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Memo

From: Todd Tucker, Public Citizen[1]
Date: August 5, 2011
Re: Stop Tax Haven Abuse Act and Panama FTA

Introduction

House Ways & Means Committee Democratic staff have circulated a document (henceforth "WMD document") that attempts to assuage concerns that **the U.S.-Panama "free trade agreement" (FTA) will not alleviate – and indeed may worsen and complicate enforcement related to – tax and financial abuses by Panama and corporations with a presence in one or both countries**. But the document makes a series of misleading claims. There are two fundamental concerns in this debate that we address in this memo, neither of which the WMD document alleviates.

First, **the recently implemented U.S.-Panama Tax Information Exchange Agreement (TIEA) and the complementary legislation passed in Panama fail to adequately address concerns about Panama's financial secrecy**. We do not know if Panama will live up to the letter and spirit of even these limited obligations. This is why the leading tax justice advocates in and outside of Congress – including Senator Obama in 2007 – have called for more robust measures under the Stop Tax Haven Abuse Act (STHAA) and for automatic TIEAs (as opposed to on-request TIEAs). Indeed, Panama may see little reason to promptly comply with the modest voluntary commitments it has made under the TIEA without the threat of enforceable penalties.

Second, **the FTA could make matters worse, by allowing the Panamanian government or financial services suppliers and investors registered there to attack future U.S. anti-tax haven policies**. Some have suggested that Panama would be unlikely to launch dispute settlement under the FTA. As a small developing country, the argument goes, Panama may be unwilling to alienate the U.S., a key trading partner, on such a sensitive issue. There is little historical support for this notion. ***Panama has successfully used trade agreements to challenge anti-money laundering rules, and has threatened WTO dispute settlement over tax haven measures***. Moreover, the contribution of Panama's banking sector to national GDP is nearly three times as high as the contribution of trucking services (and 1,025 times as high as the contribution of tuna fishing) to Mexico's GDP, and Mexico (another developing country, and one with ample diplomatic incentives not to launch trade attacks on the U.S.) has relentlessly pursued high-profile challenges of U.S. tuna labeling and trucking regulations for 20 years.[2]

The first section of this memo addresses the inadequacies of the TIEA and other recent Panamanian policies. The second section provides an overview of some of the tools that

Congress has considered to combat tax havens. The third section provides an overview of relevant FTA rules that limit use of anti-tax haven policies, while the fourth section explores a series of weak defense provisions that some have (unpersuasively) argued could protect the U.S. in the event of a challenge. The fifth section documents the case that Panama successfully brought against Colombia's anti-money laundering rules.

At the outset, it is worth noting that the WMD document states that, "Public Citizen has not identified any specific measure (either in existing U.S. law or under consideration) to address tax haven abuses or money laundering. This makes it difficult to analyze whether such a measure would be inconsistent with U.S. obligations under the FTA." In fact, our 2009 report on the topic explicitly mentions the proposed STHAA (which Public Citizen strongly supports) as a potential FTA violation.[3]

The conflict between anti-tax haven rules and trade rules is not only Public Citizen's perspective. Panama's government has spoken out about how various policies aimed at tax-haven countries could violate World Trade Organization (WTO) rules.[4] Bruce Zagaris, a leading tax attorney, has written in the American Bar Association's attorney training materials that the STHAA…

> "violate[s] the principle in Article II of the GATS [most favored nation, or MFN article, of the General Agreement on Trade in Services] that prohibit countries from discriminating among foreign trading partners on the basis of nationality and require that rules and regulations be based on objective, non-discriminatory criteria. The bills are constructed in a clearly arbitrary and discriminatory manner because the anti-money laundering and tax/corporate transparency laws show that many of the targeted countries meet international standards, while the U.S. does not. In this connection, in light of the U.S. government's protracted non-compliance of the WTO ruling in the online gaming case filed by Antigua and Barbuda, the Caribbean trade delegation in the WTO Doha negotiations also shared their concerns about the enforcement of the rights of small and vulnerable economies (SVEs) in the multilateral trading system. Enactment of the anti-tax haven bills is likely to land the U.S. in another WTO case."[5]

In more recent training materials, Zagaris writes, "countries and persons adversely impacted by countermeasures against tax havens may argue that the countermeasures violate the soft law commitment in the G20 Communique to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) measures to stimulate exports. In particular, the adversely impacted countries and persons may argue and bring petitions against countries imposing countermeasures on the basis that they discriminatorily restrict trade in financial services and investment."[6]

Because **the FTAs' services and investment rules go far beyond U.S. commitments under the WTO's GATS, U.S. tax justice initiatives will be even more vulnerable to FTA challenge**. (While the WTO does not go as far as the FTA, we will nonetheless examine WTO case law to illustrate legal points throughout the memo. This is reasonable, as investor-state and FTA panels often examine WTO precedents. There is no binding precedent doctrine in trade law, but many panelists nonetheless cite other panel rulings.)

1. Inadequacy of Panama's recent tax moves

Weakness of Tax Information Exchange Agreement (TIEA)

On April 18, 2011, the Obama and Martinelli administrations implemented the U.S.-Panama TIEA,[7] following the Panamanian assembly's adoption of the pact on April 13.[8] This came after eight years of foot-dragging by Panama,[9] during which time tax transparency best practice moved far beyond the TIEA template. For instance:

- Internal Revenue Service Commissioner Douglas Shulman stated earlier in June 2010 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."[10]
- 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."[11]
- The Stop Tax Haven Abuse Acts of 2007 and 2009 – cosponsored by Levin in the Senate and Rep. Lloyd Doggett (D-Texas) in the House – called for penalties to be imposed on tax havens that did not have "in effect a treaty or other information exchange agreement with the United States that provides for the prompt, obligatory, *and automatic exchange* of such information as is forseeably relevant for carrying out the provisions of the treaty or agreement or the administration or enforcement of this title…" [italics added][12] Senator Barack Obama was a cosponsor of the 2007 act.
- The United Nations Commission on Reforms of the International Monetary and Financial System (also known as "the Stiglitz Commission," after its chair, Nobel prize winner Joseph Stiglitz) stated: "Institutional arrangements for improving harmonization and cooperation on tax matters need to be strengthened… [the UN] should work to ensure that all countries commit themselves to the voluntary *automatic exchange of information* that would help root out tax evasion and corruption and also the repatriation of illegal funds." [italics added][13]

Indeed, tax experts have noted that requests for information under TIEAs must be framed with a degree of precision that may be nearly impossible to establish. Article 5.5 of the U.S.-Panama TIEA establishes that:

> "Any request for information made by a Party shall be framed with the greatest degree of specificity possible. In all cases, such requests shall specify in writing the following:
>
> (a) the identity of the taxpayer whose tax or criminal liability is at issue;
> (b) the period of time with respect to which the information is requested;
> (c) the nature of the information requested and the form in which the requesting Party would prefer to receive it;

> (d) the matter under the requesting Party's tax law with respect to which the information is sought;
> (e) the reasons for believing that the information requested may be relevant to tax administration and enforcement of the requesting Party, with respect to the person identified in subparagraph (a) of this paragraph;
> (f) grounds for believing that the information requested is present in the requested Party or is in the possession or control of a person within the jurisdiction of the requested Party;
> (g) to the extent known, the name and address of any person believed to be in possession or control of the information requested;
> (h) a statement as to whether the requesting Party would be able to obtain and provide the requested information if a similar request were made by the requested Party;
> (i) a statement that the requesting Party has pursued all reasonable means available in its own territory to obtain the information, except where that would give rise to disproportionate difficulty."

As a CPA and scholar noted,

> "The result is a slow and unwieldy process that precludes serious real-time help to tax authorities. Offshore tax cases are complex and labor-intensive, taking 500 days longer than normal to develop. The cumbersome, low-yield information exchange process contributes to these delays and deters the IRS from aggressive enforcement. Even when the government has proven criminal activity, the process is ineffectual. The U.S. sent tax information requests to Switzerland after UBS admitted to criminal activity; it received back only 12 names (out of an estimated 52,000 U.S. accounts holding $15 billion). It is not surprising that there are only a few dozen TIEA requests each year. To be of genuine value, information sharing needs to be comprehensive, real-time and automatic… The OECD's Model TIEA seems to have adopted a lowest-common-denominator approach – offering minimal effectiveness to gain widespread acceptance by havens, in turn allowing world leaders to proclaim a global assault on offshore tax evasion…. There are many reasons not to engage in offshore tax evasion, but the Model TIEA is not one of them."[14]

Another reason tax experts believe the old TIEA template is outmoded is because it contains many means by which the partner country's government can refuse to cooperate – even when the information request follows these precise guidelines. For instance, Article 6.1(c) of the U.S.-Panama TIEA allows Panama to refuse an information request "where the disclosure of the information requested would be contrary to the public policy of the requested Party." Given Panama's longstanding public policy of encouraging tax haven activities, this Article 6.1 loophole is big enough to drive an offshore economy through.[15] Likewise, Article 6.5 has been criticized because "Panama is not obliged to provide information if the US could not provide such information in comparable circumstances. It is well known that the US has little ability to determine the beneficial owners of corporations organized in many US states, notably Delaware, Nevada, and Wyoming..."[16]

The WMD document responds to these lines of argument by noting the similarity of the U.S.-Panama TIEA (including Article 6) to past TIEAs (e.g. "The U.S.-Panama TIEA is identical in all material respects to" other U.S. TIEAs), and that the "United States does not include automaticity in its TIEAs because we generally do not want to agree to automatically provide information to other countries" and that "Canada may be the only exception".

But a bad precedent does not good policy make. It is precisely because of the frustration on the limitations of outmoded TIEAs that tax experts are counseling a move towards automaticity of information exchange. Even Ways & Means Committee Ranking Member Sander Levin (D-Mich.) and Trade Subcommittee Ranking Member Jim McDermott (D-Wash.) signed onto the STHAA of 2009, which envisioned automatic exchange.

The WMD document quotes an OECD document that states:

> "… Contracting Parties do not have to supply information the disclosure of which would be contrary to public policy (ordre public). 'Public policy' and its French equivalent 'ordre public' refer to information which concerns the vital interests of the Party itself. This exception can only be invoked in extreme cases. For instance, a case of public policy would arise if a tax investigation in the applicant Party were motivated by political or racial persecution. Reasons of public policy might also be invoked where the information constitutes a state secret, for instance sensitive information held by secret services the disclosure of which would be contrary to the vital interests of the requested Party. Thus, issues of public policy should rarely arise in the context of requests for information that otherwise fall within the scope of this Agreement."[17]

But this OECD interpretation is not binding on the parties, and the "public policy" clause is not defined in the agreement itself. In any case, the lack of enforcement mechanisms in the TIEA means that each country will decide if, how and on what terms to cooperate, and Article 6 of the TIEA gives them ample reasons to choose not to cooperate.

The WMD document dismisses the concern that Panama's long-standing policy of actively facilitating tax and regulatory arbitrage activities may make the country more likely to abuse the TIEA's exception provisions. It argues that other tax havens have signed TIEAs, and "staff is not aware of any examples of abuse of the public policy exception in any TIEAs to which the United States is party." Given that the Treasury Department does not disclose other countries' compliance information with TIEAs, it is unclear whether the authors of the WMD document do not have access to the compliance data, did not seek access to the data, or are not persuaded by data in their possession. In any case, no further argumentation is provided, so it is difficult to know what strength to accord this component of the WMD document's argument.

The WMD document also notes that the U.S. has signed comparable TIEAs with other tax havens like the Cayman Islands (2001) and British Virgin Islands (2002). Is the position of the authors that these jurisdictions' tax and regulatory policies are satisfactory? Indeed, the WMD document suggests that this may be their view, where it states that "U.S. tax authorities fully expect that the U.S.-Panama TIEA and the changes Panama made to implement the TIEA will address the problem of Panama serving as a tax haven for U.S. taxpayers seeking to evade taxes. If so, the United States would not need to resort to unilateral measures to address tax evasion…" It is improbable that co-sponsors of any iteration of the STHAA would agree with the statement that the TIEA with the Cayman Islands has dealt with all concerns related to tax and regulatory arbitrage with that jurisdiction. Even if these jurisdictions had a record of perfect compliance with the letter of their TIEAs, there continues to be widespread concern in regards to U.S. tax evasion and avoidance in these jurisdictions.

Indeed, **the lingering of such concerns appears to be a fundamental motivation behind the STHAA legislation**. Every effective lawmaker understands the importance of having ***both*** "carrots and sticks": carrots may be more effective when ultimate recourse to sticks is on the table. But as we show in this memo, **while the TIEA carrot is not enforceable, the FTA gives Panama an enforceable means of disarming the U.S. stick. The U.S. Congress should never waive its right to use "unilateral measures" as a backstop without risking FTA attacks.**

Moreover, in the case of Panama (and unlike other tax havens to our knowledge), the Martinelli administration is on the record describing the limited reach of the TIEA, and that it won't allow fishing expeditions.[18] Panamanian business leaders have also launched a constitutional challenge to the TIEA.[19] In sum, it is unknown and unknowable whether Panama will comply with even its limited TIEA commitments. But the available evidence argues for much more precaution than what the Obama administration is demonstrating by not renegotiating the FTA to carve out all tax justice policy space.

