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**Testimony of Todd Tucker  
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**On Bill C-46, An Act To Implement The Free Trade Agreement Between Canada And The  
Republic Of Panama**

**Before  
Standing Committee On International Trade, Meeting No. 35  
Canadian House Of Commons, 3<sup>rd</sup> Session, 40<sup>th</sup> Parliament  
Wednesday, November 17, 2010, 4:30 pm EST**

On behalf of Public Citizen, thanks to the committee for the invitation to testify on Bill C-46, the Act to Implement the Canada-Panama trade agreement.

Public Citizen is a national, nonprofit public interest organization with 150,000 members and supporters that champions citizen interests before Congress, the executive branch agencies and the courts. We have conducted extensive analysis on the U.S.-Panama trade agreement,<sup>1</sup> which was signed in 2007 and is virtually identical to the Canada-Panama trade pact signed in May 2010. At the request of your Committee, I have conducted an analysis of some of the tax and regulatory implications of the Canada-Panama trade pact, focusing on Chapters 9 ("Investment"), 12 ("Financial Services") and 23 ("Exceptions").<sup>2</sup>

Canada has been a global leader on advocating for the perspective that greater trade in financial services should not undermine prudential regulations. But this admirable record is at risk with the current investment and financial services text of the Canada-Panama trade agreement.

**I have two central points. First, Panama is one of the world's worst tax havens. It is home to an estimated 400,000 corporations, including offshore corporations and multinational subsidiaries.**<sup>3</sup> This is almost four times the number of corporations registered in Canada at the federal level.<sup>4</sup> This makes Panama a very unusual developing country.

**Second, the Canada-Panama trade agreement should not be thought of primarily or solely in the traditional trade terms of cutting tariffs. Instead, it should be seen for what it is: hundreds of pages of text that commit Canada to follow certain domestic policies. The pact would give new rights to the government of Panama and the hundreds of thousands of offshore corporations to challenge Canadian anti-tax haven measures outside of the Canadian judicial system.**

Let me elaborate on the first point. What makes Panama a particularly attractive location for tax dodgers and offshore corporations?

For decades, the Panamanian government has pursued an intentional tax haven strategy. It offers foreign banks and firms a special offshore license to conduct business.<sup>5</sup> Not only are these businesses not taxed, but they are subject to little to no reporting requirements or regulations. According to the OECD, the Panamanian government has little to no legal authority to ascertain key information about these offshore corporations, such as their ownership.<sup>6</sup>

Because of this secrecy, precise numbers of the taxes lost to Panama do not exist. However, according to the U.S. Office of Management and Budget (OMB), eliminating tax evasion in tax havens overall could save U.S. taxpayers \$210 billion over the coming decade,<sup>7</sup> while the Senate Homeland Security Committee estimates a savings five times as great.<sup>8</sup> Since Panama is one of the world's leading tax havens, the country is likely to account for a significant share of those revenue losses, which could be used to meet other urgent policy priorities at home.

Last year, to test how simple it is to set up a corporation in Panama, I assigned my 20-year old intern, with no legal or accounting experience whatsoever, to set up a corporation in Panama over the telephone from the U.S. She could do so in a matter of moments, and we have a video documenting this effort that I ask be made part of the record.<sup>9</sup>

Panama's financial secrecy practices also make it a major site for money laundering from throughout the world. According to the U.S. State Department, "Panama is a major logistics control and trans-shipment country for illegal drugs... major Colombian and Mexican drug cartels as well as Colombian illegal armed groups use Panama for drug trafficking and money laundering purposes... the funds generated from illegal activity are susceptible to being laundered through" Panamanian banks, real estate projects, and more.<sup>10</sup>

The OECD reports that the secrecy protections for lawyers in Panama are so high that they cannot be compelled to reveal information – under penalty of prison – about clients even if that information *is not* protected by attorney-client privilege.

Panama's domestic legal regime is supplemented by a steadfast refusal to engage in far-reaching tax information exchange with its key trading partners. Up until last year, Panama had no international tax treaties of any kind. Now, it is on track to have up to a dozen or more double taxation treaties signed this year. As a technical matter, these actions ensure that the country will be removed from the OECD gray list.

But the OECD has recently recognized the inadequacy of its own listing protocols, and – with the support of the G-20 – has implemented a more comprehensive peer review process to see how tax transparency is actually working on the ground. It has released several of its three-stage peer review reports over the last few months. Despite its recent treaty actions, Panama was the only country in the Western Hemisphere that the OECD did not allow to graduate from the first to the second stage – a dubious distinction not accorded even to the infamous Cayman Islands tax haven.<sup>11</sup> Table 1 shows ways in which Panama fell short of the OECD standards, as found in the conclusion tables of its OECD Phase 1 Peer Review reports.

OECD Standard	Panama's Performance
Jurisdictions should ensure that ownership and identity information for all relevant entities and arrangements is available to their competent authorities.	<p>Information on the owners of bearer shares is not available.</p> <p>There is no requirement for nominees to have, or make available, information about the person on whose behalf shares are registered</p> <p>Although “know your client” rules apply to resident agents for companies and foundations, in accordance with Executive Decree No. 468 of 1994, it is not clear what information these rules require to be kept.</p> <p>Unless a <i>Sociedad Anónima</i> is subject to audit by the tax authorities there appears to be no mechanism to ensure that the stock register is kept up to date, or at all.</p>
Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements.	<p>Only companies and partnerships operating in Panama [i.e. non-offshore] are required to maintain accounting records.</p> <p>The Trusts Law and Foundations Law are silent on the type of records which are required to be kept and their retention period.</p>
Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information arrangement from any person within their territorial jurisdiction who is in possession or control of such information (irrespective of any legal obligation on such person to maintain the secrecy of the information).	<p>The power of Panama's tax authorities to obtain information for exchange purposes is limited to circumstances in which the information is also required for their own tax purposes (domestic tax interest).</p> <p>It is unclear that the Directorate General of Revenue's power to obtain information overrides competing requirements prohibiting disclosure of information, particularly with respect to lawyers acting in capacity other than that of legal representative.</p> <p>The penalties available to ensure access to information for exchange purposes are not adapted to ensure access to information likely to be requested under exchange of information arrangements.</p>
Exchange of information mechanisms should allow for effective exchange of information.	Panama has no agreements in force which provide for effective exchange of information.
The jurisdictions' network of information exchange mechanisms should cover all relevant partners.	Panama has been approached by a number of jurisdictions to negotiate TIEAs but has not done so. Further, recent amendments to its domestic law to allow for exchange of information in the case of DTCs do not extend to TIEAs or other information exchange arrangements such as a multilateral agreement.
The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties.	Professional secrecy protects information held by lawyers even when they are not acting as legal representatives.
The jurisdiction should provide information under its network of agreements in a timely manner.	The assessment team is not in a position to evaluate whether this element is in place, as it involves issues of practice that are dealt with in the Phase 2 review.

