



AFRICAN TAX  
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FISCALE AFRICAINE

POLICY BRIEF

# Understanding the Overlaps Between Trade and Investment Obligations and Tax Measures –

Setting a Foundation for Dialogue  
on the AfCFTA



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## 1. INTRODUCTION

Trading under the African Continental Free Trade Area (AfCFTA) officially began on 1 January 2021, marking the commencement of the largest free trade area in the world measured by the number of countries participating.<sup>2</sup> The AfCFTA is a product of many years of efforts to achieve regional integration that first emerged with the establishment of the Organization of African Unity (OAU) in 1963. Its full implementation and operationalization reflects a long-standing desire of post-colonial governments to realize self-reliance, shared prosperity and sustainable growth and development.<sup>3</sup> In this regard, the Agreement establishing the AfCFTA commits to oversee the creation of a single market for goods and services, facilitated by the free movement of persons, eliminate tariff and non-tariff barriers to trade and establish a continental customs union.<sup>4</sup>

By achieving these ambitious objectives, it is anticipated that the AfCFTA will not only boost trade and real income in the continent but will also significantly impact poverty, radically change Africa's position in the global value chain and lead to the development of African based value chains.<sup>5</sup> Indeed, the AfCFTA represents "a unique opportunity to promote inclusive growth and accelerate the achievement of the post-pandemic recovery, the 2030 Agenda for Sustainable Development and Agenda 2063 of the African Union".<sup>6</sup> In the period post the COVID-19 pandemic, as countries slowly recover from the resulting economic downturn, they will need to adopt effective policies that facilitate trade, diversification and inclusivity to maximise the AfCFTA's potential to deepen socioeconomic integration; improve cooperation; to enable trade, investment and the mobility of people; support industrialization; and facilitate the dynamic services sector.<sup>7</sup> This could lead to an increase in decent jobs, increased revenues and expansion of the

tax base for domestic resource mobilization (DRM). This would be helpful to most African countries given that ATAF's African Tax Outlook (ATO) found that pandemic-containment measures significantly affected economic activity, causing a steep drop in year-on-year real GDP growth as well as in real total tax revenue.<sup>8</sup>

The extent to which the potential of the AfCFTA will be realized, will be dependent on the level of integration, the policies and the complementarity of interventions put in place that permit countries to efficiently exploit the opportunities arising from deeper integration.<sup>9</sup> Most importantly, consistency between countries' trade policy frameworks will be essential and they must now engage in establishing what this consistency means in the context of taxation measures and, in the future, efforts to combat illicit financial flows (IFFs).

This means that member countries must now begin to evaluate the potential challenges and inconsistencies in tax policy and administration that may impact the operationalization of the AfCFTA. For instance, State Parties have differing capacities to establish Customs procedures and differences in Customs infrastructure that may affect the transit of goods through borders.<sup>10</sup> In addition, some studies estimate that the AfCFTA could lead to a decrease in tariff revenue in the short term.<sup>11</sup> However, it is anticipated that this loss in revenue will be recovered in the medium term due to an overall increase in the volume of imports and a higher level of economic activity.<sup>12</sup> Even so, the distributional impact of the decrease in tariff revenue is not uniform with some projections anticipating a decrease of up to 10% in some countries.<sup>13</sup> Therefore, countries will need to consider policies that offset the impact of these expected short-term revenue losses.

<sup>2</sup> World Bank, *The African Continental Free Trade Area: Economic and Distributional Effects*, Washington, DC: World Bank, doi:10.1596/978-1-4648-1559-1. License: Creative Commons Attribution CC BY 3.0 IGO, pg. 1, Accessed on 25 February 2022 at <https://openknowledge.worldbank.org/bitstream/handle/10986/34139/9781464815591.pdf>

Only the Regional Comprehensive Economic Partnership (RCEP), an agreement between Australia, Brunei Darussalam, Cambodia, China, Japan, Laos PDR, New Zealand, Singapore, Thailand and Vietnam, rivals the AfCFTA. According to the World Bank, the RCEP will cover 2.3 billion people or 30% of the world's population accounting for 31% of global foreign direct investment flows. See: ASEAN, *RCEP Agreement Enters into Force*, ASEAN, 1 January 2022. Accessed on 1 March 2022 at: <https://asean.org/rcep-agreement-enters-into-force/>