Other Weak Financial Policy Changes in Panama

The WMD document makes no attempt to analyze other recent Panamanian measures. The character of these measures also serves as important evidence of Panama's weak commitment to tax justice reform. When the TIEA was signed, the Obama administration exchanged a diplomatic note with the Martinelli administration regarding additional domestic transparency promises.[20] But Panama's actual domestic legislative changes have been very disappointing. For instance, Panama's executive branch drafted "Know Your Client" legislation (Bill Number 275, presented on Jan. 11, 2011), that started off weak and was even further watered down in the National Assembly. The Martinelli administration signed the weak bill into law on February 1.[21]

First, lawyers that violate the "Know Your Client" legislation would see their temporary suspension period from offering registered agent services shrink from one to three years in the Martinelli administration's proposal, to as little as three months in the National Assembly-approved legislation (see Article 20).[22] In other words, after a small slap on the wrist, a lawyer could return to offering nontransparent services to anonymous tax dodgers, assuming the laws are enforced in the first place (a big "if").

Second, the Martinelli proposal would have required resident agents to: 1) identify their clients and verify that identity through a paper trail; 2) ascertain the purpose for the creation of the corporate entity; and 3) share information with the government under certain extenuating circumstances. But the National Assembly scaled this back so that, in order to comply with item No. 2, "the resident agent shall not have the obligation to carry out any proactive step or verification of the information provided by the client." (Article 3, as amended.) In other words, trust, but do not verify.

Moreover, the fines for failing to preserve financial secrecy under the "Know Your Client" legislation are as much as five times larger than the sanctions for failing to cooperate with the legislation's limited information gathering and cooperation mandates.[23]

The U.S. government has repeatedly noted the problem with bearer shares and other Panamanian practices. In 2009, the U.S. Embassy in Panama said, "should the [Government of Panama] GOP agree to immobilize bearer shares and/or regulate anonymous corporations, it would address their single area of FATF 40 9 non-compliance in the 2006 IMF/FATF Financial Sector Review and represent a significant step forward in achieving greater transparency."[24]

The State Department's 2011 International Narcotics Control report is even starker:

> "Panama's strategic geographic location and its economic openness make it a natural location for laundering money derived from drug sales. However, location is only one reason for Panama's attractiveness for money launderers. Panama is promoting itself as the new hub for Central America because it is a leader in developing the physical and financial infrastructure that go with that role. The Colon Free Trade Zone is the second largest free trade zone in the world and the major airline, Copa, is expanding international and local flights. The financial sector is increasing direct marketing efforts to attract regional financial institutions. This current and future access to infrastructure and global connections attracts international clients who know how to use financial and commercial accounts for money laundering.
>
> During 2010, Panama made progress on the policy front in improving the transparency of its financial system… **Unfortunately, the lack of enforcement of Panamanian banking and anti-money laundering laws undercuts the policy progress the GOP has made**. The very factors that contribute to Panama's economic growth and financial sector sophistication – the dollar-based economy, the large number of offshore banks and shell companies, loosely regulated free trade zones, and sustained growth in the ports and maritime industries – are also mechanisms that are vulnerable to abuse for money laundering and other illicit financial activities. Legislation that allows bearer share corporations remains in effect and provides a near impenetrable corporate veil for shareholders. In addition, corruption and weak regulatory bodies impede Panama's progress toward a more transparent economy [emphasis added]."[25]

While the Martinelli administration has played up the recent policy changes for maximum public relations advantage in the international media, back at home they have been more candid about their real intentions. In announcing the campaign to get off of the OECD gray lists, Panama set up a government-corporate initiative called the High Level Presidential Commission for the Defense of International Services ("*Comisión de Alto Nivel Presidencial para la Defensa de los Servicios Internacionales*"). Panamanian officials said that – in addition to tax treaties as a carrot – WTO attacks on countries' anti tax-haven initiatives can be the stick to ward off challenges to Panama's service sector. They said these "are part of the measures contemplated in the national strategy to promote and defend Panama's service sector."[26] In January 2011, after the signing of the U.S. TIEA, Panamanian official Frank de Lima bragged to a reporter how little would change: "We'll maintain competitive advantages like bearer shares (other jurisdictions have eliminated them) and we won't immobilize bearer shares as other jurisdictions have done."[27]

2. Possible U.S. approaches to combating tax havens

U.S. legislators have considered various approaches to combating tax havens. We consider three approaches in this section.

First, Section 101 of the Stop Tax Haven Abuse Act (STHAA) of 2007 and 2009 empowered the Treasury Secretary to craft a list of "offshore secrecy jurisdictions." The determination would be informed by considerations such as whether the country automatically exchanged tax information with the United States. The legislation contained an initial list of secrecy jurisdictions that included Panama. The STHAA would have created various rebuttable presumptions regarding U.S. persons that transacted with entities in such jurisdictions. This rule would make it easier for the IRS in civil proceedings to pursue its tax collection goals.

A second approach is contained in the Foreign Account Tax Compliance Act (FATCA), enacted in 2010. That bill subjects transfers to foreign financial institutions to the 30 percent U.S. tax withholding, unless the foreign financial institution chooses to send information to the IRS on its U.S. clients. Section 102 of the 2011 STHAA would amend FATCA by creating rebuttable presumptions regarding transfers to institutions that do not participate in the FATCA system. It appears that the FATCA-based approach was favored because it was argued that "blacklists" were unpopular with tax haven governments.[28]

A third approach is contained in all the iterations of STHAA and would amend and extend Patriot Act style sanctions to tax haven jurisdictions.[29] The Patriot Act (31 U.S.C. Sec. 5318A (b)(5)) states:

> "If the [Treasury] Secretary finds a jurisdiction outside of the United States, 1 or more financial institutions operating outside of the United States, or 1 or more classes of transactions within, or involving, a jurisdiction outside of the United States to be of primary money laundering concern, the Secretary, in consultation with the Secretary of State, the Attorney General, and the Chairman of the Board of Governors of the Federal Reserve System, *may prohibit, or impose conditions upon, the opening or maintaining in the United States of a correspondent account or payable-through account by any domestic financial institution or domestic financial agency for or on behalf of a foreign banking institution, if such correspondent account or payable-through account involves any such jurisdiction or institution*, or if any such transaction may be conducted through such correspondent account or payable-through account" [italics added].[30]

In making this determination, the Treasury Secretary…

> "shall consider in addition such information as the Secretary determines to be relevant, including the following potentially relevant factors:
> (A) Jurisdictional factors.— In the case of a particular jurisdiction—

(i) evidence that organized criminal groups, international terrorists, or entities involved in the proliferation of weapons of mass destruction or missiles have transacted business in that jurisdiction;
(ii) the extent to which that jurisdiction or financial institutions operating in that jurisdiction offer bank secrecy or special regulatory advantages to nonresidents or nondomiciliaries of that jurisdiction;
(iii) the substance and quality of administration of the bank supervisory and counter-money laundering laws of that jurisdiction;
(iv) the relationship between the volume of financial transactions occurring in that jurisdiction and the size of the economy of the jurisdiction;
(v) the extent to which that jurisdiction is characterized as an offshore banking or secrecy haven by credible international organizations or multilateral expert groups;
(vi) whether the United States has a mutual legal assistance treaty with that jurisdiction, and the experience of United States law enforcement officials and regulatory officials in obtaining information about transactions originating in or routed through or to such jurisdiction; and
(vii) *the extent to which that jurisdiction is characterized by high levels of official or institutional corruption*." [italics added]

This laudable approach has nonetheless been controversial internationally. The Patriot Act has generated much consternation among trading partners such as the European Union.[31] The STHAA uses and extends this controversial approach. Section 101 of the 2011 STHAA would amend 31 U.S.C. Sec. 5318A (b)(5) to state:

> "PROHIBITIONS OR CONDITIONS ON OPENING OR MAINTAINING CERTAIN CORRESPONDENT OR PAYABLE-THROUGH ACCOUNTS OR AUTHORIZING CERTAIN PAYMENT CARDS.—If the Secretary finds a jurisdiction outside of the United States, 1 or more financial institutions operating outside of the United States, or 1 or more classes of transactions within or involving a jurisdiction outside of the United States to be of primary money laundering concern or to be impeding United States tax enforcement, the Secretary, in consultation with the Secretary of State, the Attorney General of the United States, and the Chairman of the Board of Governors of the Federal Reserve System, may prohibit, or impose conditions upon—
>
> > (A) the opening or maintaining in the United States of a correspondent account or payable-through account; or
> >
> > (B) the authorization, approval, or use in the United States of a credit card, charge card, debit card, or similar credit or debit financial instrument by any domestic financial institution, financial agency, or credit card company or association, for or on behalf of a foreign banking institution,
>
> if such correspondent account, payable-through account, credit card, charge card, debit card, or similar credit or debit financial instrument, involves any such jurisdiction or institution, or if any such transaction may be conducted through such correspondent

account, payable-through account, credit card, charge card, debit card, or similar credit or debit financial instrument."

The factors informing the Treasury Department's finding are similarly amended to add tax enforcement related provisions. One of these factors – but only one – is the existence of a TIEA. It is interesting that Panama would meet many of the criteria in the original Patriot Act, and certainly in the proposed changes to it under the Stop Tax Haven Abuse Act, as Wikileaks confirms even the U.S. government believes.[32]

3. FTA Could Undermine U.S. Anti-Tax Haven Efforts

There are multiple ways that a U.S. anti-tax haven initiative could be hampered by the U.S.-Panama FTA. For the purposes of illustration and unless otherwise noted, we will focus on the third approach outlined in Section 2 above: that of Section 101 of the STHAA of 2011.

A. Scope issues

If a dispute settlement or arbitral panel were convened to hear a case brought against the United States by the Panamanian government or a Panama-registered corporations, the panel's first task would be to define whether the challenged measure falls under FTA Chapter 12 (Financial Services), Chapter 11 (Cross-Border Trade in Services) or Chapter 10 (Investment).[33] Depending on this determination, the claimant could argue that the U.S. measure violated particular U.S. substantive obligations. Similarly, the U.S. could invoke slightly different defenses depending on the chapter. (Unfortunately, as we show below, the U.S. defenses would be unlikely to be given much weight in the event of an FTA challenge of the STHAA.)

Chapter 12 defines "financial services" broadly as including everything from credit cards, to bank deposits, to derivatives and swaps.[34] The Chapter applies to all "measures adopted or maintained by a Party *relating to*: a) financial institutions of the other Party; b) investors of the other Party, and investments in such investors, in financial institutions in the Party's territory; and c) cross-border trade in financial services" [italics added] (Article 12.1).

Chapter 11, in contrast, applies "to measures adopted or maintained by a Party *affecting* cross-border trade in services by service suppliers of the other Party…" (Article 11.1, italics added).

And while Article 12.1 establishes that Chapter 12 applies to measures "relating to" investors and investments *in financial institutions*, Chapter 10 applies to a broader set of measures: those "adopted or maintained by a Party relating to: (a) investors of the other Party; [and] (b) covered investments…" (Article 10.1)

The meaning of "measures" can include statutes, regulations, court decisions, agency determinations, and government actions to implement any of the foregoing. "Measures" can even include statutes that grant the executive the discretion to impose certain sanctions or take enforcement actions, without requiring that these actions be taken.[35]

In other trade law contexts, the phrase "relating to" has been interpreted as meaning "primarily aimed at."[36] If a panel followed trade law precedent, an anti-tax haven initiative would only fall under Chapter 12 if it were shown to be "primarily aimed at", say, "cross-border trade in financial services" or investments in financial institutions. If the measure were aimed at a broader range of cross-border service providers than only cross-border *financial* services suppliers, the measure would instead fall (at least in part) under Chapter 11.

It is unclear how a panel would categorize the STHAA. Although the bill would clearly have significant implications for cross-border *financial* service providers and investors in *financial* institutions, the measure would have impacts on *non-financial* service suppliers as well. The STHAA could probably be interpreted as a measure relating to financial services, or a measure affecting cross-border services, or some combination therein. How a panel determined this would influence what obligations the U.S. had to meet, and what exceptions it could invoke.

The definition of protected investments in Chapters 12 and 10 also differ. Article 10.29 in Chapter 10 defines investment very broadly:

> "**investment** means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, *the expectation of gain or profit, or the assumption of risk*. Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) *futures, options, and other derivatives*; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges..." [italics added, internal footnotes omitted]

Chapter 12, in contrast, which applies to measures primarily aimed at "investors of the other Party, and investments of such investors, in *financial* institutions *in the Party's territory*;" states:

> "**investment** means 'investment' as defined in Article 10.29 (Definitions), except that, with respect to 'loans' and 'debt instruments' referred to in that Article:
> (a) a loan to or debt instrument issued by a financial institution is an investment only where it is treated as regulatory capital by the Party in whose territory the financial institution is located; and
> (b) a loan granted by or debt instrument owned by a financial institution, other than a loan to or debt instrument of a financial institution referred to in subparagraph (a), is not an investment;
>
> for greater certainty, a loan granted by or debt instrument owned by a cross-border financial service supplier, other than a loan to or debt instrument issued by a financial institution, is an investment for purposes of Chapter 10 (Investment) if such loan or debt instrument meets the criteria for investments set out in Article 10.29 (Definitions)…"

These definitions of investment are troubling. As half of the members of the State Department Model BIT Subcommittee wrote, "the definition of 'Investment' in [trade and investment pacts] is much broader than the real property rights and other specific interests in property that are protected under the U.S. Constitution. The inclusion of 'futures, options, and derivatives' is also worrisome, given the troublesome role these instruments played in the financial crisis and ongoing regulatory reform efforts."[37] The U.S. Supreme Court has noted that "a mere unilateral expectation or an abstract need is not a property interest entitled to protection,"[38] and "business in the sense of the activity of doing business, or the activity of making a profit is not property in the ordinary sense."[39] The Panama FTA, in contrast, states that the mere "expectation of gain or profit" is a sufficient characteristic to endow an "asset" with the status of "investment" subject to FTA protection.