Moreover, we don't know how well or if Panama's latest double taxation treaties will work in practice. What we do know from the text of the agreements – such as the Panama-Mexico double taxation treaty – is troubling. The agreement and its implementing protocol put a great number of reservations and qualifications on the exchange of information. It gives tax dodgers the opportunity to be notified by Panama before the information is handed over to the requesting government. The requesting government must have extensive information about the taxpayer, the time period of information sought, why it is being sought, etc. It explicitly states that tax information requests cannot be used for “the simple collection of pieces of evidence.”<sup>12</sup> In other words, under such a tax treaty, a requesting government could only get the information if it no longer really needs it.

Moreover, Panama has resisted until the last few weeks the negotiation of what Canada and the U.S. have demanded – a tax information exchange agreement, as opposed to a double taxation treaty.<sup>13</sup> Now, some press reports have indicated that Panama may start up these negotiations. While these comments attracted some news attention,<sup>14</sup> note that Panama had committed to a TIEA with the U.S. back in 2002,<sup>15</sup> and dragged its heels for the last eight years.

History is rapidly passing Panama by. Policymakers with the IRS,<sup>16</sup> U.S. Congress<sup>17</sup> and even the United Nations Stiglitz Commission<sup>18</sup> are increasingly frustrated with the inefficiency of existing double taxation and tax information exchange treaties. The emerging gold standard is *automatic* exchange of tax information,<sup>19</sup> which the U.S. and Canada have done for certain reporting of interest for years.<sup>20</sup> Canadian and U.S. citizens are already engaged deeply in Panama – making the country an excellent candidate for automatic exchange of tax information.

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This takes me to my second major point. The Canada-Panama trade deal would worsen the tax haven problem. As the OECD has noted, having a trade agreement without first tackling Panama's financial secrecy would incentivize even more offshore tax dodging.<sup>21</sup> **But there is reason to believe that the trade deal will not only increase tax haven abuses, but also make fighting them much harder.**

Chapter 9 of the Panama agreement reproduces the investor-state system under NAFTA's Chapter 11, where Canada has paid out hundreds of millions of dollars in legal fees and compensation to U.S. investors.<sup>22</sup> And certain provisions of Chapter 9, the investment chapter, apply to the financial services chapter, Chapter 12.<sup>23</sup> This allows certain Canadian financial services regulations to be challenged under the Canada-Panama "free trade agreement" (FTA).

Canada's defensive interests are many in the case of the Panama pact, because there are hundreds of thousands of U.S., Chinese, Cayman and other corporations that can attack Canadian regulations by using aggressive nationality planning through their Panamanian subsidiaries. Even Canadian corporations, through engaging in so-called "corporate inversions,"<sup>24</sup> could launch such cases.

How are these types of corporate shell game challenges possible? The definition of an investor and investment under Article 9.01 of the Canada-Panama trade pact's investment chapter is not limited to Canadian or Panamanian corporations' bricks-and-mortar investments in the other country's market. Instead, the definition of investor is "a national *or* enterprise of a party." *As I mentioned with regards to the intern video, becoming an "enterprise of Panama" is one of the easiest things in the world.* (The only qualification put on this in Article 9.15.2 is that Canada can deny FTA benefits to a Panama-registered investor that has no "substantial business activities" in Panama.<sup>25</sup> But the threshold for such a finding in past investor-state cases has been very low: as few as two employees and a small paper trail have been found to constitute "substantial business activities."<sup>26</sup>)

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What threat would the Canada-Panama trade deals' investment and services terms pose in practice to Canadian regulations?

Let's say that, after the Canada-Panama trade deal is ratified, Panama continues to be a bad actor on the tax haven front, and Parliament puts in place legislation to give Panama a deadline to clean up its act, or face sanctions. Under this plan of action, banks operating in Canada would be restricted from transferring money to their counterparts or business partners operating in Panama. Transfers to and from non-tax haven countries would not be affected. The Canada-operating banks that would be affected by the anti-tax haven measure could be owned by Canadians, Panamanians, and investors from third countries operating in Canada and Panama (including some Chinese investors that structured their Canadian subsidiary operations through a Panama-registered corporation).

But Article 9.10 of the Canada-Panama trade pact says "Each Party shall permit transfers related to a covered investment to be made freely and without delay, into and out of its territory."<sup>27</sup> Either the government of Panama or an investor registered there could challenge the Canadian anti-tax haven measure as a violation of the transfer guarantees under the trade deal.

And, if a Canadian anti-tax haven measure wiped out the value of a Panama-registered corporation's investment in Canada, then Article 9.11 and Section C would allow that investor to challenge the Canadian measure as an indirect expropriation.<sup>28</sup>

Moreover, both Chapter 9 and Chapter 12 have extensive requirements for Panama-registered investors and service providers to be accorded non-discriminatory treatment.<sup>29</sup> Under Article 12.06.2, Canada has a commitment to always allow Canadians to purchase financial services from banks operating in Panama.<sup>30</sup> The government of Panama could challenge the Canadian anti-tax haven measure as an FTA-prohibited discriminatory measure or a violation of the market access rights for cross-border trade.