<sup>3</sup> See the Maseru Declaration of Commitment of the Heads of State and Government of the OAU, 1979, and the Lagos Plan of Action, 1980

<sup>4</sup> Article 3, AfCFTA Agreement

<sup>5</sup> The World Bank estimates that the AfCFTA has the potential to lift 30 million people from extreme poverty and 68 million people from moderate poverty. Real income gains are estimated to increase by 7% by 2035; intra-African trade is also expected to see a boost with exports projected to increase by almost 29%. Ibid

<sup>6</sup> UNCTAD, *Economic Development in Africa Report: Reaping the Potential Benefits of the African Continental Free Trade Area for Inclusive Growth*, UNCTAD, 2021, p.xii

<sup>7</sup> UNCTAD, (2021), n.6, p.19

<sup>8</sup> See, ATAF, *African Tax Outlook 2021*, ATAF, 2021, p.29

<sup>9</sup> UNCTAD (2021), n.6, p.21

<sup>10</sup> For more on this discussion see: The Brookings Institution Webinar, *The State of Africa's Free Trade Agreement and Strategies for Greater Integration* – w. Hon. Wambele Meme, Aloysius Uche Ordu & Landry Signe, Brookings Institution, 29 November 2021

<sup>11</sup> Ibid

<sup>12</sup> Ibid

<sup>13</sup> Ibid

Generally, the provisions within the AfCFTA are similar to provisions in existing trade agreements such as the World Trade Organisation (WTO) Agreements and the European Union (EU) Agreements but with additional provisions applying to investments. These agreements have led to unique challenges for both domestic and cross-border taxation policies, which are similarly raised by the AfCFTA. Specifically, the Most Favoured Nation (MFN) and National Treatment (NT) obligations have been relied upon to challenge tax policy measures introduced by countries. Therefore, tax policy experts need to consider the interaction between the trade obligations contained in the AfCFTA and their national tax policies.

The objective of this policy brief is to scope out the main tax-related issues arising in established regional and global trade communities that can be viewed as lessons ahead of the full operationalization of the AfCFTA. It is the first of a series of publications that will engage our membership in taking advantage of the early stages of implementation to set the necessary foundations for dialogue with trade policymakers and reform for compliance with trade obligations. It will also set out a framework of issues that ATAF will provide further research on to continue to build the knowledge, capacity and guidance for engagement between African trade and tax policymakers in the future.

This policy brief is structured as follows: section 2 provides an overview of the interaction between taxation and trade and identifies key issues arising at the WTO, European Union (EU); section 3 analyses the relationship between taxation and investment agreements and includes an evaluation of some of the most controversial investor-state dispute settlement cases; finally, section 4 provides recommendations on the key issues that countries should pay attention to and some of the next steps that should be taken to address them by ATAF and its membership.

## 2. OVERVIEW OF THE INTERACTION BETWEEN TAXATION, TRADE, AND INVESTMENT AGREEMENTS

Although the frameworks for multilateral trade, international investment agreements (IIAs) and international taxation "have been developed in parallel and are naturally governed by different sets of rules and principles, in specific instances, the scope of these rules and principles overlap – that is, the facts governed by international tax law are also within the scope of EU law as well as international trade and investment law".<sup>14</sup> Indeed, due to the broad coverage of the rules of FTAs and IIAs, overlaps with domestic tax measures and tax agreements often arise.<sup>15</sup> These overlaps can give rise to breaches of the various obligations contained in FTAs and IIAs, and lead to often expensive and lengthy disputes either between countries or between investors and countries.<sup>16</sup> Where breaches of trade or investment provisions are found by the respective dispute panels, this can introduce constraints to the ability of a country to reform and enhance their tax regime.<sup>17</sup> For instance, "guarantees in favour of foreign investors in bilateral investment treaties (BITs) can create a presumption in favour of the status quo at the time the investment is made".<sup>18</sup> This can lead to "foreign investors [bringing] monetary claims against states subsequently changing the interpretation or enforcement of their tax policy".<sup>19</sup> As a result, the management of this overlap is important and State Parties to the AfCFTA need to understand the ways in which the impact on taxation measures may vary from one provision to another.<sup>20</sup> Whilst new IIAs contain provisions that try to address or provide guidance on these concerns, old generation IIAs, which in practice represent a vast majority, do not and in fact, present more of a risk.