WMD Document Obscures FTA's Scope

The WMD document states that "the FTA does not govern the relationship between the United States and its citizens. The United States only takes obligations vis a vis Panama (and, indirectly, Panamanian exporters and investors operating in the United States). For example, while it is true that the United States is generally required to treat Panamanian financial services suppliers no less favorably than U.S. suppliers, it is not clear how this obligation would ever undermine any measure to address tax evasion by a U.S. citizen. Thus, the national treatment and MFN obligations do not appear to be relevant."

This obscures the FTA's scope in several ways. First, to the extent that measures between the U.S. and its citizens "affect cross-border trade in services" by Panamanian suppliers, it could be covered under Chapter 11. To the extent that these measures "relate to" Panamanian cross-border financial service suppliers or investors, they could be covered by Chapter 12 and 10 respectively.

Moreover, the WMD document seems to conflate the underlying income taxation measures (which apply to U.S. citizens and taxpayers) with ancillary enforcement measures like the STHAA. Section 101 of the STHAA clearly envisions sanctions that would limit transfers to and from tax haven countries as a whole. Such enforcement measures would likely be seen as affecting or relating to Panamanian cross-border service suppliers, if Panama was designated as a problem country under the STHAA.

B. STHAA Analysis Under Chapter 12

If the STHAA were deemed as falling under Chapter 12, there would be various standards it would have to meet to be FTA-compliant. Here are some of the most relevant:

1. **Open markets:** Article 12.5.2 states: "Each Party shall permit persons located in its territory, and its nationals wherever located, to purchase financial services from cross-border financial service suppliers of the other Party located in the territory of the other Party."[40] This means that the U.S. commits to allow its citizens and anyone who happens to be in the U.S. to

purchase Panamanian financial services located in Panama. The U.S. also commits to allow U.S. nationals to access these services directly in Panama, or anywhere else outside the U.S..

2. **Free transfers:** Article 12.1.2 also incorporates FTA Articles 10.8 and 11.10 into the financial services rules that the U.S. must follow. These require transfers “relating to” (respectively) financial services investments and cross-border supply in financial services “to be made freely and without delay into and out of [a Party’s] territory.”[41] In other words, say a U.S. client wishes to consume Panamanian banking services, the supply of which almost definitionally would lead to transfers and payments between the client and service supplier. Under the FTA, the U.S. commits to allow all transfers related to the supply of this service to go back and forth freely and without delay in and out of the U.S. to Panama. Even measures that do not take conventional transfer-restricting forms, like enforcement actions, could be shown to amount to a transfer restriction.[42]
3. **Panama must be treated on par with other countries:** While the U.S. has carved out the right to treat Panamanian cross-border financial service suppliers less favorably than it treats *U.S.* investors “in like circumstances” (see Articles 12.2.3 and 12.5.1, and Annex 12.5.1), it is obligated to accord Panamanian cross-border financial service suppliers treatment “no less favorable” than it accords third-country investors: say, Canadian cross-border financial service suppliers. This is known as the most favored nation (MFN) principle, and is contained in Article 12.3.1. The notion of “like circumstances” in trade and investment law has been interpreted to mean suppliers that supply the same service,[43] or investors in the same economic sector.[44] The U.S. attempted to argue under the *Cross-Border Trucking Services* case in NAFTA that “in like circumstances” should mean “subject to similar regulations,” and that Mexican providers were in unlike circumstances with U.S. providers because of Mexico’s weaker regulatory regime for trucks. But the five-member dispute settlement panel rejected that argument, saying that it would render NAFTA services trade commitments “meaningless.”[45] The “no less favorable” clause has been interpreted to prohibit both *de jure* and *de facto* discrimination.[46] Specifically, treatment can be deemed de facto “less favorable” when the challenged measure “modifies the conditions of competition in the relevant market to the detriment” of foreign competitors.[47]
4. **The U.S. lists no relevant non-conforming measures.** Article 12.9 of the FTA allows countries to list non-conforming measures (NCMs) in an Annex III of the agreement to numbered items 1 and 3 (but not item 2) above. The U.S. lists no NCMs in Annex III relevant to the STHAA.

The threat of (indirectly) restricting U.S. taxpayers’ access to foreign bank services in problematic jurisdictions is precisely the policy mechanism envisioned by Section 101 of the STHAA of 2011. If the FTA is signed, the U.S. would never be able to apply Section 101 against Panama without risking a claim of violation of any or multiple of these FTA provisions. Panama would be able to argue one or multiple of the following claims:

1. A determination to prohibit U.S. firms from processing credit cards issued in Panama or opening correspondent accounts for transactions with Panamanian institutions is in effect a prohibition on cross-border financial services trade with Panama contrary to U.S. obligations under Article 12.5.2. While the U.S. could argue that the determination does not *prohibit* this trade per se (but only *limits* U.S. institutions’ ability to process the trade), a trade or investment panel would be unlikely to give such an argument weight. The WTO Appellate

Body has determined that measures that take the form of a prohibited market access measure or "in effect" prohibit market access should be seen as equally incompliant with trade obligations.[48] Limiting U.S. firms' ability to process transactions related to Panama would be "in effect" a market access ban on Panamanian cross-border financial service suppliers.[49]

2. Even if the market access argument failed, the argument that STHAA violates the FTA's free transfer provisions for cross-border trade in financial services like payments processing is much more straightforward.
3. Panama could also argue that, because the STHAA determination would name Panama, it is a *de jure* discrimination that treats Panamanian financial service suppliers less favorably than third-party financial service suppliers. While that argument would almost certainly hold, Panama would also have the option of arguing that it *de facto* discriminates by modifying the conditions of competition in favor of non-Panamanian financial services (i.e. service suppliers from countries not subject to the STHAA determination.)

If Treasury were to fail to utilize its Section 101 authorities, Congress may decide in the future to enact legislation that would reduce Treasury's discretion and require that market access for U.S. consumers to Panama's service suppliers be prohibited if certain thresholds were met. In that case, Panama would even be able to challenge the measure before Treasury were to apply it.

FTA Obligations Go Beyond the WTO

The U.S. currently would be able to apply Section 101 of the STHAA against Panama without running afoul of its WTO services trade commitments. The FTA contains broader transfers obligations than what the U.S. undertook in the WTO services agreement: the U.S. has virtually no Mode 1 market access or transfers commitments in financial services ("cross border supply", where the consumer is located in the U.S. but the financial service provider is overseas, such as through the Internet) and the GATS does not appear to contain transfers obligations for Mode 2 ("consumption abroad", as when a U.S. client travels to Panama to consume banking services).

Moreover, the WTO has one procedural protection for tax-related challenges that the FTA does not have. GATS Article XXII states that a member "may not invoke" dispute settlement against another WTO member for a national treatment violation if the two members have a double taxation treaty (DTT) with one another, and if the challenged measure falls within the DTT's scope. This in effect states that DTTs can trump WTO rules in certain instances.

This procedural protection is not perfect. First, it only applies to national treatment (not MFN) violations. Second, the scope of covered tax agreements may not apply to TIEAs. Third, the scope of the covered measures could be construed too narrowly to provide sufficient protections. Finally, if the two members disagree as to the applicability of Article XXII, an arbitrator can authorize the case to proceed anyway. But it is a procedural protection not contained in the FTA.

C. STHAA Analysis Under Chapter 11

As noted in the section above on scope, it is possible that a panel could find that the STHAA or other anti-tax haven measures could be interpreted to be a measure "adopted or maintained by a Party affecting cross-border trade in services by service suppliers of the other Party" more generally, rather than pertaining to Chapter 12 financial services obligations (which deal more with regulation of financial services providers *per se,* in their capacity as banks, etc.).

In some respects, the U.S. has wider obligations under Chapter 11 than Chapter 12, including:

1. **No bans or quantitative limitations:** Article 11.4 is a "ban on bans." It will keep the U.S. from banning (i.e. capping at zero) "the total value of service transactions" from Panamanian suppliers of services subject to Chapter 11 scope.
2. **Free transfers:** We've already covered Article 11.10, which is incorporated by reference into Chapter 12. The U.S. commits to allow all transfers related to cross-border service supplies to enter and exit the U.S. freely and without delay.
3. **Panama must be treated on par with service suppliers from the U.S. and other countries:** In Chapter 12 on financial services, the U.S. took limited national treatment commitments, but more extensive MFN treatments. This obligated the U.S. to treat Panamanian financial service suppliers no less favorably than Canadian financial service suppliers, but did not require the U.S. to treat Panamanian financial service suppliers as favorably as *U.S.* financial services providers. This distinction is erased in Chapter 11, which simply requires that Panamanian cross-border services suppliers be treated no less favorably than U.S. or Canadian service suppliers.
4. **The U.S. lists no relevant non-conforming measures.** Article 11.6 of the FTA allows countries to list non-conforming measures (NCM) in Annexes I and II of the agreement to numbered items 1 and 3 (but not item 2) above. But the U.S. took no NCM in these annexes relevant to the STHAA.[50]

D. STHAA Analysis Under Chapter 10

The STHAA and other tax haven measures could also be challenged under Chapter 10, which will afford certain privileges to Panama-registered investors operating in the U.S. with respect to their U.S. investments operations, and covered investments of Panama-registered enterprises. Investors in financial institutions (e.g. stockholders in banks) would have recourse to investor-state arbitration for claims of indirect expropriation and free transfers.[51] Every other type of investor (including those that incidentally use banks to facilitate their investments) would additionally be able to launch investor-state claims for national treatment, MFN, fair and equitable treatment, and other violations. The Panamanian government could launch claims on behalf of its investors on any of these grounds – whether or not the measure related to financial services.

- Fair and equitable treatment claims can lead to arguments that new regulations went against an investor's expectations when they made the investment, and that they should be compensated for the kinds of profits that they could have made in the pre-regulated environment. This is the most common and most successful basis for arbitral awards in favor of investors;

- National treatment and MFN claims can cite (even inadvertent) modifications to the conditions of competition as grounds for demanding compensation; and
- Indirect expropriation claims can lead to cash awards for regulatory measures that do not destroy all of an investment's value, where the state does not physically appropriate or invade the investment, and that affect investments other than real property. This is the international corollary of the controversial U.S. "regulatory takings" debate.[52]

A detailed exposition of these standards is beyond the scope of this memo, but a few points are in order, especially since the WMD document questions the plausibility of an investor-state case on tax justice matters. Certainly, the STHAA in its various iterations contemplates actions primarily on cross-border transactions that are intended to incentivize better behavior from offshore jurisdictions and institutions (like the government of Panama and the entities offering services there). But an important part of the U.S. tax justice agenda is also about changing domestic rules governing conduct in U.S. territory. Indeed, one of the WMD document's arguments against Public Citizen is that many anti-tax haven measures are directed at "U.S. entities." But as the current fight over FATCA makes clear, distinctions must be made between "U.S. entities" proper, and the foreign-owned entities operating in the U.S. To the extent that these latter entities feel that new tax justice measures diminish their future profits, they may seek to launch investor-state proceedings.

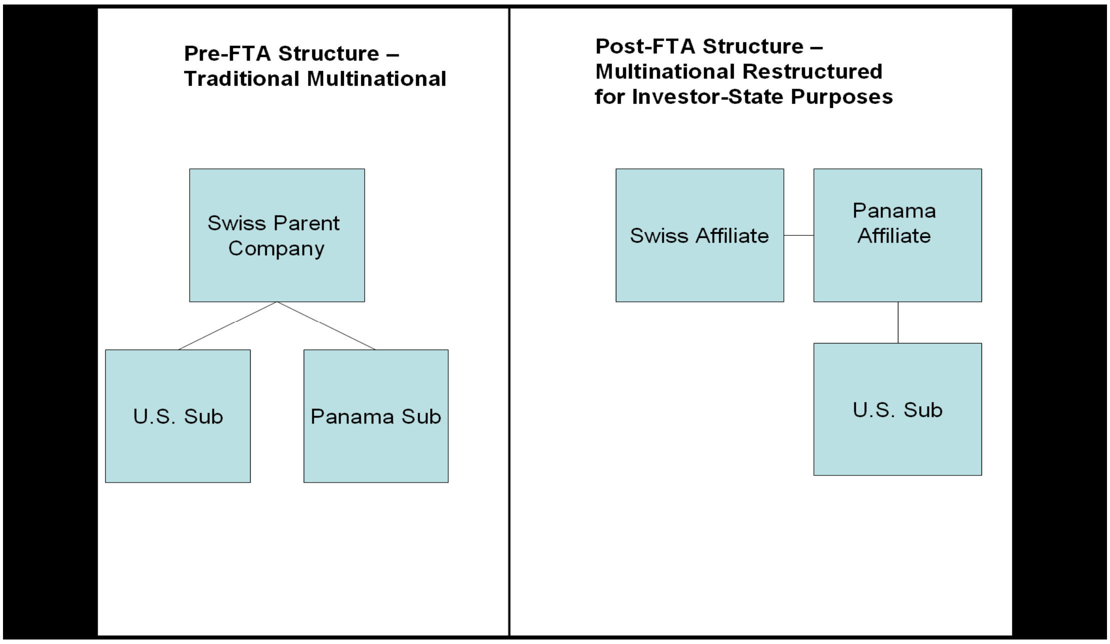
While there may be few traditional Panamanian investors operating in the U.S., a wide range of investors could utilize incorporation in Panama to claim Panamanian status for FTA purposes. Figure 1 displays how this could occur. Say a Swiss multinational has operations in the U.S. and Panama. The company has to deal with regulators in all three countries, and enjoys only those rights guaranteed to its subsidiaries under applicable domestic law. Say the U.S. announced a series of new transparency initiatives, limitations on transfers, or some other policy affecting all investors in the U.S. There is no U.S.-Swiss FTA, so the corporation enjoys no FTA investor rights. Once the U.S.-Panama FTA goes into place, however, the Swiss multinational could restructure its operations so that the Panamanian operation is the owner and controller of the U.S. operation.[53]