These are not speculative threats. Panama has actually threatened WTO cases against other countries' anti-tax haven measures.<sup>31</sup>

And corporations can and have used sophisticated shell games that have benefited them in their ability to launch investor-state cases. Chinese corporations (for one) have been advised to structure their parent-subsidiary relationships through countries that are parties to bilateral investment treaties so as to be able to take advantage of investor-state arbitration – even when China is not a party to the underlying bilateral investment agreement.<sup>32</sup> It is worth taking note of the recent investor-state arbitration between the Pacific Rim Mining Company and El Salvador. In this case, a Canadian parent company with a Cayman Islands subsidiary invested in mining operations in El Salvador. Just months before the company began complaining about new environmental policy measures in El Salvador, the Cayman subsidiary was reincorporated as a Nevada corporation. This gave Pacific Rim standing as a "U.S. investor" under the U.S.-Central America trade agreement – despite the fact that neither Canada nor the Cayman Islands is party to the U.S.-Central America pact.<sup>33</sup>

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There are a series of defenses that Canadian regulators could invoke under the Canada-Panama trade deal, but they are largely weak. For instance, Article 12.11.1 says that prudential measures would be allowed, except where they would violate the terms of the agreement.<sup>34</sup> But the transfers guarantees and other terms of the agreement already conflict with prudential anti-tax haven regulation. So this language is self-cancelling.

Likewise, Article 9.10.3 allows for a set of derogations from the transfers disciplines, but only for non-discriminatory measures<sup>35</sup> – which anti-tax haven measures would by definition not be.

Finally, Article 23.04.1 states that “Except as set out in this Article, this Agreement does not apply to a taxation measure.” However, the Article then states that the national treatment and expropriation provisions of Chapters 9 and 12 do apply to taxation measures.

There is a limited exception to the non-discrimination obligation on taxation measures that states that the rule does not “apply to a new taxation measure that is aimed at ensuring the equitable and effective imposition or collection of taxes (including, for greater certainty, a measure that is taken by a Party in order to ensure compliance with the Party’s taxation system or to prevent the avoidance or evasion of taxes) and that does not arbitrarily discriminate between persons, goods or services of the Parties.”<sup>36</sup>

This is a broader exception than what the U.S. included in its trade deal with Panama,<sup>37</sup> but it is not without its complications. If the Panamanian government challenged Canada’s anti-tax haven policies as a violation of the FTA’s national treatment obligations, Canada would have two options under Article 23.04. First, Canada could argue that the anti-tax haven measure should not be evaluated with reference to the national treatment disciplines, but instead to some other disciplines of the agreement. Then, Canada could argue that the exception for taxation measures in Article 23.04.1 applies, and that the claim should be dismissed. Alternatively, Canada could attempt to argue that its policy should be evaluated with respect to national treatment disciplines, but that it is a measure that is “aimed at ensuring the equitable and effective imposition or collection of taxes” and that, while discriminatory, it is not an *arbitrary* discrimination but one based on Canada’s anti-tax haven goals.

A panel of arbitrators operating outside of the Canadian judicial system – not Canadian tax authorities, judges or elected officials – would rule whether Canada’s defense had merit. With either defense, there is the strong possibility that the anti-tax haven measure would not be ruled a tax measure per se, but instead a financial services or other regulation – which would not be covered by the exception, and would therefore be bound to all of the FTA’s highly restrictive disciplines on transfers, offshore market access, and more. Indeed, countries are considering using non-tax specific policy tools to incentivize better behavior on the part of tax havens. For instance, some countries have considered restricting tax haven-incorporated firms from bidding for government procurement contracts.<sup>38</sup> This policy, while related to the ultimate goals of improved tax collection, would likely not be considered a tax measure per se for the purposes of a general exception related to tax measures under an FTA.

If a Panama-registered investor challenged Canada’s anti-tax haven measure as an indirect expropriation, Canada would not be able to utilize the Article 23.04 exceptions unless the government of Panama formally agreed with the government of Canada that the Canadian anti-tax haven measure did not constitute an expropriation. There is no reason to believe that, if an investor-state case turned on such a determination, that Panama would give its assent, after decades of actively cultivating a comparative advantage in tax haven activities.

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Canada and Panama already have a bilateral investment treaty (BIT), but it is not as far-reaching as the investor-state system contemplated in the FTA. The main difference under the FTA relative to the BIT is that investors can attack regulations that Canada imposes as a condition of establishing an operation, while both investors and the Panamanian government could attack a Canadian regulation that related to the acquisition of an investment.<sup>39</sup> These “pre-establishment” guarantees would also apply to financial services suppliers. So, any policy that put a hold on new establishments or acquisitions by Panama-registered investors in Canada until Panama cleaned up its act could be newly challenged under the trade pact.

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In conclusion, there is widespread agreement that trade agreements should not discipline *non-discriminatory* regulations, even though, in fact, many non-discriminatory financial services regulations are disciplined by the World Trade Organization and other trade deals.<sup>40</sup> But there are some instances where policymakers will want to make principles-based distinctions between countries on the basis of their non-trade policies. Such is the case with anti-tax haven policies. Yet these policies would be open to attack by the Panamanian government or Panama-registered investors under the Canada-Panama trade deal’s investment and financial services text.