FTAs, on the other hand, may contain some carve-outs for taxation measures and tax treaties intended to provide guidance on the limited circumstances under which the violation of a trade obligation may be found. However, these limitations have not always been successful in preventing breaches.

### Box 1: General Challenges in the interaction between taxation, trade, and investment agreements (UNTC)

- Unawareness of tax officials of the potential impact of non-tax agreements on tax measures, including legislation, regulation, and administration.
- Unawareness of trade and investment negotiators of the potential overlap, including of the coverage of tax treaties.
- Challenges in achieving whole of government approaches to pre-empting problems, identifying them, and responding to them.
- Uncertainties about the scope of the overlap, especially because of the many undefined or broadly defined terms used in such treaties, variations from treaty to treaty and diverse "jurisprudence" approaches to their interpretation.
- Rules of supremacy chosen to address the overlap and their clarity or otherwise.
- Where disputes arise, determining who decides whether there is an overlap will be key as their decision making may be affected by their tax or non-tax knowledge and perspectives.
- The, often, stark differences between dispute resolution provisions in the agreements – with mandatory binding arbitration at the instance of the investor being the norm in trade and investment agreements (although this has become more controversial recently) – and most tax treaties, where the Mutual Agreement Procedure (MAP) is relied on and mandatory binding arbitration is rarely part of that process, especially for developing countries.

Whether a tax measure breaches the provisions of a FTA or IIA will be dependent on the following key aspects highlighted by the United Nations Tax Committee (UNTC):<sup>21</sup>

- The types of tax measures involved.
- The nature of the obligations entered into in the various IIAs, FTAs or even by way of investment chapters in trade agreements.
- The extent of any tax carve-outs<sup>22</sup> contained in the investment or trade agreements.
- The dispute settlement mechanisms available to countries and investors.

This section identifies some of the ways in which taxation measures have interacted with trade and investment using specific examples from the WTO, EU and selected IIAs in order to establish the basis for an analysis of the provisions of the AfCFTA. This

foundational understanding is essential in providing the rationale for immediate action amongst State Parties and negotiators to address the treatment of tax and in determining the options available to resolve the following challenges already classified by the UNTC<sup>23</sup> contained in Box 1 above.

In addition to addressing the challenges identified in Box.1, there are noted pressures that the reforms introduced by the AfCFTA will have on fiscal resources that are crucial to financing sustainable development and will need to be urgently evaluated:

***"Constraints on developing countries' fiscal resources resulting from trade and investment treaties are much more complex and nuanced than the mere loss of tariff revenue. For developing countries aiming to mobilize their fiscal resources more effectively, one crucial step is to fully understand the impact of their current trade***

<sup>14</sup> Pedro Guilherme Lindenberg Schouert, *Conflicts of International Legal Frameworks in the Area of Harmful Tax Competition*, IBOF, WU Institute for Austrian International Tax Law European and International Tax Law Policy Series, Vol. 14, ch.1.1

<sup>15</sup> Committee of Experts on International Cooperation in Tax Matters (United Nations Tax Committee – UNTC), *Secretariat Paper: The Interaction of Tax, Trade and Investment Agreements*, UN Tax Committee, 4 April 2019.

<sup>16</sup> *Ibid.*, p.3

<sup>17</sup> Sonia E. Rolland, *The Impact of Trade and Investment Treaties on Fiscal Resources and Taxation in Developing Countries*, Chicago Journal of International Law, Vol. 21, June 2020, No. 1 (3), p.51.

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

<sup>20</sup> UNTC (2019), p.3

<sup>21</sup> UNTC (2019), p.3

<sup>22</sup> These are provisions arising in IIAs or FTAs that provide either specific or general exceptions for selected tax measures that effectively limit the application of an obligation from being applied.