This is not as far-fetched as it may seem, for several reasons:

- There are an estimated 400,000 corporations registered in Panama – many of them connected to multinational corporate families that might be able to employ such a restructuring strategy.[54]
- Corporations can and have used sophisticated shell games that have benefited them in their ability to launch investor-state cases. In 2008, a Canadian firm that would not have had standing under CAFTA, Pacific Rim Mining Corp., reincorporated in the United States shortly before filing a CAFTA investor-state case against El Salvador.[55]
- In one investor-state case, the presence of two employees and a small paper trail in the claimed home country was seen as evidence of "substantial business activities" sufficient to avoid a denial of benefits.[56]

- Chinese corporations 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.[57]
- Moreover, Chinese companies' aggressive use of "reverse mergers" – where defunct but pre-existing U.S. companies that meet regulatory requirements absorb a vibrant Chinese firm that might not meet U.S. regulatory requirements – proves that nationality planning is alive and well.[58]

FIGURE 1: GAMING FTA SYSTEM TO GAIN STANDING



WMD document misrepresents the U.S.-Panama BIT

The WMD document states that "last year, a U.S. investor lost an investor-state case against Panama under the U.S.-Panama bilateral investment treaty ('BIT'). In that case, the investor asserted that Panama's actions associated with its attempt to transfer certain fiscal tax credits to third parties constituted an indirect expropriation. The arbitrator disagreed and ordered the investor to pay the Government of Panama $4.6 million in attorney fees and costs." An internal footnote says, "The BIT was concluded in 1982. It will be suspended once the FTA enters into force, and replaced with the investment obligations in the FTA. The investment obligations in the FTA provide a number of safeguards that are not found in the BIT."

This passage is misleading on a number of counts. The draft statement of administrative action on the FTA states that the FTA "does not change the provisions of any agreement the United States has previously negotiated with Panama. Article 1.3.2 of the Agreement suspends on the date the Agreement enters into force Articles VII and VIII of the *Treaty Between the United*

States of America and the Republic of Panama Concerning the Treatment and Protection of Investments, with Annex and Agreed Minutes, signed at Washington on October 27, 1982 (the "Treaty") concerning investor-to-state and state-to-state dispute settlement, respectively. However, Article 1.3.3 of the Agreement preserves, for ten years, the option of invoking dispute settlement under the Treaty with respect to investments covered by the Treaty as of the date of entry into force of the Agreement and in the case of disputes that arose prior to the date of entry into force of the Agreement. Article 1.3.3 also preserves investor-to-state dispute settlement under the Treaty with respect to disputes arising on or after the date of entry into force of the Agreement out of an investment agreement that was in effect before the date of entry into force of the Agreement. If the Agreement terminates, the dispute settlement provisions of the Treaty will automatically resume operation."[59]

In other words, the BIT will not be suspended. It will coexist in its entirety for the first 10 years of the FTA, and could continue to exist if the FTA is ever discontinued. In between, only two articles of the BIT are suspended: Articles VII and VIII. These articles spell out the dispute settlement procedure under the BIT.[60] The rest of the BIT would presumably continue to coexist with the FTA.

While it is true that the FTA contains additional exception language, these defenses are weak, as we note below. Moreover, the FTA goes beyond the BIT in its substantive rights. According to the U.S. International Trade Commission, the FTA "would extend coverage to a significant number of industry sectors which were excluded from the BIT… One particular area of new opportunity for U.S. investors is in the Panamanian retail sector, where investment would be permitted beginning in 2010."[61] The FTA's definition of investment is also expanded relative to the BIT to include the expectation of gain or profit, or the assumption of risk; bonds, debentures, other debt instruments, and loans; futures, options, and other derivatives; authorizations and similar rights conferred pursuant to domestic law; and movable or immovable property, and related property rights, such as leases. In short, **a wide range of challenges could be launched under the FTA that were not possible under the BIT.**

Finally, the WMD document notes the finalization of the first BIT case under the U.S.-Panama BIT, but omits very pertinent information. José María Chillón Medina, the tribunalist picked by the claimants, argued that even hortatory tax obligations under the BIT should be seen as binding.[62] Chillón constituted the minority in this case. But investors help select two of the three tribunalists, and these proceedings lack the traditional hallmarks of judicial independence. This creates a structural bias in favor of investors and against governments.[63] Thus, this line of argument could easily be taken up by panelists under a U.S.-Panama investor-state case.[64]

IV. FTA exception provisions unlikely to help shield the STHAA from FTA challenge

A. Chapter 12 defenses

If the STHAA were successfully challenged as a violation of a Chapter 12 rule, the U.S. may choose to invoke various defenses listed in Article 12.10. Before examining these in any detail, it

is important to emphasize that trade and investment panels place much more emphasis on maximization of trade volumes than they do over domestic policy space.[65] This bias (which is reflected in the rules that panels interpret) has limited the utility of defense provisions.

Articles 12.10.1 and 12.10.2 would apply only to Panamanian financial service suppliers or investors operating *in the U.S. territory*, so would not be relevant for analysis of the STHAA under Chapter 12.[66] But Articles 12.10.3 and 12.10.4 may be more relevant. They read:

> Article 12.10.3: "Notwithstanding Articles 10.8 (Transfers) and 11.10 (Transfers and Payments), as incorporated into this Chapter, a Party may prevent or limit transfers by a financial institution or cross-border financial service supplier to, or for the benefit of, an affiliate of or person related to such institution or supplier, *through the equitable, non-discriminatory, and good faith application of measures relating to maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service suppliers*. This paragraph does not prejudice any other provision of this Agreement that permits a Party to restrict transfers."
>
> Article 12.10.4: "For greater certainty, nothing in this Chapter shall be construed to prevent the adoption or enforcement by any Party of measures *necessary* to secure compliance with laws or regulations *that are not inconsistent with this Chapter*, including those relating to the prevention of deceptive and fraudulent practices or to deal with the effects of a default on financial services contracts, *subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on investment in financial institutions or cross-border trade in financial services*." [italics added]

At first read, either of these provisions may appear to constitute defenses for a Section 101 determination under the STHAA. Unfortunately, Article 12.10.3 has two clauses that show it would not be applicable to such a measure. First, because penalties pursuant to Section 101 of the STHAA would be explicitly targeting "bad actor" countries, it would not survive the requirement that measures be "non-discriminatory." These penalties would undoubtedly tilt the conditions of competition in favor of non-Panamanian financial service suppliers to the detriment of Panamanian financial service suppliers, even if that was not Treasury's primary aim. (Indeed, their very design would single out Panama on a de jure discriminatory basis, and Panama would not even need to establish that a single Panamanian service supplier had been actually injured for the measure to be deemed FTA-illegal.) Second, the requirement that measures relate "*to maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service suppliers*" suggests that this provision is intended solely to protect the health of individual service suppliers or institutions. The STHAA is, in contrast, about the interests of the U.S. government and public as a whole.[67]

It would also be difficult to defend the STHAA under Article 12.10.4. In the *Cross-Border Trucking Services* case under NAFTA, the panel rejected the U.S. invocation of a similar defense. First, the panel noted that trade panels had interpreted the "necessary to secure compliance" obligation "strictly," and have "required that a Party adopt measures reasonably available to it that were the least inconsistent" with trade pact obligations. Bilateral diplomatic consultations were deemed less trade restrictive and thus more consistent with NAFTA than unilateral moratoriums or embargoes.

Second, the *Trucking* panel also stated that in order for the defense to work and "in order for the U.S. moratorium on processing of Mexican applications for operating authority to be NAFTA-legal, any moratorium must secure compliance with some other law or regulation that does not discriminate…" The panel did not delve more deeply into the notion that the underlying law or regulation must be "not inconsistent" with trade pact obligations. (We know from other GATT/WTO cases that, when the underlying measure violates trade pact rules, the defense under comparable exception provisions fails.[68])

(The panel did, however, reference the successful U.S. attack at the WTO on Canada's periodical taxation policies. In that case, the panel did not rule on the WTO-consistency of the underlying taxation policy, but only because the U.S. had not formally challenged it. Instead, the panel noted the necessity of separately analyzing the WTO-consistency of the initial taxation requirement and the enforcement instruments ("measures") ancillary to that requirement. **The WTO panel found that Canada could not utilize a defense measure worded similarly to Panama FTA Article 12.10.4, even though the challenged enforcement measure "greatly reduced" the "possibility of non-compliance with a tax provision" of domestic law**.[69])

Finally, the *Trucking* panel noted that "the United States was well aware during NAFTA negotiations that the Mexican truck regulatory system was deficient in many respects in the U.S. view, and that many changes would be required to improve it significantly." The panel noted, however, that despite having this knowledge, the U.S. did not carve out cross-border trucking from its NAFTA commitments (as it could have done). The U.S., therefore, could not successfully invoke the defense provision and had to bring its trucking policies into compliance with NAFTA.

If the U.S. attempted to invoke Article 12.10.4 as a defense for SHTAA's violation of the FTA, it would have to argue that the SHTAA was intended to enforce income tax rules, that the income tax rules are themselves FTA-legal, that the STHAA is "necessary to secure compliance" with the underlying income tax rules, and that the STHAA is not "arbitrary" or affording protection to U.S. banks (even if in effect, if not intent).

A threshold question for the panel would be whether the STHAA Section 101 determination was intended to help secure compliance with income tax rules, or with the STHAA itself. This is more difficult than it may seem. For instance, it would be possible to comply with the terms of the STHAA, and still see tax avoidance in Panama. While the STHAA may contribute to the aim of income tax compliance, the two matters are segregable as a matter of law. As such, actions under STHAA could be seen to require compliance with STHAA, rather than income tax rules.

Assume for the sake of argument that all parties agreed that the STHAA Section 101 was intended to help secure compliance with income tax rules themselves.[70] In its challenge of the STHAA, Panama would likely argue, based on precedents from NAFTA and WTO rulings, that the U.S. could instead utilize the TIEA or other bilateral consultations to secure compliance with income tax rules, and that therefore the STHAA is a unilateral measure that is "arbitrary" or "unnecessary" within the meaning of the FTA. If Panama were able to list ways to deal with tax evasion that had lesser negative impacts on Panamanian financial service suppliers than the STHAA (even if there were other reasons to strongly prefer the Section 101 method), then the Section 101 action would likely be deemed "not necessary."[71] Indeed, Panama may be able to argue that unilateral measures like the STHAA alienate Panamanian service providers, making it more difficult to get them to voluntarily comply with the TIEA.[72] Following the *Canada – Periodicals* precedent, Panama may additionally argue that, even if the U.S. could show that the STHAA "greatly reduced" the "possibility of non compliance" with income tax rules, the U.S. must nonetheless conform the STHAA to the FTA.

Moreover, Panama may be able to make some type of argument that the U.S. tax rules themselves are not FTA-compliant, or that there is too indirect of a connection between the tax rules and the STHAA for the purposes of consideration under Article 12.10.4. **Panama could argue that the U.S. was well-aware of potential financial secrecy problems in the country before the FTA was implemented, but did not include conditions in the FTA barring the financial cross-border services obligations from going into effect**. Finally, Panama would argue that – even if the panel found in favor of the U.S. on these previous questions, that the U.S. would still have to show that the STHAA determination was not a disguised restriction on cross-border trade in financial services. Panamanians have long pointed to financial secrecy practices of Delaware as support for their argument that blacklists are protectionist devices intended to favor U.S. banks. Based on existing precedent, a panel would likely side with Panama.

(The U.S. may make a counter argument that even if the STHAA has some incidental protectionist effect to the detriment of Panamanian financial service suppliers, that U.S. and Panamanian financial service suppliers should not be seen as operating "in like circumstances." The WMD document anticipates this line of defense, arguing against the relevance of national treatment and MFN obligations to the STHAA by stating that "a financial institution or investor in a tax haven country is not 'in like circumstances' as a financial institution or investor in a country that is not a tax haven." Unfortunately, the U.S. made the argument that different regulatory environments constituted "unlike circumstances" and was ruled against in the *Cross-Border Trucking* case.)

B. Chapter 11 defenses

Chapter 11 contains a defense provision for transfer limitations that is read in to Chapter 12 as well. A comparable article also exists in Chapter 10. The entire article reads:

> "Article 11.10: Transfers and Payments
> 1. Each Party shall permit all transfers and payments relating to the cross-border supply of services to be made freely and without delay into and out of its territory.
> 2. Each Party shall permit such transfers and payments relating to the cross-border supply of services to be made in a freely usable currency at the market rate of exchange prevailing at the time of transfer.

> 3. Notwithstanding paragraphs 1 and 2, a Party may prevent a transfer or payment through the equitable, non-discriminatory, and good faith application of its laws relating to:
> (a) bankruptcy, insolvency, or the protection of the rights of creditors;
> (b) issuing, trading, or dealing in securities, futures, options, or derivatives;
> (c) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities;
> (d) criminal or penal offenses; or
> (e) ensuring compliance with orders or judgments in judicial or administrative proceedings."