## ENDNOTES

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<sup>1</sup> See Todd Tucker and Lori Wallach, “Panama FTA Would Undermine U.S. Efforts to Stop Offshore Tax-Haven Abuse and Regulate Risky Financial Conduct,” Public Citizen Report, April 2009. Available at: <http://www.citizen.org/Page.aspx?pid=519>

<sup>2</sup> The full text of this agreement is available at: [http://sice.oas.org/TPD/CAN\\_PAN/CAN\\_PAN\\_Texts\\_e/index\\_e.asp](http://sice.oas.org/TPD/CAN_PAN/CAN_PAN_Texts_e/index_e.asp)

<sup>3</sup> OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, “Peer Review Report, Phase 1, Legal and Regulatory Framework, Panama,” at page 12, paragraph 23. Available at: <http://www.oecd.org/dataoecd/0/48/46103294.pdf>

<sup>4</sup> The number of corporations in Canada (121,000) was derived from Canada's database of registered corporations at <https://www.ic.gc.ca/app/scr/cc/CorporationsCanada/fdrlCrpSrch.html?> and inputting each digit (0-9) in the “Corporation Number” field, and selecting only active corporations (which excludes discontinued, amalgamated, and dissolved corporations), and noting the number of results for each search. Inputting each digit only gets corporation numbers that start with that digit, not all corporation numbers that contain that digit. This number refers to federally incorporated corporations, to make for an apples and apples comparison with Panama’s federal system of incorporation. See Corporations Canada, Federal Corporations Database, Accessed November 17, 2010.

<sup>5</sup> Barney Warf, “Tailored for Panama: Offshore Banking at the Crossroads of the Americas,” *Geografiska Annaler*, 84:1, 2002

<sup>6</sup> See OECD “Peer Review Report,” at pages 6-7, paragraph 5. Available at: <http://www.oecd.org/dataoecd/0/48/46103294.pdf>

<sup>7</sup> Office of Management and Budget, “A New Era of Responsibility: Renewing America’s Promise,” February 2009, at 122. Available at: [http://www.whitehouse.gov/omb/assets/fy2010\\_new\\_era/A\\_New\\_Era\\_of\\_Responsibility2.pdf](http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf). Accessed March 6, 2009.

<sup>8</sup> Permanent Subcommittee on Investigations, “Tax Haven Banks and U.S. Tax Compliance,” U.S. Senate Committee on Homeland Security and Governmental Affairs, July 17, 2008, at 1. Available at:

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[http://hsgac.senate.gov/public/\\_files/REPORTTaxHavenBanksJuly1708FINALwPatEliseChgs926080.pdf](http://hsgac.senate.gov/public/_files/REPORTTaxHavenBanksJuly1708FINALwPatEliseChgs926080.pdf). Accessed March 6, 2009.

<sup>9</sup> Available online at: <http://www.youtube.com/watch?v=5jtsGDBL7Mc>

<sup>10</sup> U.S. State Department Bureau of International Narcotics and Law Enforcement, 2009 International Narcotics Strategy Report.

<sup>11</sup> See OECD “Peer Review Report,” at page 7, paragraph 7.

<sup>12</sup> See analysis of Article 25 of the implementing protocol of the Panama-Mexico DTT at Todd Tucker, “Panama’s Latest Tax Moves Way off the Mark,” Public Citizen, June 21, 2010. Available at: <http://citizen.typepad.com/eyesontrade/2010/06/panamas-latest-tax-moves-way-off-the-mark.html>

<sup>13</sup> Since the 1980s, the U.S. has preferred to negotiate TIEAs instead of DTTs with most developing countries. The exchange of information provisions in TIEAs are much more detailed than those in DTTs. According to one former IRS official, “TIEAs work in countries where a tax treaty is either not necessary – because the country doesn’t have income taxes – or where it would be difficult to get a treaty ratified for a variety of reasons.” See Kristen A. Parillo, “TIEAs: A Worthy Endeavor,” *Tax Notes International*, March 9, 2009, at 860.

<sup>14</sup> Matthew Schewel, “Official: Panama Enters TIEA Talks With U.S. To Facilitate FTA Approval,” *Inside U.S. Trade*, October 28, 2010.

<sup>15</sup> U.S. Treasury Department statement, Jan. 8, 2002. Available at: <http://www.treasury.gov/press/releases/po907.htm>. Accessed Nov. 15, 2010.

<sup>16</sup> U.S. Internal Revenue Service Commissioner Douglas Shulman stated earlier this year with regard to U.S. TIEAs and DTTs: “It often takes a long time to get the requested information from partners; and the information may also be incomplete. There are also very strict rules and you may have to jump through a lot of hoops to get the information you need.” See Prepared Remarks of Commissioner of Internal Revenue Douglas H. Shulman before the OECD/BIAC, Washington, D.C., June 8, 2010. Available at: <http://www.irs.gov/irs/article/0,,id=224121,00.html>

<sup>17</sup> Senator Carl Levin (D-Mich.) has also said that: “the Administration may want to consider finalizing a regulation proposed by the Clinton Administration years ago. That regulation would allow the United States to engage in automatic information exchanges of account information with countries on a reciprocal basis for tax enforcement purposes. Right now, the only automatic tax information exchanges we engage in are with Canada. A lot more countries may be willing to participate. The resulting account data could produce new information identifying U.S. tax dodgers.” See “Opening Statement of Senator Carl Levin at Permanent Subcommittee on Investigations Hearing on Tax Haven Banks and U.S. Tax Compliance: Obtaining the Names of U.S. Clients with Swiss Accounts,” March 4, 2009. Available at: <http://levin.senate.gov/newsroom/release.cfm?id=309057>

<sup>18</sup> Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, September 2009 Report, at 84. Available at: [http://www.un.org/ga/econcrisissummit/docs/FinalReport\\_CoE.pdf](http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf).