<sup>23</sup> UNTC (2019), p.3-4

and investment commitments on tax policy. They must also be able to evaluate the fiscal impact of future trade and investment negotiations. Both aspects are essential for developing countries' ability to exercise their fiscal sovereignty in a dynamic environment, where their domestic socio-economic needs change over time and the international framework also evolves with ongoing negotiations.<sup>24</sup>

Indeed, although lessons can be learned from other frameworks, ongoing analysis of these issues will be essential given the current transformation of all three disciplines. The ability to connect the experiences of other frameworks with the treatment of tax measures to the future implementation of the AfCFTA will be an advantage to dispute prevention, harmonization, and effective mobilization of resources.

## 2.1 The Treatment of Taxation in the WTO Agreements

The Agreement Establishing the WTO (WTO Agreement) and its Annexes primarily seek to eliminate barriers to trade liberalization, guarantee non-discrimination, prohibit the use of subsidies, and resolve trade-related disputes between countries. Article XVI:4 of the WTO Agreement requires that all Members ensure that their national laws, regulations, and administrative procedures conform with WTO Laws. However, WTO Law does not have direct effect and cannot, therefore, be invoked in national courts. Instead, the WTO Dispute Settlement Understanding (DSU) provides for a State-State dispute settlement mechanism, meaning that only WTO Members can access the Dispute Settlement Body (DSB), although this mechanism is currently under review. Although investors cannot directly access the WTO DSB, "in practice...almost all disputes are brought by a Member at the instigation of an affected industry or company".<sup>25</sup>

Whilst there are a number of WTO Annexes that also have relevance to this discussion, this analysis focuses on the General Agreement on Tariffs and Trade, 1994 (GATT), the General Agreement on Trade in Services (GATS) and the Subsidies and Countervailing Measures Agreement (SCM Agreement) to provide an initial

overview of the most pertinent areas where taxation measures have been challenged at the DSB. The main objective is to identify some of the principal issues that tax and trade policymakers need to be aware of particularly considering that the AfCFTA bases a significant number of the provisions contained in the Protocols on Trade in Goods and Trade in Services on the WTO Agreements.

### 2.1.1. Non-tariff measures

Tax policies, taxation measures and tax administration as a whole can be viewed as non-tariff measures (NTMs) that could, following an evaluation, be treated as non-tariff barriers (NTBs). This is important because where a NTB is found, it must be reformed or eliminated altogether and this poses a risk to overall tax policymaking and administration. This section sets out to establish an overview of the common types of NTMs that are related either to tax policy or tax administration itself.

Non-tariff measures (NTMs) include "all policy measures other than tariffs and tariff-rate quotas that have a more or less direct impact on international trade".<sup>26</sup> NTMs often arise from "domestic regulations and aim to overcome or reduce the impact of market imperfections, such as those related to negative externalities (e.g. pollution), information asymmetries (e.g. the condition of a used car), and risks from human, animal or plant health".<sup>27</sup> They are typically divided into three categories<sup>28</sup>:

- NTMs on imports – including import quotas, prohibitions, licensing, customs procedures, and administration fees.
- NTMs on exports – including export taxes, subsidies, quotas, prohibitions, and voluntary export restraints.
- NTMs on the domestic economy – including domestic legislation on health, labour, technical or environmental standards; internal taxes or charges; and domestic subsidies.

The range of NTMs that can be considered barriers (whether explicitly designed to do so or not) is broad and identifying them can be complex.<sup>29</sup> A 2005 OECD survey of business concerns about NTMs highlighted what some businesses from the EU, Japan and US considered to be the main impediments to access to

foreign markets.<sup>30</sup> The top three NTMs most frequently reported include technical measures, internal taxes or charges and customs rules and procedures.<sup>31</sup> For customs rules and procedures common concerns and issues raised in the COMESA region included:

- Administrative blocking at the borders caused by shorter working days
- Low efficiency
- Equipment breakdowns
- Shortage of special forms of documentation
- Documents requirements
- Transit charges
- Duplication of documentation

In Zimbabwe, 59% of businesses reported that "despite the intention of moving on to a common market, the average level of tariff in individual exports was reported to be about 20%".<sup>32</sup> In evaluating the NTBs between developing countries, it was found that customs and administrative procedures were a key concern, and some of the key challenges included<sup>33</sup>:

- Lack of automation.
- Customs valuations not based on market prices.
- Long and complex customs clearance processes.
- Weak customs administration leading to increased opportunities for and incidences of smuggling.