While the defense in the third paragraph (Article 11.10.3) sounds reassuring, it is worth noting that any SHTAA action (such as a prohibition on transfers) against Panama would by definition be "discriminatory" – which is one of the three required planks in the introductory paragraph. It is highly improbable that the STHAA could be shown to be non-discriminatory. Assuming for the sake of argument that it could, the U.S. may attempt to argue that the STHAA is "relating to… financial reporting or record keeping of transfers when necessary to assist law enforcement…" But this would bring its own burdens of proof. First, the U.S. would have to prove that the STHAA was "primarily aimed at" (i.e. "relating to") the subject matter of *financial* reporting or record keeping. This seems difficult to maintain, since the STHAA is not justified primarily as a "financial" or record keeping policy, and envisions instead an outright ban on transfers. Then, the U.S. would have to show that the STHAA was "necessary" to assist law enforcement, and that less trade-restrictive means (such as consultations with Panama) are not reasonably available. This would be a difficult case to make. And while the subparagraph (d) might give the U.S. a plausible defense under criminal tax *evasion* proceedings, it may not help the U.S. combat the tax *avoidance* strategies that the STHAA aims to root out.

Finally, Article 11.10.3 is a defense only for the absolute prevention of a transfer. But Article 11.10.1 establishes a broader requirement to not even impose delays on transfers. It is unclear whether an anti-tax haven initiative that stopped short of full prevention (such as a mere restriction or delay) of transfers could be defended under Article 11.10.3.

Chapter 11 also has a "denial of benefits" provision (Article 11.11.2): "a Party may deny the benefits of this Chapter to a service supplier of the other Party that is an enterprise of the other Party if the enterprise has no substantial business activities in the territory of the other Party, and persons of a non-Party, or of the denying Party, own or control the enterprise." As this makes clear, both conditions – "no substantial business activities in Panama" *plus* non-Panamanian ownership and control – would have to be proven for an investor to be denied their FTA benefits. Either condition would suffice to beat back an attempt to deny benefits. As noted above, in a past investor-state case, the presence of two employees and a small paper trail in the claimed home country was seen as evidence of "substantial business activities" sufficient to avoid a denial of benefits.[73]

C. Defenses under Chapter 10

The most relevant defenses under Chapter 10 are related to the “denial of benefits” and transfers language already explored above. We will not repeat that analysis here, as the provisions are virtually identical to those of Chapter 11.

D. Defenses under Chapter 21

Chapter 21 of the FTA contains a series of additional exception provisions. Unfortunately, they offer little to no hope for anti-tax haven measures dodging a challenge.

Article 21.1 has an environmentally focused exception (which has its own problems), but it does not apply to measures subject to Chapters 10 through 12.

Article 21.2 “reads in” an exception provision of the GATS, but only for Chapter 11 (cross-border trade in services). The GATS Article XIV provision that is “read in” states:

> “Article XIV: General Exceptions
>
> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> (a) necessary to protect public morals or to maintain public order;(5 [Footnote reads: “The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.”)
> (b) necessary to protect human, animal or plant life or health;
> (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:
>> (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
>> (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
>> (iii) safety;
>
> (d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective(6) imposition or collection of direct taxes in respect of services or service suppliers of other Members;
> (e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.”

Footnote 6 in GATS Article XIV(d) reads:

> "Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which: (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or (iii) *apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures*; or (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base. Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure."

There are multiple hurdles to invoking this as a defense:

1. The only recourse to that provision would be if the STHAA were deemed to fall under the Chapter 11 scope, rather than a measure "relating to" financial services (for the purposes of Chapter 12 coverage) or investment (for the purposes of Chapter 10 coverage).
2. Assuming that the anti-tax haven initiative fell only under Chapter 11 coverage, then the U.S. would have to define how the STHAA fit within the scope of one of the subparagraphs of GATS Article XIV. While the goals of the STHAA are very important, the U.S. would be unlikely to be able to defend them as related to the fundamental interest of society or human welfare, much less "necessary" for protecting those interests under subparagraphs a and b. Subparagraph e (on enforcement of otherwise WTO-compatible laws) mirrors Article 12.10.4, which we explored above.
3. While Article XIV(e) would seem to provide a defense for tax treaty-related measures that treated Panamanian service suppliers differently than third-country service suppliers, the defense is only allowed for differential treatment arising under *double taxation treaties* (DTTs, rather than TIEAs) or under other non-DTT agreements (like TIEAs) – but only to the extent that the provision deals with *double taxation.* This Article ensures a defense that the U.S. could invoke if Panama challenged the U.S. granting of relief of income tax to certain (say) French taxpayers so as to avoid double taxation under a U.S.-France DTT. It would not serve as a defense against a Panamanian challenge of other financial transparency initiatives or the STHAA.
4. Through this process of elimination, we can see that only GATS Article XIV(d) is relevant to the STHAA. In that case, only U.S. obligations related to *National Treatment* are covered in the exception, not commitments related to MFN or free transfers. Again, the trade pact compliance problem with most anti-tax haven initiatives is that they treat service suppliers from one country (say Panama) less favorably than those from other countries (say Canada), not that they treat them less favorably than U.S. service suppliers. So most anti-tax haven initiatives would not fall under the scope of this exception.

5. If the FTA challenge did turn on a national treatment violation, and the anti-tax haven initiative was seen as falling under the scope of Chapter 11, then the U.S. would face additional hurdles in invoking GATS Article XIV(d) as a defense. The U.S. would likely try to justify the measure by reference to footnote 6 of the GATS, which defines the scope of Article XIV(d) as including "Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which: … *apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures*." The U.S. may well be able to show that – under these narrow circumstances of a national treatment rather than MFN violation – that the STHAA falls under the scope of GATS Article XIV(d). However, then it would have to prove that the STHAA met the hurdles of the so-called chapeau (or introductory paragraph) of GATS Article XIV, including that it is "not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services." As noted above, these would be virtually impossible hurdles to meet, and Panama would likely note that diplomatic consultations may be more GATS-compliant than black lists or prohibitions.

FTA Chapter 21 has additional exception provisions. Article 21.2 is an "essential security" exception, which would not cover tax haven matters.

Finally, Article 21.3.1 states that "Except as set out in this Article, nothing in this Agreement shall apply to taxation measures." The WMD document goes as far as to call this a "dispositive" legal argument against Public Citizen's arguments with respect to the free transfers, market access and cross-border trade provisions of the FTA. We do not know if the authors have other legal objections to Public Citizen's case, since none are provided.

But the WMD document does not make a compelling argument against Public Citizen's argument, much less a dispositive one. At stake is a simple definitional issue: what constitutes a "taxation measure"? The term is not defined. But recall how the FTA text distinguishes between measures that "relate to" certain subject matter (a stronger connection) versus those that "affect" certain subject matter (a weaker connection). Moreover, the FTA distinguishes in numerous places (such as GATS Article XIV as read into FTA Article 21.1.2) between underlying laws, ancillary measures necessary for compliance with underlying laws, and ancillary measures related to compliance with underlying laws. When the reference to "taxation measures" in FTA Article 21.3.1 is put in this context, as called for by the Vienna Convention on the Law of Treaties (VCLT) Article 31 and 32, it is clear that the STHAA would have to be distinguished from the underlying section of the internal revenue code that states which income is taxable.[74] Measures ancillary to taxation must comply with the FTA, and Article 21.3.1 provides no defense against them.[75]

Even if the STHAA were somehow found to be a "taxation measure" instead of an ancillary enforcement measure, it is not correct to suggest that Article 21.3 carves out all taxation measures from challenge. While Article 21.3.1 partially carves out "taxation measures" from the FTA, Article 21.3.4 inserts back in many taxation measures subject to Chapter 10, 11 and 12 coverage. For instance, most "taxation measures on income, capital gains, or on the taxable capital of corporations that relate to the purchase or consumption of particular services…" (i.e.

direct taxes) are subject to the national treatment requirements of Chapters 11 and 12. And "all taxation measures, other than those on income, capital gains, or on the taxable capital of corporations, taxes on estates, inheritances, gifts, and generation-skipping transfers" (i.e. indirect or event taxes) are subject to the national treatment and most favored nation requirements of Chapters 10, 11 and 12.

Article 21.3.4 proceeds to make a carve-out to the carve-out to the carve-out, stating that the national treatment and MFN obligations on taxation measures shall not apply to:

> "(c) any most-favored-nation obligation with respect to an advantage accorded by a Party pursuant to any tax convention;
> (d) to a non-conforming provision of any existing taxation measure;
> (e) to the continuation or prompt renewal of a non-conforming provision of any existing taxation measure;
> (f) to an amendment to a non-conforming provision of any existing taxation measure to the extent that the amendment does not decrease its conformity, at the time of the amendment, with any of those Articles;
> (g) 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); or
> (h) to a provision that conditions the receipt, or continued receipt, of an advantage relating to the contributions to, or income of, pension trusts or pension plans on a requirement that the Party maintain continuous jurisdiction over the pension trust or pension plan."

Subparagraph (c) simply means that Panama cannot claim tax advantages that the U.S. accords other countries it has tax conventions with. Subparagraphs (d-f) simply grandfather in existing non-conforming taxation measures, not substantially new measures like the STHAA that have not yet been enacted. Subparagraph (g) is clearly relevant, but the reference to GATS Article XIV(d), as we note above, means that this provision would be interpreted as only excusing national treatment violations (not MFN violations like a black list), and then subject to the plethora of GATS hurdles.

Article 21.3.5 carves back in performance requirements disciplines on most taxation measures, and Article 21.3.6 carves back in most expropriation measures as they relate to taxation measures, and makes clear that Panama would be able to block any attempt to derail a taxation-as-expropriation claim. The provision then sets out a special procedure for handling such claims. This includes a process for the tax authorities listed for both countries to meet to try to come to consensus on whether the policy being challenged by an investor from one of the countries is an expropriation. If U.S. and Panamanian authorities cannot agree on this question, then the investor is free to file an investor-state claim six months after requesting the determination. Given how aggressively Panama defends its financial services sector, Panama would be unlikely to be cooperative in this regard.

The WMD document states that "it is hard to imagine how any measure aimed at improving tax collection could be viewed as an 'expropriation.' Staff is not aware of any investor-state dispute that has involved a measure to enforce tax laws." While there are an ample number of cases related to taxation measures (as such) and national treatment violations, Public Citizen is also not aware of any attempt to launch investor-state arbitration with respect to such enforcement measures. But as this memo shows, such cases are indeed possible. Moreover, it is only in recent years that recourse to investor-state arbitration has become widespread. While ICSID heard only 50 disputes from 1972 to 2000 (or less than two a year on average), 173 cases were resolved and 128 filed after 2000. This sums to 301 new cases over 11 years (or nearly 30 a year).[76] Surely there are a great many subject matters and possible cases that are constantly being considered.

In sum, there are a number of defenses envisioned in the FTA, but none appear applicable to the STHAA – which is meant as a unilateral supplement for traditional tax enforcement and bilateral consultations. Determinations under the STHAA would impact some problem jurisdictions but not *all* jurisdictions. They would have significant trade-restrictive effects on service providers operating outside of U.S. territory. Despite the U.S.' long history of documenting Panama's tax and regulatory haven problems, it did not take the opportunity to pare back the FTA Chapter 10, 11 and 12 obligations to Panamanian service providers. All of these factors would weaken if not eliminate U.S. ability to invoke the FTA defense provisions.

Even rebuttable presumptions can violate trade pacts

The WMD document sidesteps analysis of Section 101 by focusing instead on other aspects of the STHAA: "in the case of the Stop Tax Haven Abuse Act, it is important to note that the U.S. taxpayer can rebut the presumption that any amount of thing of value received by that person in an offshore secrecy jurisdiction constitutes taxable income. It is hard to imagine that a rebuttable presumption would be viewed as 'less favorable treatment.'"

As the Bruce Zagaris quote above noted, the mere act of putting a jurisdiction like Panama on a blacklist – even if only for the purposes of rebuttable presumptions – could be found to accord de jure "less favorable treatment" to Panamanian service suppliers than other countries' service suppliers. Panamanian lawyers have already begun to complain about the extraterritorial impact of the FATCA,[77] as has the international banking community.[78] (As noted above, the STHAA of 2011 builds on provisions of FATCA.) And, as noted in the section below, WTO panels have found that rebuttable presumptions can violate trade pact rules. In sum, even the more modest provisions of the STHAA Section 102 could run afoul of FTA commitments.

4. Panama has already successfully challenged anti-money laundering rules

Underlying the WMD document seems to be a presumption that Panama would not use the powerful tools that the FTA gives it to attack U.S. anti-tax haven initiatives.

But arguments for diplomatic restraint only go so far: Panama's financial services industry is actually much more important to its economy than trucking or tuna fishing were to Mexico's economy, and Mexico has fought U.S. policies in these areas for decades.

Moreover, Panama is very much on the record as using trade rules to defend its interests, even in highly sensitive areas. In fact, in a little-discussed 2009 case, Panama successfully challenged Colombia's anti-money laundering laws at the WTO.