<sup>19</sup> Richard Murphy, “Information Exchange: What Would Help Developing Countries Now?” Tax Research LLP, June 2009. Available at: <http://www.taxresearch.org.uk/Documents/InfoEx0609.pdf>

<sup>20</sup> See Regulations 1.6049.8, 1.6049-4, and 1.6049.6 of the U.S. Internal Revenue Service. Available at: [http://www.taxalmanac.org/index.php/Treasury\\_Regulations,\\_Subchapter\\_A,\\_Part\\_1,\\_Sections\\_1.1551-1-End\\_-\\_Index](http://www.taxalmanac.org/index.php/Treasury_Regulations,_Subchapter_A,_Part_1,_Sections_1.1551-1-End_-_Index). See Letter dated 9 February 2009 to U.S. Treasury Secretary Timothy Geithner from Mexican Finance Secretary Agustin Carstens. Available at: [http://faculty.law.wayne.edu/tad/Documents/Country/mexico-carstens\\_letter.pdf](http://faculty.law.wayne.edu/tad/Documents/Country/mexico-carstens_letter.pdf)

<sup>21</sup> “It is also important for OECD governments to consider the importance of establishing effective exchange of information mechanisms when expanding trade relations with offshore jurisdictions (e.g. through free trade agreements or other similar agreements) so that the further removal of trade barriers does not also result in expanded opportunities

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for offshore evasion... For example, the U.S. Treasury announced the commencement of TIEA negotiations with Panama in January 2002 and in December 2006 the United States Trade Representative announced the completion of the Free Trade Agreement negotiations with Panama.” See Jeffrey J. Owens (Director, OECD Center for Tax Policy and Administration), Testimony Before Senate Finance Committee On Offshore Tax Evasion, May 3, 2007. Available at: <http://finance.senate.gov/hearings/testimony/2007test/050307testjo.pdf>.

<sup>22</sup> Available at: [http://www.sice.oas.org/TPD/CAN\\_PAN/CAN\\_PAN\\_Texts\\_e/Ch\\_09\\_1604\\_e.pdf](http://www.sice.oas.org/TPD/CAN_PAN/CAN_PAN_Texts_e/Ch_09_1604_e.pdf)

<sup>23</sup> Article 9.03: Relation to Other Chapters reads in part: “1. In the event of an inconsistency between this Chapter and another Chapter, the other Chapter prevails... 3. This Chapter does not apply to a measure adopted or maintained by a Party to the extent that the measure is covered by Chapter Twelve (Financial Services).”

However, an examination of Chapter 12’s Article 12.02 reads in part:

“2. Chapters Nine (Investment) and Ten (Cross-Border Trade in Services) apply to measures described in paragraph 1 only to the extent that those Chapters are incorporated into this Chapter.

3. Articles 9.10 (Investment – Transfers), 9.11 (Investment – Expropriation), 9.15 (Investment – Denial of Benefits), 9.16 (Investment – Health, Safety and Environmental Measures), 9.18 (Investment– Special Formalities and Information Requirements) and 10.10 (Cross-Border Trade in Services – Denial of Benefits) are incorporated into and made a part of this Chapter.

4. Section C of Chapter Nine (Investment – Settlement of Disputes between an Investor and the Host Party) is incorporated into and made a part of this Chapter solely for claims that a Party has breached Articles 9.10 (Investment – Transfers), 9.11 (Investment – Expropriation), or 9.15 (Investment – Denial of Benefits) as incorporated into this Chapter, or claims pursuant to Article 9.20(c) (Investment – Claim by an Investor of a Party on Its Own Behalf) or Article 9.21(1)(c) (Investment – Claim by an Investor of a Party on Behalf of an Enterprise).”

So, a claim made by Panama or a Panama-registered investor that Canada’s anti-tax haven measure constituted an FTA-prohibited indirect expropriation or a restriction on transfers related to a financial services investment would be allowed. Put differently, there would be no “inconsistency” between Chapters 9 and 12 for the purposes of the claim, so the requirement in Article 9.03.1 would be met. Moreover, Article 12.02, paragraphs 3 and 4 “read in” certain obligations from Chapter 9. Thus, for these types of obligations, there is an exception to the general segregation under Article 9.03.3 between measures affecting financial services-related investments and non-financial services-related investments.

<sup>24</sup> According to the U.S. Government Accountability Office, “According to the Department of the Treasury, the term “inversion” is used to describe a broad category of transactions through which a U.S.-based multinational company restructures its corporate group so that after the transaction the ultimate parent of the corporate group is a foreign corporation. Generally, after an inversion transaction, shareholders of the former U.S. parent company hold stock of the newly formed foreign parent, and the operations of the company are unchanged. Treasury also noted that there has been a marked increase recently in the frequency, size, and profile of inversion transactions. This year, several bills have been introduced in Congress that address such transactions.” See “Federal Contractors Incorporated Offshore,” GAO-03-194R, October 2002, at 1-2. Available at: <http://www.gao.gov/new.items/d03194r.pdf>

<sup>25</sup> The full text reads: “A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of that Party and to investments of that investor if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose domestic law it is constituted or organized.”

<sup>26</sup> In the *AMTO v. Ukraine* case, the presence of two employees and a small paper trail in Latvia was seen as evidence of “substantial business activities” in the claimed home Party. See Arbitration Institute Of The Stockholm Chamber Of Commerce, Arbitration Number 080/2005, In The Matter Of: An arbitration pursuant to the Energy Charter Treaty and the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce: Limited Liability Company Amto (Claimant) v. Ukraine (Respondent), Final Award, March 26, 2008, at para 69. Available at: <http://ita.law.uvic.ca/documents/AmtoAward.pdf>.

For a more detailed explanation of the problems with “Denial of Benefits” provisions like Article 9.15, see the report that Public Citizen produced with a coalition of other public interest groups: “Investment Rules in Trade Agreements:

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Top 10 Changes to Build a Pro-Labor, Pro-Community and Pro-Environment Trans-Pacific Partnership,” August 2010. Available at: <http://www.citizen.org/documents/InvestmentPacketFINAL.pdf>

<sup>27</sup> Paragraphs 1 and 2 of this article read: “1. Each Party shall permit transfers relating to a covered investment to be made freely and without delay, into and out of its territory. Those transfers include: (a) contributions to capital; (b) profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment; (c) proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment; (d) payments made under a contract entered into by the investor, or the covered investment, including payments made pursuant to a loan agreement; (e) payments made under Articles 9.11 and 9.12; and (f) payments arising under Section C.

