlands. The European Court of Justice held that the provisions in a double tax treaty are not extended to other nationals of a Member State which is not party to that Convention.⁷⁴ In other words, the provisions of the double tax treaty between Belgium and the Netherlands are not applicable to other situations or persons than the ones that have signed the treaty. All these examples illustrate the current developments towards the use of MFN clause in taxation. One may expect that in the future other bilateral tax treaties include a MFN clause and that more cases by the European Court of Justice are decided in light of the EU freedoms and MFN.

Finally, it is submitted that the following issues introduce restrictions to the importance of the role of the WTO, to wit: the proliferation of Free Trade Agreements and the current failure of DOHA negotiations. Moreover, these two current features in trade result in less authority to the WTO to regulate trade. The authority of the WTO as an institutional vehicle to achieve coordination is also diminished. In this context, one may argue that in trade the main attention should be given to the regional and bilateral trade agreements in order to find out the solutions for integration and promotion of investment in the world-business economy.

6.2. Trade agreements including tax provisions

Trade agreements may influence international taxation. One interesting example is found in the MERCOSUR⁷⁵-CAN⁷⁶ trade agreement in effect as of 1 July 2004. The aim of this agreement is to create a free-trade area and for this purposes, the reduction of trade tariffs and non-trade tariffs is foreseen insofar as they affect trade. With regard to double taxation it refers in Art 31 of the Agreement to the possibility to conclude new bilateral tax treaties. Due to the recent withdrawal of Venezuela from the CAN and the current interest of the countries towards US FTAs it is submitted that no current developments are expected in the short term in this regard. Nonetheless, the MERCOSUR-CAN region consists of Latin American developing countries that lack of a consistent bilateral tax treaty policy with only few exceptions such as Brazil, Chile, and Argentina. Hence, it is submitted that the introduction of

⁷⁴ Case C-376/2003 dated 5 July 2005. Para. 63

⁷⁵ Argentina, Brasil, Paraguay and Uruguay.

⁷⁶ A multilateral agreement with Andean Community countries (Colombia, Bolivia, Ecuador, and Peru) is currently in force. The purpose of this agreement is the economic and social integration towards a Common Market. As a result, more attention has been directed towards double taxation and tax harmonization mainly with regard to indirect taxes. Following the WTO provisions, in the Constitutive Treaty reference has been made to the most favoured nation clause (Art 139).

Art. 31 is an important factor that stimulates countries to conclude bilateral tax treaties.

Another example is found for instance in article 21 (2) lid b of the Association Trade Agreement concluded by the European Union and Chile. This article states that cooperation in the promotion of investments includes also the introduction of bilateral tax treaties. The wording of this paragraph is the following “developing a legal framework for the Parties that favour investments by conclusion, where appropriate, of bilateral agreements between the Member States and Chile to promote and protect investment and avoid dual taxation”. In the wording of this article, the importance of both European Union and Chile to prevent double taxation is enlightened in the context of trade. In other words, the wording of this article shows that the developments of both international trade and international taxation are closely related.

7. Analysis and recommendations: international taxation in the context of integration and trade

This paper addresses the differences in the international tax policy of the institutions in the countries chosen, that is, Chile and Colombia and their influence in the processes of Latin American integration and trade.

In Chile, trade agreements are being concluded at the same pace than bilateral tax treaties. The government and law-makers understood the importance of not only trade measures but also tax measures. In addition, up to the best of the author’s knowledge, the intervention of the judiciary is limited given the lack of constitutionality review. In other words, agreements ratified by the Congress have the status of ordinary laws that can be invoked by the taxpayer or investor before the courts. The importance attached to trade is the result of the several types of agreements for cooperation, investment, free trade, etc. Likewise, taxation is also of importance and follows the OECD principles leaving behind for instance the principle of territoriality for the principle of world-wide taxation of income and following the OECD Model to conclude bilateral tax treaties. The evaluation of the trade policy and tax policy in the context of integration is positive and it is only the result of the efforts of Chilean law-makers and tax administration in the last decade.

In contrast, Colombia initiated the process of liberalization of its economy slowly and resulting more in changes in the financial (banking) system and the introduction of a new Constitution. Trade agreements have been just recently addressed by the Government. It is submitted that the main focus of the Government in the past two years has been the free trade agreement with the United States (not yet in force). In this context, one may argue that to attract foreign investors not only trade agreements are of importance but also bilateral tax treaties. The introduction in 2002 of transfer pricing rules and the bilateral tax treaty with Spain concluded in 2005 (ratified in 2006) can be regarded as steps towards the development of an international tax policy. Nonetheless, it is the author's opinion that Colombia is characterized by the strong influence of the Constitutional Court in tax policy, the insufficient knowledge of the tax administration to negotiate bilateral tax treaties, the lack of English websites in Colombia for investors, and the traditional approach of law-makers towards collection of revenue and social issues like the value added tax strongly discussed in the current tax reform proposal (2006). All of the above deviate the focus of Colombian law-makers, tax administration, legal scholars, etc to promote a more consistent tax policy that leaves behind the tax incentives and to promote actively long-term investment.

In conclusion, in the past, international organizations such as the World Bank⁷⁷ and the World Trade Organization⁷⁸ amongst others have referred to the importance for investors of doing business in a climate of stability, consistency, transparency and openness. It is the author's opinion that these goals need to be achieved not only by means of trade agreements to promote foreign investment but also by means of an international tax policy. The development of an international tax policy should promote long-term investments. In this regard, it is submitted that the main aim of taxation in the context of integration and trade should be to provide clear and stable rules for trade and for investment. The promotion of investment should not be only the result of exemptions for source-based income for instance in Free Trade Zones, or by means of another tax incentives (percentage of tax deduction, tax allowances, etc). The approach to taxation for investors has been followed differently in Latin American countries and more specifically in the countries studied Colombia and Chile.

⁷⁷ World Bank: Doing business in 2005: Removing obstacles to growth: an overview. Available in the doing business database at www.doingbusiness.org (last visited September 2006).

⁷⁸ See for instance the trade policy reviews dealing with investment issues in taxation. Available at the website of the World Trade Organization www.wto.org (Last visited September 2006).