This WTO dispute, *Colombia – Indicative Prices and Restrictions on Ports of Entry*, has many corollaries to the types of cases Panama will be empowered to bring under the FTA against the United States. The basic facts are the following:

- **Drug trafficking and money laundering are a unique plague for Colombia**. As Colombia stated, "these illegal activities undermine the political and economic stability of Colombia in its present context. Colombia is not like every other country in this respect. It is faced with an important domestic problem of drug trafficking and public order."[79]
- **Panama is a particular and documented money laundering concern.** Colombian authorities have concluded that, unlike trade with other countries, 84.27 of Colombia's total trade with Panama was contraband trade. This sum goes up to 89 percent for textiles trade. Moreover, Panama's reported exports to Colombia are three times larger than Colombia's reported imports from Panama. Colombia believes that this discrepancy is due to under-invoicing and smuggling, and could be associated with money laundering. While these discrepancies exist with respect to imports from other countries as well, Panama's incidence is the total distortion is five times larger than its share in total trade. In Colombia's words, "The problem is exacerbated by the lack of control exercised over Panama's Free Trade Zone of Colon, which is recognized internationally as a focal point of illicit trade."[80] As State Department documents have noted, Panama in general and the Colon Free Zone in particular serve as key conduits for the laundering of Colombian narcotraffickers' money. Cleaning up Panama is therefore an essential part of cleaning up Colombia.
- **Colombia attempted a cooperative approach with Panama, but this failed to produce results.** In 2005, Colombia took some initial steps targeting trade with Panama to try to address this trade mispricing, but then rolled them back in 2006 after establishing a customs cooperation agreement with the country. But problems emerged with this cooperative approach. In Colombia's words, "such efforts proved to be fruitless. The frequent failures of the authorities of Panama to respond to requests for assistance, and the numerous inconsistencies in respect of the answers received affected the credibility of the cooperation offered by Panama and thus undermined an important element of the regional system of customs enforcement."[81] Under various customs cooperation attempts over a longer time period, "of the 455 Colombian requests for assistance from Panama from 2001-2005, only 3 responses were provided, a cooperation rate of 0.65 per cent. Of the total 1234 requests for assistance made between 2001 and 2007, only 372 responses were provided by the Panamanian authorities."[82]
- **Colombia introduced ports measures to try to tackle the problem.** In 2007, Colombia introduced a set of measures to tackle the problem. First, it required imports of textiles, apparel and footwear shipped from Panama to go through two designated ports of entry: the Bogota airport or the Barranquilla seaport. As Colombia states, "the two ports of entry

imposed by the ports measure are among the most modern ports of Colombia and are the closest to Panama's Free Zone de Colon, which, like the port of Barranquilla, is located on the Atlantic coast."[83] Moreover, these are "the two ports that are closest in proximity to the CFZ and main markets of Colombia – Bogota and Medellin. Colombia also claims that Barranquilla seaport operates 24 hours per day and that Bogota airport has more customs officials than any other office in Colombia. Colombia describes the ports at Bogota and Barranquilla as 'among the most modern and important ports of Colombia', which staff officials specialized in handling contraband concerns related to textiles, apparel and footwear and offer improved container processing."[84] This reflects a general approach allowed for under Colombian law: "Colombian customs law permits customs authorities to limit access to ports of entry whenever authorities are not satisfied of their ability to fully exercise their powers of control and verification. On these grounds, although Colombia has 26 ports of entry for international trade, it has limited imports of textile and apparel imports to 11 ports of entry."[85] In other words, the measure appears to be a creative way to use scarce government resources to tackle a targeted problem.

- **Colombia also introduced rebuttable presumptions to deal with price distortions.** Given the widespread price distortions in the textile, apparel and footwear trade with Panama, Colombia also established "indicative prices" for these products based on a survey of their estimated market costs. If the transaction price exceeded the indicative price, the Colombia-side importer would pay customs duties on the transaction price. If the indicative price exceeded the transaction price, then Colombia took that to be possible evidence of contraband, and duties would be assessed on the indicative price. The importer could then appeal the finding, and if the lower price were legitimate, Colombia would reimburse the importer for the difference.[86]
- **Unilateral measures in textile sector justified by market characteristics.** Colombia set up cooperation initiatives with the electronics and tobacco sectors, where smuggling and under-invoicing were also a concern, but where the small number of market participants made such arrangements practicable. As Colombia stated: "in other sectors also prone to smuggling and under-invoicing such as cigarettes and electrical appliances, Colombia was able to conclude agreements with the private sector to jointly fight contraband. The limited number of importers and distributors of such products allowed the government to require the cooperation of these private parties in combating smuggling, something which is not possible in the case of the covered products due to the number of importers and traders in such products."[87]

The parallels to the STHAA could not be clearer. If it were adopted and Section 101 were to be utilized, it would be precisely because:

- The U.S. non-territorial tax system presents problems that affect the U.S. in particular.
- Panama has posed a special problem for U.S. tax collection.
- Cooperation with Panama under the TIEA didn't work to solve all of the U.S. concerns (either because Panama wasn't being responsive or the TIEA wasn't strong enough). At best, this calls for a multi-pronged approach that may involve unilateral measures.
- U.S. legislators and regulators undertake a targeted approach based on what they believe they have the capacity to enforce.
- The approach may utilize rebuttable presumptions.

The details of the legal basis of Panama's successful challenge needn't be explored in detail for the purposes of this memo, as they apply to WTO rules, not FTA rules, and to goods trade rather than services trade. But several points have special relevance for the STHAA type measures:

- **Panama did not hold back from a trade-pact case simply because of the sensitivity of the topic, and neither did the panel.** In fact, the panel noted that "WTO Members have a legitimate right to apply measures aimed at combating under-invoicing, smuggling and money laundering.[88] However, these measures should be WTO-consistent" or fall within a WTO exception. In other words, as another WTO panel stated: "Members' regulatory sovereignty is an essential pillar of the progressive liberalization of trade in services, but this sovereignty ends whenever rights of other Members under the GATS are impaired."[89]
- **Panama did not hold back from launching a case simply because it is a developing country**. In fact, Panama argued that its status as a developing country obligated it to enjoy more prompt elimination of the challenged measure.[90]
- **Panama did not hold back from a trade-pact case simply because the rules had not been tested by previous panels.** In fact, Panama's case was the first time a WTO panel ever examined GATT Article V and the WTO Customs Valuation Agreement.[91]
- **Panama's main legal arguments were that measures violated MFN rules, and violated per se rules against trade restrictions.** The panel would have likely ruled against Colombia on both grounds. In an exercise of "judicial economy," the panel did not explicitly rule on the MFN claims, but made clear it would have taken Panama's side. The panel instead found that Colombia's measures violated various per se rules of the GATT and WTO's Customs Valuation Agreement.
- **Panama launched a case on behalf of its offshore, not onshore, firms.** There was little evidence that Panamanian firms per se even produced textiles for export. Instead, Panamanian business interests function as intermediaries for Chinese products. This fact did not deter Panama from launching a case on behalf of its "offshore interests."[92]
- **Rebuttable presumption deemed WTO-inconsistent.** As noted above, importers can and did successfully appeal the application of the indicative price measure to get reimbursements for customs overcharging. This form of rebuttable presumption was deemed a form of less favorable treatment.[93]
- **The panel did not find that Colombia could rely on the defense provisions, even though the issue at hand was very important**. The panel determined that Colombia had not shown that the measures were "necessary" to combat money laundering, despite the fact that money laundering is a huge problem for Colombia and is associated with under-invoicing.[94]
- **Panama did not demonstrate that anti-money laundering rules had a negative impact on trade**.[95] The measures Colombia took seemed carefully designed to have minimal impacts on legitimate trade. The ports of entry were closely located to Panama. Colombia's imports of the affected products from Panama actually increased after implementation of these measures to higher than ever levels.[96] In fact, some of the documentation requirements may have given Panama a leg up over other trading partners, by accelerating the importation process.[97] Panama produced no evidence of a single Panamanian being harmed by the rules, nor any evidence that Colombian textile production had benefited from the rules.
- **Colombia was penalized for having a multi-prong approach, as a trade panel makes selective use of data.** The WTO panel rejected Colombia's defense that the anti-money

laundering rules were working, because Colombia was utilizing so many different tools to combat money laundering that it was difficult to isolate the contribution of the ports of entry requirement per se to any observed reduction in money laundering. In essence, if Colombia was only utilizing one approach, it may have been more able to demonstrate the marginal contribution of this one policy tool. At the same time, Panama produced little-to-no data that the ports of entry measure was restricting trade or raising transaction costs. The panel noted "the inherent difficulty of interpreting trade statistics." But rather than call in economists, or defer to both Panama and Colombia as to their representations of the data, the panel simply resolved the uncertainty in favor of Panama on both counts, saying (without proof) that the measure "undoubtedly" increased transaction costs.[98]

- **Colombia should put trade-pact compliance ahead of other considerations.** In the October 2009 WTO arbitration proceedings to analyze Colombia's compliance with the April 2009 panel ruling, the WTO-appointed arbitrator ruled that Colombia should comply within a number of months. This was despite the sensitivity of the smuggling issue, and the fact that Colombia was a developing country, and that legal processes might move more slowly there. Indeed while noting that the WTO contemplates "modification" rather than "elimination" of challenged measures, the arbitrator noted that elimination of the measure is the "preferred means" of compliance. When Colombia mentioned the need to consult with Congress, the arbitrator mentioned that he had "not been persuaded that amendment… cannot be accomplished by the executive branch."[99]
- **Colombia carved out FTA partners.** In its discussion of the earlier 2005 measures that Colombia took on indicative prices against textile imports from all countries (not just Panama), the panel ruling notes that Colombia had to carve out its FTA partners.[100]
- **USTR takes Panama's side.** Underlying the sales pitch for the U.S.-Colombia FTA is that Colombia is a great partner to the U.S., and the U.S. must stand with them in the fight to combat money laundering and other ills. Underlying the sales pitch for the U.S.-Panama FTA is that the U.S. will always defend tax justice interests. But in the WTO case, USTR took Panama's side in its attack on Colombia's anti-money laundering policies. If the USTR is willing to undermine Colombia's efforts in this regard, it calls into question the commitment of the U.S. not only to Colombia, but to the anti-money laundering fight more generally.[101]

In sum, this WTO case provides ample support that Panama would launch an attack against a measure like the STHAA under a trade pact. This precedent shows that a trade pact challenge is not precluded because of the sensitivity of the measures, or the relative untested nature of the legal norms. Indeed, whenever a measure targets certain countries and not others (as does the STHAA), there is a greater likelihood of FTA challenge, and defenses are less likely to be successful.

ENDNOTES

[1] Tucker is research director with Public Citizen's Global Trade Watch. He thanks Martin Hearson, Heather Lowe and the FACT Coalition for many enlightening conversations on this topic. Travis McArthur provided some research assistance.

[2] 2010 Mexico Tuna catch: 1 billion pesos (79.8 million USD) Percent of GDP: 0.008%
Sources: Comisión Nacional de Acuacultura y Pesca, México, "Anuario Estadístico de Acuacultura y Pesca: Base de datos Anuario 2010 preeliminar," 2011, Available at:
http://www.conapesca.sagarpa.gob.mx/wb/cona/cona_anuario_estadistico_de_pesca

International Monetary Fund, "World Economic Outlook Database, April 2011", Available at: http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx

2008 Mexican trucking GDP: 29.2 billion USD Percent of GDP: 2.75%
Source: North American Transportation Statistics, "Table 1 - 2a, Gross Domestic Product by Industry (NAICS Basis)" Available at: http://nats.sct.gob.mx/nats/sys/tables.jsp?id=33&i=3

Financial services were valued at 1.7 billion USD, or 8.2 percent of Panama GDP in 2010
Source: Instituto Nacional de Estadistica y Censo de Panama, "Producto Interno Bruto a precios Corrientes Anual y a precios Constantes Anual y Trimestral: año 2010", Cuadro 1, Available at: http://www.contraloria.gob.pa/inec/Publicaciones/04-16-43/Cuadro1.pdf

[3] "The Panama FTA further conflicts with other initiatives the Obama administration has endorsed – such as the Stop Tax Havens Abuse Act and financial service re-regulation." 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, at 31. Available at: http://www.citizen.org/Page.aspx?pid=525

[4] 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 does 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."

[5] Bruce Zagaris, "Ethical Issues In Offshore Planning," American Law Institute - American Bar Association Continuing Legal Education, ALI-ABA Course of Study, August 16 - 17, 2007, International Trust and Estate Planning.

[6] Bruce Zagaris, "Enforcement Issues In Offshore Planning: The Practitioner Increasingly Squeezed By Overlapping And Conflicting Laws And Ethics," American Law Institute - American Bar Association Continuing Legal Education, ALI-ABA Course of Study, August 19 - 20, 2010, International Trust and Estate Planning.

[7] http://www.treasury.gov/press-center/press-releases/Pages/tg1144.aspx

[8] http://www.asamblea.gob.pa/apps/seg_legis/PDF_SEG/PDF_SEG_2010/PDF_SEG_2011/PROYECTO/2011_P_331.pdf

http://www.asamblea.gob.pa/actualidad/proyectos/2010/2010_P_178.pdf created the legal basis for tax information exchange pursuant to treaties.

[9] U.S. Treasury Department statement, Jan. 8, 2002. Available at: http://www.treasury.gov/press/releases/po907.htm.