2. Each Party shall permit transfers relating to a covered investment to be made in the convertible currency in which the capital was originally invested, or in another convertible currency agreed to by the investor and the Party concerned. Unless otherwise agreed by the investor, transfers shall be made at the market rate of exchange in effect on the date of transfer.”

<sup>28</sup> Section C spells out the procedural aspects of the investor-state rules. The text from Chapter 9 containing the substantive obligation reads, in part: “Article 9.11: Expropriation: 1. A Party may not nationalize or expropriate a covered investment either directly or indirectly through a measure having an effect equivalent to nationalization or expropriation (“expropriation”) except for a public purpose, in accordance with due process of law, in a non-discriminatory manner and on payment of prompt, adequate and effective compensation. For greater certainty, this paragraph shall be interpreted consistent with Annex 9.11....”

Annex 9.11 reads: “The Parties confirm their shared understanding that:

(a) indirect expropriation results from a measure or a series of measures of a Party that has an effect equivalent to direct expropriation without formal transfer of title or outright seizure;

(b) the determination of whether a measure or series of measures of a Party constitute an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:

(i) the economic impact of the measure or a series of measures, although the sole fact that a measure or a series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred,

(ii) the extent to which the measure or the series of measures interfere with distinct, reasonable investment-backed expectations, and

(iii) the character of the measure or the series of measures;

(c) except in rare circumstances, such as when a measure or a series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith, a non-discriminatory measure of a Party that is designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, does not constitute indirect expropriation.”

The annex appears to represent some important qualifications on what would otherwise be a wide-ranging right to challenge economic legislation. However, a closer read shows that the economic legislation in question would not have to constitute “formal transfer of title or outright seizure,” meaning it could be a measure of general application.

It is positive that the “sole fact” that a measure “has an adverse impact on the economic value of an investment” will not be seen as constituting an “indirect expropriation.”

But any smart lawyer will present more than just this “sole fact,” and will have other arguments, such as that indicated by the following clause – that a Panama-registered investor operating in Canada probably had “distinct, reasonable investment-backed expectations” when it made the investment in the pre-tax haven crackdown days that it would be able to transfer funds to and from its Panama-based parent. Arbitral tribunals have interpreted the nature of “investment-backed expectations” very broadly. (See Todd Tucker, “Economists Don’t Count in Enron Attack on Argentina,” Public Citizen, August 10, 2010. Available at: <http://citizen.typepad.com/eyesontrade/2010/08/economists-dont-count-in-enron-attack-on-argentina.html>)

The final clause on “rare circumstances” has language that is not typically included in U.S. FTAs: that a “rare circumstance” could be when “a measure or a series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith.” However, the Canadian and Panamanian

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negotiators could have stated that the “so severe” scenario represented the *only* instance of a “rare circumstance” where a public welfare legislation could be ruled an indirect expropriation. Instead, the negotiators decided that this would simply be an example (among others) of a “rare circumstance.” This means that a non-severe, good faith public welfare measure could still be seen as an indirect expropriation in certain cases.

<sup>29</sup> The relevant section from Chapter 9 reads:

“Article 9.04: National Treatment

1. Each Party shall accord to an investor of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to *the establishment, acquisition*, expansion, management, conduct, operation and sale or other disposition of an investment in its territory.

2. Each Party shall accord to a covered investment treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to *the establishment, acquisition*, expansion, management, conduct, operation and sale or other disposition of an investment in its territory.

3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a sub-national government, treatment no less favourable than the treatment accorded in like circumstances by that sub-national government to investors and to investments of investors of the Party of which it forms a part.

Article 9.05: Most-Favoured-Nation Treatment

1. Each Party shall accord to an investor of the other Party treatment no less favourable than that it accords, in like circumstances, to investors of a non-Party with respect to *the establishment, acquisition*, expansion, management, conduct, operation and sale or other disposition of an investment in its territory.

2. Each Party shall accord to a covered investment treatment no less favourable than that it accords in like circumstances to investments of investors of a non-Party with respect to *the establishment, acquisition*, expansion, management, conduct, operation and sale or other disposition of an investment in its territory.

3. For greater certainty, the treatment accorded by a Party under this Article means, with respect to a sub-national government, treatment accorded, in like circumstances, by that sub-national government to investors, and to investments of investors, of a non-Party.” [italics added]

The relevant section from Chapter 12 reads, in part: “Article 12.03: National Treatment

1. Each Party shall accord to an investor of the other Party treatment no less favourable than that it accords to its own investors in like circumstances with respect to *the establishment, acquisition*, expansion, management, conduct, operation, and sale or other disposition of financial institutions or an investment in financial institutions in its territory.

2. Each Party shall accord to a financial institution of the other Party and to an investment of an investor of the other Party in a financial institution treatment no less favourable than that it accords to its own financial institutions and to investments of its own investors in financial institutions, in like circumstances, with respect to *the establishment, acquisition*, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments....”

<sup>30</sup> The text reads: “Article 12.06: Cross-Border Trade:

1. Each Party shall permit, under terms and conditions that accord national treatment, a cross-border financial service supplier of the other Party to supply a financial service specified in Annex 12.06.

2. Each Party shall permit a person located in its territory, and its nationals wherever located, to purchase a financial service from a cross-border financial service supplier of the other Party located in the territory of the other Party. Subject to paragraph 1, this obligation does not require a Party to permit that supplier to do business or solicit in its territory. Each Party may define “doing business” and “solicitation” for the purposes of this Article.

3. Without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of the other Party and of financial instruments.”

To draw metaphors from the WTO context, paragraph 1 essentially refers to the “Mode 1” mode of services trade (where consumers in Canada consume services offered from Panama, over the Internet, say), and paragraph 2 essentially refers to the “Mode 2” mode of services trade (where consumers from Canada “travel” to Panama to consume the service).

The Mode 1-type commitments that Canada undertook in Annex 12.06 are fairly limited, but the Mode 2-type commitments in Article 12.06.2 are not.