Evidently, customs procedures and the related border protocols are a most immediate issue for businesses and this is an opportunity for African countries to evaluate current policies, their limitations and develop harmonized solutions to prevent any escalation to NTBs. In addition, businesses should be frequently surveyed to determine the NTMs affecting their ability to invest in or trade with foreign markets.

The importance of NTMs, "has grown significantly over the last two decades...with the successful conclusion of numerous [FTAs], customs tariffs barriers are gradually falling such that [NTMs] now constitute the main friction to trade".<sup>34</sup> An additional challenge is a lack of regulatory transparency or clarity regarding the way decisions are made. This is a critical issue especially relating to the granting of tax incentives, any form of special tax treatment and even the accessibility of tax authority services such as advanced pricing agreements (APAs). At the WTO, there has been recognition that the changing nature of trade (and the overall impact of globalization) has created new complexities for dealing with the problem of NTBs.<sup>35</sup> A majority of disputes concerning NTMs at the WTO have focused on determining whether they are legitimate or designed for protectionist purposes.<sup>36</sup> Those designed for protectionist reasons will be considered NTBs. The complexity of NTMs has, over time, necessitated cooperation and transparency between members of a free trade agreement (FTA) to regulate them. Indeed, according to the WTO, as of 2012, FTAs no longer simply focused on tariff liberalization, but also sought to address "behind-the-border measures".<sup>37</sup> In 2012, 88 agreements addressed customs, 65 on export taxes, and 2 on taxation.<sup>38</sup>

Although NTMs can be introduced to meet legitimate policy objectives, they have the potential to be used for protectionist purposes.<sup>39</sup> NTMs will become a concern where they are unclear or applied in a discriminatory manner; lacking in transparency; or exceed what is necessary to meet the intended objective.<sup>40</sup> To address NTMs as they emerge, FTAs will establish a notification and monitoring mechanism for member states and for traders. For instance, the WTO Committee on Market Access was established in 1995 to, amongst other duties, supervise the implementation of concessions relating to NTMs and provide a forum for consultation on matters relating to NTMs. Where NTBs arise and countries do not reform or eliminate them, within the WTO context, they face the risk of concessions which can be expensive.

<sup>24</sup> Rollan (2020), p.52

<sup>25</sup> Peter Van den Bossche & Denise Prevost, *Essentials of WTO Law (2nd ed.)*, Cambridge University Press, 2021, p.35

<sup>26</sup> OECD Trade Policy Brief, *Non-tariff Measures*, OECD, February 2019.

<sup>27</sup> *Ibid*

<sup>28</sup> Robert W. Stalger, *Non-Tariff Measures and the WTO*, WTO Economic Research and Statistics Division, Staff Working Paper ERSD-2012-01

<sup>29</sup> OECD Trade Policy Studies, *Looking Beyond Tariffs: The Role of Non-Tariff Barriers in World Trade*, OECD, 2005.

<sup>30</sup> OECD Trade Policy Statistics (2005), n.26, p.20

<sup>31</sup> OECD Trade Policy Statistics (2005), n.26, p.24

<sup>32</sup> OECD Trade Policy Statistics (2005), n.26, p.43

<sup>33</sup> OECD Trade Policy Statistics (2005), n.26, p.232

<sup>34</sup> A.I. Sanjuan Lopez, P. Gracia de Renteria, G. Philippidis & E. Ferrari, *WTC Technical Report: Non-Tariff Measures (NTMs) and Intra-African Trade*, European Commission, 2021, p.3

<sup>35</sup> WTO, *World Trade Report*, WTO, 2012, p.160

<sup>36</sup> *Ibid*

<sup>37</sup> WTO, *World Trade Report*, WTO, 2014, p.120

<sup>38</sup> *Ibid*

<sup>39</sup> WTO (2012), n.35

<sup>40</sup> Department of Foreign Affairs and Trade (DFAT), Australia, *Addressing non-tariff trade barriers*, DFAT Australia, available online at: <https://www.dfat.gov.au/trade/tar-austrian-business/addressing-non-tariff-trade-barriers>.