[10] 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

[11] 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*
Wednesday, March 4, 2009. Available at: http://levin.senate.gov/newsroom/press/release/?id=1cc17ddd-d117-4dc1-83e3-7dc150a9e168

[12] Stop Tax Haven Abuse Act of 2009, S. 506, Sec. 101. Available at: http://www.govtrack.us/congress/billtext.xpd?bill=s111-506

[13] United Nations Commission on Reforms of the International Monetary and Financial System, "Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System," September 21, 2009, at 83-84. Available at: http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf

[14] Kristofer Neslund, "Why Tax Information Exchange Agreements Are 'Toothless'," *Tax Insider*, July 19, 2009. Available at: http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2009/Tax/Toothless.jsp

[15] http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/PanamaTIEA10.pdf

[16] http://taxjustice.blogspot.com/2010/12/us-signs-new-deal-with-panama.html

[17] http://www.oecd.org/dataoecd/15/43/2082215.pdf

[18] http://mensual.prensa.com/mensual/contenido/2010/12/01/hoy/panorama/2420373.asp

[19] HTTP://MENSUAL.PRENSA.COM/MENSUAL/CONTENIDO/2011/04/27/HOY/ENGLISH/ECONOMY_6993.ASP
and
http://mensual.prensa.com/mensual/contenido/2011/04/18/hoy/Negocios/2569401.asp
and
http://mensual.prensa.com/mensual/contenido/2011/05/02/hoy/negocios/2583079.asp
http://www.panamaamerica.com.pa/periodico/buscador/resultado.php?story_id=1038181&page=5&texto=tpc

[20] http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/PanamaTIEAnote.pdf
[21] See: http://www.asamblea.gob.pa/APPS/LEGISPAN/PDF_GACETAS/2010/2011/26713-C_2011.PDF
[22] Law 275: original and amended versions here:
http://www.asamblea.gob.pa/main/LinkClick.aspx?fileticket=73qHuGsQDLU%3d&tabid=39
[23] For instance, Bill 275's Article 7 reads: "Public functionaries and natural and legal persons in the private sector, who are tasked with managing the information that emerges in the present Law, are obligated to keep this information secret, even after leaving their posts, except when this information is available in public registries. Violations of this article will be sanctioned with a fine of $1,000 to $25,000 balboas per infringer, without prejudice to civil or penal sanctions that may be applicable." Article 20, in contrast, establishes that "Failure to comply with the obligations established in the present Law will be sanctioned by the Fourth Chamber of General Business Affair of the Supreme Court of Justice through the following sanctions: 1. Reprimand. 2. Fine of up to $5,000 balboas. 3. Temporary suspension of the capacity of the lawyer or law firm to offer resident agent services for new legal entities for a period of not less than three months nor more than three years."
[24] http://wikileaks.org/cable/2009/03/09PANAMA255.html
[25] Bureau of International Narcotics and Law Enforcement Affairs, 2011 International Narcotics Control Strategy Report, March 3, 2011. Available at: http://www.state.gov/p/inl/rls/nrcrpt/2011/vol2/156376.htm#panama
[26] Original Spanish: "Una posible acción contra Ecuador en el ámbito de la OMC forma parte de las medidas contempladas en la estrategia nacional para la promoción y defensa de los servicios internacionales de Panamá", dice la carta fechada el 17 de septiembre de 2009." See Edith Castillo Duarte, "Pedirán a OMC que investigue a Ecuador," *La Prensa,* Sept. 18, 2009. Available at: http://mensual.prensa.com/mensual/contenido/2009/09/18/hoy/negocios/1927688.asp
[27] "Se mantienen las ventajas competitivas como las acciones al portador (otras jurisdicciones las han eliminado) y tampoco se inmovilizan las acciones al portador como han hecho otras jurisdicciones". See Edith Castillo Duarte, "Proyecto de ley ofrece garantía a privacidad," *Prensa,* Jan. 31, 2011. Available at:
http://mensual.prensa.com/mensual/contenido/2011/01/31/hoy/negocios/2486347.asp
[28] In a FATCA hearing in 2009, Rep. Pat Tiberi (R-Ohio) said, "Do you agree that excluding blacklisting from the legislation that Chairman Rangel and Chairman Neal have introduced makes countries around the world more willing to continue providing the Internal Revenue Service the critical information needed to combat tax evasion effectively?" The IRS Chief Counsel William Wilkins responded, "I think the approach in this bill was focused more on institutions than countries. I think institutions is really where the activity is and where the money is, and I think that was a -- I think that was a good choice." See House Committee On Ways And Means, Subcommittee On Select Revenue Measures Holds A Hearing On Foreign Bank Account Reporting, November 5, 2009.
[29] See Section 102 of the 2009 legislation (http://www.govtrack.us/congress/billtext.xpd?bill=s111-506), and Section 101 of the 2011 legislation (http://levin.senate.gov/imo/media/doc/PSI.TaxHavenAbuseAct.071211.pdf) .
[30] Codified at U.S.C. 31 Sec. 5318A (b)(5). Available at: http://www.law.cornell.edu/uscode/31/usc_sec_31_00005318---A000-.html
[31] The European Union has said: "Section 319 of the PATRIOT Act, adopted in 2001, deals with the forfeiture of funds in United States inter-bank accounts by those accused of money laundering. It requires U.S. correspondent banks to maintain certain records concerning a foreign bank that has a U.S. correspondent account. Furthermore it provides authority for the Treasury Secretary and the Attorney General to subpoena the foreign bank's offshore records concerning the account and authorises forfeiture of deposits in the foreign bank. State of Play: Both the subpoena authority and the forfeiture clause have potential extraterritorial impact. The European Commission and others have complained vigorously both at the time of the adoption of the Act and during the comment period on proposed Treasury implementing regulations. In response, U.S. authorities said that they had no intention of using this seizure authority indiscriminately or in derogation of existing and efficient mechanisms, such as Mutual Legal Assistance Treaties, for the seizure of funds located outside of the U.S. Despite this reassurance, there were allegations in the past, from European banks and individual Member States, of a lack of clarity about the circumstances under which the U.S. would make use of Section 319 and when it would refrain from doing so, but for the last two years there have been no new allegations." Available at:
http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc_144160.pdf
[32] See for instance: http://citizen.typepad.com/eyesontrade/2011/07/wikileaks-blows-lead-on-panamas-corruption.html
[33] All FTA related texts are available here: http://www.ustr.gov/trade-agreements/free-trade-agreements/panama-tpa/final-text
[34] Article 12.20 defines "financial service" as "any service of a financial nature. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance), as well as services incidental or auxiliary to a service of a financial nature. Financial services include the following activities:

Insurance and insurance-related services

(a) Direct insurance (including co-insurance): (i) life, (ii) non-life; (b) Reinsurance and retrocession; (c) Insurance intermediation, such as brokerage and agency; and (d) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment, and claim settlement services.

Banking and other financial services (excluding insurance): (e) Acceptance of deposits and other repayable funds from the public; (f) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transactions; (g) Financial leasing; (h) All payment and money transmission services, including credit, charge, and debit cards, travelers checks, and bankers drafts; (i) Guarantees and commitments; (j) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market, or otherwise, the following: (i) money market instruments (including checks, bills, and certificates of deposits); (ii) foreign exchange; (iii) derivative products, including, but not limited to, futures and options; (iv) exchange rate and interest rate instruments, including products such as swaps and forward rate agreements; (v) transferable securities;
(vi) other negotiable instruments and financial assets, including bullion; (k) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues; (l) Money broking; (m) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository, and trust services; (n) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments; (o) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services; and (p) Advisory, intermediation, and other auxiliary financial services on all the activities listed in subparagraphs (e) through (o), including credit reference and analysis, investment and portfolio research and advice, and advice on acquisitions and on corporate restructuring and strategy;…"

[35] Simon Lester, "A Framework for Thinking About the 'Discretion' in the Mandatory / Discretionary Distinction," *Journal of International Economic Law,* June 22, 2011.
[36] According to the WTO's analytical compendium, "In interpreting the term "relating to" under Article XX(g), the Appellate Body noted that all the parties and participants to the appeal agreed that the term "relating to" was equivalent to "primarily aimed at": "All the participants and the third participants in this appeal accept the propriety and applicability of the view of the *Herring and Salmon* report and the Panel Report that a measure must be 'primarily aimed at' the conservation of exhaustible natural resources in order to fall within the scope of Article XX(g).(**898**) Accordingly, we see no need to examine this point further, save, perhaps, to note that the phrase 'primarily aimed at' is not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g)."(**899**) See http://wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20C5b

[37] Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, Annex B, Anderson et. al collective statement, Sept. 30, 2009. Available at: http://www.state.gov/e/eeb/rls/othr/2009/131118.htm
[38] Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980).
[39] See College Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 675 (1999).
[40] See Article 12.5.2. Available at:
http://www.ustr.gov/sites/default/files/uploads/agreements/fta/panama/asset_upload_file494_10346.pdf
[41] Article 10.8: Transfers
1. Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory. Such transfers include:
(a) contributions to capital;
(b) profits, dividends, capital gains, and proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment;
(c) interest, royalty payments, management fees, and technical assistance and other fees;
(d) payments made under a contract, including a loan agreement;
(e) payments made pursuant to Article 10.6.1 and 10.6.2 and Article 10.7; and
(f) payments arising out of a dispute.

Article 11.10: Transfers and Payments
1. Each Party shall permit all transfers and payments relating to the cross-border supply of services to be made freely and without delay into and out of its territory.

[42] Panama may also be able to cite the precedent of the *U.S. – Gambling* case that showed that even non-discriminatory transfers restrictions on credit card payments (even when they take the form of a "mutual settlement" rather than a more

classic transfer restriction) were thought possible of violating trade commitments. Similar restrictions that took on an explicitly discriminatory hue (like the STHAA) might then be seen even more likely to be covered by trade pact rules.

In this GATS case (which the U.S. lost), the island nation of Antigua alleged that "the United States maintains measures that restrict international money transfers and payments relating to the cross-border supply of gambling and betting services. In particular, Antigua points to the laws of the state of New York that render contracts that are based on wagers or bets void as well as an example of an 'enforcement measure' taken by the New York Attorney General against a financial intermediary that provides Internet payment services. In Antigua's view, the purpose of these measures is to prevent foreign suppliers of gambling and betting services from offering their services on a cross-border basis. Antigua argues that, therefore, these measures violate Article XI:1 [prohibiting current account restrictions] of the GATS." The U.S. responded that, "Antigua has provided no evidence that the provisions of the agreement in question result in restrictions on the movements of funds across borders. The United States submits that, on the contrary, by the terms of the agreement, it applies without regard to whether the payments in question are destined for further transfer to a domestic or international destination. The United States further submits that, insofar as Antigua relies upon the agreement in question as evidence of the application of the laws of the state of New York, the agreement is not an application of those laws. Rather, it is a mutual settlement between the relevant contracting parties." The panel ruled that Antigua did not submit enough information to be able to assess the claim. The ruling stated that, "However, the Panel wants to emphasize that Article XI plays a crucial role in securing the value of specific commitments undertaken by Members under the GATS. Indeed, the value of specific commitments on market access and national treatment would be seriously impaired if Members could restrict international transfers and payment for service transactions in scheduled sectors. In ensuring, inter alia, that services suppliers can receive payments due under services contracts covered by a Member's specific commitment, Article XI is an indispensable complement to GATS disciplines on market access and national treatment. At the same time, the Panel is of the view that Article XI does not deprive Members from regulating the use of financial instruments, such as credit cards, provided that these regulations are consistent with other relevant GATS provisions, in particular Article VI." See U.S.-Gambling, WT/DS285/R, November 2004.

[43] See discussion of *Canada – Autos* at para 27:
http://wto.org/english/res_e/booksp_e/analytic_index_e/gats_01_e.htm#article2B3B

[44] See *Archer Daniels Midland Company v. Mexico,* para 198. See also

[45] "Final Report of the Panel", In the Matter of Cross-Border Trucking Services, Feb. 6, 2001, Panel: J. Martin Hunter, Luis Miguel Diaz, David A. Gantz, C. Michael Hathaway, Alejandro Ogarrio. Available at:
http://www.naftaclaims.com/Disputes/USA/USTrucking/USTruckingChapter20.pdf.
At paras 259-260 and 276.

[46] See discussion of EC-Bananas III, at para 24
http://wto.org/english/res_e/booksp_e/analytic_index_e/gats_01_e.htm#article2B3B

[47] See Appellate Body Report, *Korea – Various Measures on Beef* , WT/DS161/AB/R, adopted Jan. 10, 2001, para 137.

[48] WTO Appellate Body, *U.S. – Gambling*, WT/DS285/AB/R**,** April 2005, at para 230.

[49] Moreover, as a practical matter, if U.S. taxpayers began to avoid any entanglements with U.S. correspondent banks or U.S. credit card processors (and somehow simply dealt with Panamanian banks directly) as a way of getting around STHAA strictures, the U.S. government would be likely to begin to take enforcement actions to get around that circumvention.

[50] The only relevant NCM may be the carve-out from Article 11.4 obligations in Annex II, which states, "The United States reserves the right to adopt or maintain any measure that is not inconsistent with the United States' obligations under Article XVI of the General Agreement on Trade in Services." The U.S. may attempt to argue that it has sparse Mode 1 GATS commitments financial services: because the U.S. can impose bans or transfer restrictions on cross-border trade under the GATS, it would therefore be able to do so under the FTA due to the NCM listing. A treaty interpreter would find this argument hard to swallow: the U.S. substantive obligations under the FTA are more extensive than under the GATS, especially with regards to transfers. If the U.S. were to be allowed unlimited recourse to invoke its more modest GATS obligations as a defense for failing to meet its FTA commitments, the GATS-plus provisions of the FTA would be rendered meaningless.