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Problematically, the trade and investment law literature (including from the WTO Secretariat) have concluded that there is little to no distinction between Mode 1 and 2 in financial services trade. In other words, limited undertakings by a country in Mode 1 do not insulate that country from trade pact challenge if it has broad undertakings in Mode 2.

For more detail on this debate, see Todd Tucker, “The WTO Conflict with Financial Transaction Taxes and Capital Management Techniques, and How to Fix It,” Public Citizen, July 2010. Available at: <http://www.citizen.org/documents/MemoonCapitalControls.pdf>.

<sup>31</sup> Panama made a recent announcement that a major plank in its effort to be removed from tax haven watch lists is to launch WTO cases against countries that put them on such lists. See “Panamá protegerá sus servicios internacionales y financieros,” Xinhua Spanish, Aug. 6, 2009. Available at: <http://spanish.peopledaily.com.cn/31617/6720014.html>; “Panama to accuse Ecuador of discriminatory trade practices before WTO,” BBC, Sept. 18, 2009.

Panama has previously commented in WTO sessions that countries that place limits on the financial service transactions of countries deemed tax havens are violating WTO rules. See Council for Trade in Services, “Report of the Meeting Held on 9 July 2001,” WTO S/C/M/54, Released Aug. 27, 2001. In this meeting, the Panamanian delegation’s intervention focused on how GATS exceptions would not apply to OECD measures on harmful tax havens, because Panama did not have any double taxation treaties (which is one of the GATS exceptions). In regards to the other exception, on the “the imposition or collection of direct taxes in respect to services or service supplier of other members,” the Panamanian delegation said: “It was difficult to imagine how the Panamanian tax regime could have an impact on the ability of other jurisdictions to impose and collect taxes on Panamanian services or suppliers that required the application of discriminatory measures, measures distinct to those used in the cases of other suppliers other than nationality.”

Panama is not alone in advocating this line of argument. Bruce Zagaris, a leading international tax attorney that has represented tax-haven governments, has stated that anti-tax haven measures “are likely to trigger... litigation in the WTO against the United States for discriminating against trade in financial services in violation of the General Agreement on Trade in Services.” See Bruce Zagaris, “Use a Multilateral Approach in International Tax Enforcement,” Tax Analysts, 2009. See bio at: [http://www.bcr.us/2006/en/bruce\\_zagaris.shtml](http://www.bcr.us/2006/en/bruce_zagaris.shtml)

<sup>32</sup> “Today, China and the United States are not mutual parties to any bilateral or multilateral international investment agreements. However, the protections afforded by U.S. IIAs may still be available to Chinese enterprises investing in the U.S. if the Chinese enterprise invests through an intermediate operating company having the nationality of a third country, so long as that third country is a party to such an international instrument with the U.S. That process is often called ‘treaty-shopping.’” See Mark Kantor, “International investment law protections for Chinese investment into the US,” in Karl Sauvant, ed., *Investing in the United States: Is the US Ready for FDI from China?* (Northampton, MA: Edward Elgar, 2010), at 142.

<sup>33</sup> See Public Citizen backgrounder on that case at: <http://bit.ly/dmt8bM>.

<sup>34</sup> The text reads: “Article 12.11: Exceptions: 1. This Chapter or Chapter Nine (Investment), Ten (Cross-Border Trade in Services), Eleven (Telecommunications), Thirteen (Temporary Entry for Business Persons), Fourteen (Competition Policy, Monopolies and State Enterprises), or Fifteen (Electronic Commerce) do not prevent a Party from adopting or maintaining a measure for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. *Where these measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party’s obligations under those provisions.*”

A Canadian restriction on transfers to and from Panama would be a “measure” that would “not conform” with Canada’s “obligations” under Article 9.10.1 to “permit transfers relating to a covered investment to be made freely and without delay, into and out of its territory.” Thus, the measure would be “a means” that Canada would use to not meet the Article 9.10.1 obligations – even though there are perfectly justifiable public policy reasons to deviate from the FTA obligation in order to advance anti-tax haven initiatives.

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<sup>35</sup> The text reads: “Notwithstanding paragraphs 1 and 2, a Party may prevent a transfer through *the equitable, non-discriminatory and good faith application* of its domestic law relating to:

- (a) bankruptcy, insolvency or the protection of the rights of a creditor;
- (b) issuing, trading or dealing in securities, futures, options or derivatives;
- (c) a criminal or penal offence;
- (d) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; or
- (e) ensuring compliance with an order or judgment in judicial or administrative proceedings.” [italics added]

Note that, to qualify for this exception, a Canadian measure is required to be equitable and applied in good faith, which Canada’s anti-tax haven policy would likely be. However, it would also be required to be “non-discriminatory,” which by definition an anti-tax haven policy would not be.

<sup>36</sup> The relevant text reads:

“5. Subject to paragraphs 2, 3 and 6:

- (a) *Article 10.03 (Cross-Border Trade in Services – National Treatment) and Article 12.03 (Financial Services – National Treatment) apply to a taxation measure on income, capital gains or on the taxable capital of corporations that relate to the purchase or consumption of particular services; and*
- (b) *Articles 9.04 and 9.05 (Investment – National Treatment and Most-Favoured-Nation Treatment), Articles 10.03 and 10.04 (Cross-Border Trade in Services – National Treatment and Most-Favoured-Nation Treatment) and Articles 12.03 and 12.04 (Financial Services – National Treatment and Most-Favoured-Nation Treatment) apply to a taxation measure, other than one on income, capital gains or on the taxable capital of corporations.*

