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The link between tax, trade and investment: tensions and opportunities

by

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It would be an understatement to say that 2025 has brought significant attention to the relationship between tax, trade and investment. In recent months, states have reacted strongly to global tax reforms, particularly the new 15% global minimum tax (GMT). In response to other nations adopting the GMT, the US proposed, but then withdrew, Section 899 retaliatory taxes targeting companies from countries implementing the Undertaxed-Profit Rule. The US withdrew its proposal after the G7 members agreed to exempt US-parent groups' profits from the Undertaxed-Profit rule and the Income-Inclusion Rule, recognizing that these may already be covered by US minimum tax rules, although these groups may still face qualified domestic minimum top-up taxes. The G20 has also committed to discuss proposals to shield US companies. However, how these proposals will work and whether all OECD inclusive framework members will agree is still unclear. As negotiations continue, it is important to consider how exemptions for US companies might affect non-discrimination commitments under international investment and trade agreements.

Despite uncertainty with respect to the GMT, countries continue to implement the rules. Therefore, countries must contend with the need to rethink the tax tools used to improve competitiveness. Such measures must however be in line with existing international obligations to prevent unintended breaches. For instance, while countries may shift competition to indirect taxes, these may fall squarely within the ambit of trade laws and would therefore be subject to existing trade agreements. Ultimately, this highlights the continued tensions between the sovereign right to design domestic tax system on the one hand and obligations under tax, investment and trade agreements, on the other hand.

In this environment, governments must carefully navigate complex challenges as they seek to attract FDI, adapt to global tax reforms and comply with international trade and investment obligations. What can countries do? This requires a multifaceted response that appreciates the interconnectedness of the three objectives and exploits synergies that exist:

- *Greater focus on certainty for investors*. This will require better coordination between tax and non-tax incentives that can only be achieved if there is ongoing dialogue between stakeholders. However, domestically, there are disjointed policies and strategies and insufficient coordination on the treatment of tax in non-tax agreements. To mitigate this, countries should facilitate multistakeholder engagement on proposed incentives to understand their interaction with obligations under non-tax agreements. The approval/advancing of incentives should also be done by one agency, ideally under the control of the ministry of finance, to avoid overlapping and/or conflicting commitments. Policymakers should also explore opportunities for cross-learning. For instance, tax policymakers may be able to draw lessons from the investment and trade dispute-settlement system.

- *Greater emphasis on investment facilitation measures*. These measures have become increasingly popular and offer commitments that make it easier for investors to establish, expand and run their businesses. The effective implementation of these measures may offer an alternative approach to attracting investment, which moves away from that focused on investment protection only. It is no surprise, then, that more investment-related agreements focus on investment facilitation, such as the WTO Agreement on Investment Facilitation for Development and the EU's Sustainable Investment Facilitation Agreement with Angola. These investment facilitation provisions focus on improving the overall investment climate and include commitments to enhance transparency, streamline administrative procedures and promote regulatory coherence. Achieving these objectives will require close cooperation among policymakers to ensure a shared understanding of the commitments. In addition, it is necessary to establish systems that can provide the capacity and funding necessary for the implementation of these commitments.

- *Leverage of mega-regional trade agreements.* These agreements provide a more attractive market for goods and services that their member states can leverage to attract investment. Deeper economic integration within regions will therefore be instrumental in increasing the attractiveness of markets. Africa, for instance, may leverage the African Continental Free Trade Agreement that, if effectively implemented, will foster industrialization, trade and investment, accelerating Africa's competitiveness in the global market.

- *Renegotiation of old generation investment agreements.* Old generation investment agreements (which still represent the majority of agreements around the world) often contain broad provisions that may restrict a country's domestic regulatory and policy space. By renegotiating these agreements, governments can clarify obligations and add exceptions, giving them more room to undertake domestic tax reforms.

- *Capacity building concerning government policymakers.* This will ensure that tax, trade and investment policymakers appreciate the impact of the obligations under each of the agreements and their impact on specific reforms.

In this era of competition, government need to recognize that the efficiency of their corporate tax policy tools is limited and that they face rising tensions between tax issues on the one hand and trade and investment agreements on the other hand. This presents an opportunity to revisit the full range of tools outside of corporate tax incentives that increase competitiveness, particularly the overall investment climate, including infrastructure, a skilled workforce and ease of doing business. More importantly, countries should aim to adopt an integrated investment policy that considers tax, trade and investment considerations in order to minimize potential conflicts.

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