[51] Panama FTA Art. 12.1.2: (Scope and Coverage) Chapters Ten (Investment) and Eleven (Cross-Border Trade in Services) apply to measures described in paragraph 1 only to the extent that such Chapters or Articles of such Chapters are incorporated into this Chapter: (a) Articles 10.7 (Expropriation and Compensation), 10.8 (Transfers), 10.11 (Investment and Environment), 10.12 (Denial of Benefits), 10.14 (Special Formalities and Information Requirements), and 11.12 (Denial of Benefits) are hereby incorporated into and made a part of this Chapter; (b) Section B of Chapter Ten (Investment) is hereby incorporated into and made a part of this Chapter solely for claims that a Party has breached Article 10.7 (Expropriation and Compensation), 10.8 (Transfers), 10.12 (Denial of Benefits), or 10.14 (Special Formalities and Information Requirements), as incorporated into this Chapter; (c) Article 11.10 (Transfers and Payments) is incorporated

into and made a part of this Chapter to the extent that cross-border trade in financial services is subject to obligations pursuant to Article 12.5.

[52] As we've noted elsewhere, recent U.S. investment agreements contain several important clarifications concerning the standard for "indirect expropriation." Three provisions in particular are significant: language indicating that the standard is intended to reflect customary international law concerning the obligation of States with respect to expropriation," provisions indicating that in order to constitute an expropriation a measure must affect a property right, and language indicating that "[e]xcept in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations."

Despite these reforms, however, there remains the potential that the indirect expropriation provisions of investment agreements could be applied in a manner that would violate the "no greater rights" principle by providing foreign investors with greater rights than the comparable protections of the Takings Clause of the Fifth Amendment of the U.S. Constitution. For example, U.S. investment agreements typically permit tax measures to be challenged as violations of the prohibition on uncompensated expropriations, and there is substantial precedent in international arbitral practice for finding that tax measures can constitute forms of indirect expropriation. Under the Fifth Amendment's Takings Clause, in contrast, the Supreme Court has repeatedly rejected takings challenges to tax measures, even when the tax is set at a level that threatens the viability of a business.

The restriction of expropriation claims to situations involving "property" as opposed to the more broadly defined "investment" is also inadequate to ensure compliance with the "no greater rights" principle, because it does not reflect that the requirement of compensation for "regulatory takings" under the Fifth Amendment of the U.S. Constitution has generally been only held to apply to regulations affecting real property. For example, the Supreme Court has indicated that personal property is unlikely to be the basis for a successful regulatory takings claim given that "in the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulation might even render his property economically worthless." Moreover, the indirect expropriation provision in investment agreements has been interpreted to require compensation based on the impact of the government measure on the value of the investment, regardless of whether there has actually been some appropriation of an asset by the government. This interpretation of the standard for indirect expropriation cannot be justified as reflecting the general practice of states, given that the dominant practice of nations is to provide for compensation only when the government has actually acquired an asset, not when the value of an asset has been adversely affected by regulatory measures.

[53] While this paper operation would likely suffice to be granted standing as an investor with Chapter 10 rights, the conglomerate could additionally protect itself against U.S. invocation of a right to deny the firm FTA benefits under FTA Article 10.12 if it had substantial business activities in Panama.

Article 10.12.2 reads in part: "…a Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party, and persons of a non-Party, or of the denying Party, own or control the enterprise." As this makes clear, both conditions – no substantial business activities in Panama *plus* non-Panamanian ownership and control – would have to be proven for an investor to be denied their FTA benefits. Either condition would suffice to beat back an attempt to deny benefits.

[54] 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

[55] "CAFTA Investor Rights Undermining Democracy and the Environment: Pacific Rim Mining Case," Public Citizen, May 2010. Available at: http://www.citizen.org/documents/Pacific_Rim_Backgrounder1.pdf

[56] 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.

[57] "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.

[58] Jonathan Stempel, "More U.S. lawsuits target Chinese reverse mergers," *Reuters,* July 26, 2011. Available at: http://www.reuters.com/article/2011/07/26/lawsuits-classaction-study-idUSN1E76O20A20110726

[59] Draft Statement of Administrative Action, pages 1-2. Available at: http://finance.senate.gov/imo/media/doc/062811%20U%20S%20%20-%20Panama%20Trade%20Promotion%20Agreement%20Statement%20of%20Administrative%20Action.pdf

[60] http://www.bilaterals.org/IMG/html/US-PA_BIT.html

[61] USITC, "U.S.-Panama Trade Promotion Agreement: Potential Economy-wide and Selected Sectoral Effects," USITC Publication 3948, September 2007, at 5-10. http://hotdocs.usitc.gov/docs/pubs/2104F/pub3948.pdf

[62] Informal translation into English of dissenting vote of Dr. José María Chillón Medina in International Center for the Settlement of Investment Disputes, *Nations Energy Inc. et. al. v. Panama,* Award, Nov. 24, 2010, at paragraphs 4-5. Available at: http://ita.law.uvic.ca/documents/NationsResourcesVPanama_Award.pdf

Chillón cited a certain provision of the BIT that says "With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party." While the words "should strive" would seem to make this provision less binding, Chillón said that tribunalists should be able to enforce "should strive" obligations. He found that an expropriation could well have occurred in the case: "The BIT's broad definition of investment does not allow one to limit indirect expropriation to cases involving property. The formula also covers instances of associated economic rights related to an investment, as in the case of the tax credits… they have been denied a right that constitutes an enormously significant loss in terms of the overall value of the investment. " (dissent, paragraph 61-62) Chillón clearly subscribes to a fairly extreme version of takings theory, under which partial deprivation of even one stick in a bundle of economic assets can constitute a taking.

Moreover, Chillón found that "the right or the reasonable expectation that the juridical order will not be changed, altered, poorly interpreted or poorly applied, or changing the rules or application criteria, constitutes the central element of the fair and equitable treatment [FET] standard…" He goes on to say that Panama was in violation of the standard by introducing a new law, in particular one that reduced the amount of the tax credit.

Chillón also argued: "A mere change of words – from 'should accord' to 'should strive to accord' – does not change at all the meaning and character of the legal norm at stake… [the latter language] is not simply a pious exhortation directed at State virtue. It is a legal norm. The interpretive rules of the Vienna Convention on treaties, and particularly the articles that deal with the concept of effectiveness in treaty interpretation (Article 26) are also relevant here… the fact that a more or less incisive or expressive language is used does not change the unequivocal coercive nature of the norm…" The tribunalist went on to rule that Panama was affirmatively bound by obligations worded in the "should strive" format.

[63] See comments by Gus Van Harten here: http://worldtradelaw.typepad.com/ielpblog/2011/06/is-investment-treaty-arbitration-biased-against-developing-countries.html

[64] The WMD document states that "The actual award is in Spanish, and staff has not been able to obtain a copy." In fact, the award has long been posted for nearly six months on the italaw.com website, the premier source for all investor-state documents: http://italaw.com/documents/NationsResourcesVPanama_Award.pdf

[65] See here: http://www.citizen.org/documents/may-2007-preamble-change-fails-to-resolve-concerns-with-fta-investment-rules.pdf

[66] For instance, Article 12.10.1 is only applicable to measures "with respect to the supply of financial services *in the territory of a Party* by an investor of the other Party or a covered investment…" Article 12.10.2 applies to measures "with respect to the supply of financial services *in the territory of a Party* by an investor of the other Party or a covered investment…" [italics added]

[67] System-wide stability is not mentioned in Article 12.10.3. Contrast this with Article 12.10.1, which refers to prudential motivations related to both system-wide stability and individual institutions. Negotiators clearly could have referred to both policy motivations in the text of Article 12.10.3 if they had intended both types of motivation to be covered by Article 12.10.3. From Article 12.10.1, we know that negotiators were aware of the distinction between the two motivations, so the omission of stability-motivated measures in Article 12.10.3 should not be seen as an inadvertent omission. And unlike Article 12.10.1, the list of indicative policies is Article 12.10.3 is a closed list rather than an open list: the word "including" does not appear in the latter article. (Of course, due to Article 12.10.1's arguably self-cancelling second sentence, the wider scope for policy motives in theory provides little protection in practice.) Article 12.10.3 was likely intended to protect policy space for deposit insurance, resolution proceedings, and other policies intended to help individual firms avoid bankruptcy.

[68] GATT, *U.S. – Restrictions on Imports of Tuna,* DS21/R, September 1991, at para 5.40

[69] WTO Dispute Settlement Body, "Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef - Report of the Panel," July 2001, at paras 5.8-5.10.

[70] Assume also that the U.S. did not use the General Exception defense related to taxation. If the U.S. were to describe the STHAA as a taxation measure directly for the purposes of its General Exception defense, it would be difficult for the U.S. to argue for the sake of its Article 12.10.4 defense that the STHAA were, instead, a measure to secure compliance with taxation measures.

[71] http://wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20A at 620.

[72] Mexico appears to have successfully articulated such an argument in the current WTO case against U.S. dolphin-safe tuna labels. See *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products,* WT/DS381, First Written Submission of the United Mexican States, Feb. 26, 2010, at para 207.

[73] 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.

[74] In fact, because taxation measures are not defined in the FTA, an FTA panel may look to the U.S.-Panama TIEA as a "relevant rule[] of international law applicable in the relations between the parties" for defining taxation measure, as would be allowed under VCLT Article 32.3(c). The TIEA states that ""tax" means any tax covered by this Agreement that is imposed at the national or federal level by a Party, not including customs duties." See http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/PanamaTIEA10.pdf

[75] Also, recall that various FTA defense provisions – such as 12.10.4 – would require that a respondent country differentiate between an FTA-compliant underlying law and a non-FTA compliant enforcement measure for that law. If the U.S. were to attempt to invoke such a defense provision and differentiate the underlying law from its enforcement for the purposes of the Chapter 12 analysis, it could then not turn around and conflate the two for the purposes of the Chapter 21 analysis.

[76] Case listing accessed July 9, 2011. Available at: http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ListCases

[77] Oliver Chacón, "Dudas sobre alcance de ley fiscal," *La Prensa*, July 26, 2011. Available at: http://www.prensa.com/impreso/dudas-sobre-alcance-de-ley-fiscal/12961

[78] For instance, bankers have raised questions as to why this additional prong is necessary if the TIEA is in place. Contrary to popular belief, the regulations are not solely about American accounts and American account holders, but could have significant extraterritorial effect. Treasury's draft FATCA implementation proposals

> "adopts a proportionate allocation approach, based on the ratio of a FFI's [foreign financial institution's] U.S. assets to total assets (termed the 'passthru payment percentage,' or 'PPP'), to determine the extent to which FATCA withholding applies to payments made by a participating FFI (a 'PFFI') to non-participating FFIs ('NP-FFIs') and recalcitrant account holders (in addition to the withholding tax on U.S. source 'withholdable payments'… the Notice would appear to treat any payment (including swap payments, payments for services, rent and the purchase of property, routine money transfers, etc.) as a passthru payment, which is also unworkable…
>
> [W]e are very concerned that the extension, under the Notice, of the proportionate allocation approach to all payments made by an active business PFFI to any other active business FFI will create stresses in the global financial system, with indeterminate consequences. Because active business FFIs necessarily must have extensive business dealings with other active business FFIs, it will be virtually impossible for any active business FFI anywhere in the world – even if it has no U.S. assets or U.S. customers – to avoid either becoming FATCA-compliant or suffering a withholding tax on passthru payments that it receives from PFFIs. However, especially given the absence in the guidance to date of a reasonable, streamlined and low-cost method for FFIs that have very little if any connection with the United States to become FATCA compliant, there is likely to be a significant amount of worldwide exposure to FATCA withholding tax. Thus, for example, small local banks throughout the world with no known U.S. accounts and no investments in U.S. securities that cannot reasonably become PFFIs or deemed-compliant FFIs ("DC-FFIs") will be subject to FATCA withholding (to the extent of the PPP of their counterparties) on each of the numerous payments they receive from PFFIs (whether in respect of routine money transfers, loan syndications, swap transactions, foreign currency trades, etc)…"

See
http://www.iib.org/associations/6316/files/20110613EBF-IIBcomments_Notice%202011-34.pdf

[79] See WTO, *Colombia – Indicative Prices and Restrictions on Ports of Entry*, Report of the Panel, WT/DS366/R, April 27, 2009, at para 4.81.

[80] Ibid, at para 4.60

[81] Ibid, at para 4.85
[82] Ibid, at para 4.173
[83] Ibid, at para 4.171
[84] Ibid, at para 7.217
[85] Ibid, at para 2.12
[86] Ibid, at para 2.11
[87] Ibid, at para 4.86
[88] Ibid, at para, 7.155
[89] WTO, *United States – Measures Affecting The Cross-Border Supply Of Gambling And Betting Services*, Report of the Panel, WT/DS285/R, November 2004, at para 6.316.
[90] See WTO, *Colombia – Indicative Prices and Restrictions on Ports of Entry,* Report of the Panel, WT/DS366/13, October 2, 2009, at para 54.
[91] See WTO, *Colombia – Indicative Prices and Restrictions on Ports of Entry,* Report of the Panel, WT/DS366/R, April 27, 2009, at para 7.388.
[92] Ibid, at para 7.325
[93] Ibid, at para 7.195
[94] Ibid, at paras 7.612 and 7.620
[95] Ibid, at paras 7.613, 7.274, 7.256, and 7.199.
[96] Ibid, at paras 7.216 and 4.171
[97] Ibid, at para 4.162
[98] Ibid, at paras 7.255-7.256, 7.275, and 7.614-7.618
[99] WTO, *Colombia – Indicative Prices and Restrictions on Ports of Entry,* Report of the Panel, WT/DS366/13, October 2, 2009, at paras 77, 93, 111.
[100] WTO, *Colombia – Indicative Prices and Restrictions on Ports of Entry,* Report of the Panel, WT/DS366/R, April 27, 2009, at para 2.4
[101] Ibid, at para 5.95