6. Paragraph 5 does not:

- (a) impose a most-favoured-nation obligation with respect to an advantage accorded by a Party pursuant to a tax convention;
- (b) impose on a Party an obligation making the receipt, or continued receipt, of an advantage relating to the contributions to, or income of, pension trusts or pension plans conditional on a requirement that the Party maintain continuous jurisdiction over the pension trust or pension plan;
- (c) impose on a Party an obligation making the receipt, or continued receipt, of an advantage relating to the purchase or consumption of a particular service conditional on a requirement that the service be provided in its territory;
- (d) apply to a non-conforming provision of an existing taxation measure;
- (e) apply to the continuation or prompt renewal of a non-conforming provision of an existing taxation measure;
- (f) apply to an amendment to a non-conforming provision of an existing taxation measure provided that the amendment does not decrease its conformity, as it existed immediately before the amendment, with the Articles referred to in paragraph 5; or
- (g) *apply to a new taxation measure that is aimed at ensuring the equitable and effective imposition or collection of taxes (including, for greater certainty, a measure that is taken by a Party in order to ensure compliance with the Party’s taxation system or to prevent the avoidance or evasion of taxes) and that does not arbitrarily discriminate between persons, goods or services of the Parties....*

8. Notwithstanding paragraphs 2 and 3, Article 9.11 (Investment – Expropriation) applies to a taxation measure, but an investor may not invoke that Article as the basis for a claim under Articles 9.20 (Investment – Claim by an Investor of a Party on Its Own Behalf) or 9.21 (Investment – Claim by an Investor of a Party on Behalf of an Enterprise), where the designated authorities of the Parties have determined under this paragraph that a taxation measure is not an expropriation. The investor shall refer the issue of whether a measure is not an expropriation for a determination to the designated authorities of the Parties at the time that it gives notice under subparagraph 2(c) of Article 9.22 (Investment – Conditions Precedent to Submission of a Claim to Arbitration). *If, within a period of six months from the date of this referral, the designated authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation, the investor may submit its claim to arbitration under Article 9.23 (Investment – Submission of a Claim to Arbitration).*

9. A claim by:

- (a) an investor of a Party that a tax measure of the other Party breaches an agreement between a central government authority of that Party and the investor concerning an investment, or

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(b) an investor of a Party, on behalf of an enterprise of the other Party that is a juridical person that the investor owns or controls directly or indirectly, that a tax measure of the other Party breaches an agreement between a central government authority of the other Party and that enterprise, may be submitted to arbitration under Section C of Chapter Nine (Settlement of Disputes between an Investor and the Host Party) *unless the designated authorities of the Parties, within six months of being notified by the investor of its intention to submit the claim to arbitration, jointly determine that the measure does not contravene such agreement.* The investor shall refer the issue of whether a taxation measure does not contravene such agreement for a determination to the designated authorities of the Parties at the same time that it gives notice under Article 9.22 (Investment – Conditions Precedent to Submission of a Claim to Arbitration).” [italics added]

<sup>37</sup> The U.S. “exception” in Article 21.3.4 states only that the National Treatment disciplines do not apply “to the adoption or enforcement of any taxation measure aimed at ensuring the equitable or effective imposition or collection of taxes (as permitted by Article XIV(d) of the GATS);...” See: [http://www.ustr.gov/sites/default/files/uploads/agreements/fta/panama/asset\\_upload\\_file794\\_10401.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/fta/panama/asset_upload_file794_10401.pdf)

For the problems with this language, see Todd Tucker and Lori Wallach, “Panama FTA Would Undermine U.S. Efforts to Stop Offshore Tax-Haven Abuse and Regulate Risky Financial Conduct,” Public Citizen, April 2009. Available at: <http://www.citizen.org/Page.aspx?pid=519>

<sup>38</sup> Ecuador has considered using this tool vis a vis Panama. See “La banca necesita unos 1000 millones,” El Comercio, March 3, 2009; “Los paraísos fiscales en el debate,” El Comercio, March 10, 2009; “Ecuador pide a Panamá no interferir en asuntos internos,” COPE, June 24, 2009. Available at: <http://www.cope.es/mundo/24-06-09--ecuador-pide-panama-no-interferir-asuntos-internos-62602-1>

<sup>39</sup> The text of the Canada-Panama investment treaty is at: <http://www.sice.oas.org/BITS/canpan1e.asp>

Article II(4) reads: “a. Decisions by either Contracting Party, pursuant to measures not inconsistent with this Agreement, as to whether or not to permit an acquisition shall not be subject to the provisions of Articles XIII or XV of this Agreement. b. Decisions by either Contracting Party not to permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors shall not be subject to the provisions of Article XIII of this Agreement.” Article XIII refers to investor-state dispute settlement, while Article XV refers to state-state dispute settlement.

By contrast, all of the core disciplines of the investment chapter in the Canada-Panama FTA are subject to both forms of dispute settlement – even pre-establishment.

The relevant sections from Chapter 9 and 23 are reproduced above on footnote 29. This section from Chapter 12 is also relevant: “Article 12.05: Right of Establishment: 1. A Party shall permit an investor of the other Party that does not own or control a financial institution in the Party’s territory to establish, without the imposition of numerical restrictions or requirements to take a specific juridical form, a financial institution that is permitted to supply a financial service that a like institution of the Party may supply under the domestic law of the Party at the time of establishment. The obligation not to impose a requirement to take a specific juridical form does not prevent a Party from imposing a condition or requirement in connection with the establishment of a particular type of entity chosen by an investor of the other Party. 2. A Party shall permit an investor of the other Party that owns or controls a financial institution in the Party’s territory to establish in that territory such additional financial institutions as may be necessary for the supply of the full range of financial services allowed under the domestic law of the Party at the time of establishment of the additional financial institutions. Subject to Article 12.03, a Party may impose a term or condition on the establishment of additional financial institutions and determine the institutional and juridical form to be used to supply a specified financial service or to carry out of a specified activity. 3. The right of establishment under paragraphs 1 and 2 includes the acquisition of an existing entity.”

<sup>40</sup> See Lori Wallach and Todd Tucker, “Answering critical questions about conflicts between financial reregulation and WTO rules hitherto unaddressed by the WTO Secretariat and other official sources,” Public Citizen, June 22, 2010.