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*Rules of Origin in Services: The Nationality
Conundrum*

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RULES OF ORIGIN IN SERVICES: THE NATIONALITY CONUNDRUM

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ABSTRACT

Rules of origin for trade in services remains largely underdeveloped at the multilateral fora. However, with the proliferation of preferential trade agreements, governments have shown an appetite for developing restrictive origin rules in Trade in service. This is to prevent trade deflection and to limit the access of third parties to the negotiated trade preferences. As a result, several models for establishing origin in services trade have emerged. At present, nationality of the service or service supplier is the preeminent criterion for establishing origin in services. The present paper is an attempt to examine different means to identify the nationality of the service or service supplier in the international trading system and to highlight the deficiencies in these rules.

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I. INTRODUCTION

Rules of origin are an important component of international trade policy as they distinguish between the sources of supply of products or services.¹ Proliferation of free trade agreements (“FTA”) has made origin rules especially prominent as a means to prevent trade deflection.² Traditionally, rules of origin have focused on trade in goods. Origin rules for services have not received equal attention at the multilateral fora. However, with the increasing role of services in global value chains, it is crucial to examine the principles used to determine the origin of services. While several different models on such rules exist, none have been unanimously accepted and employed.

The General Agreement on Trade in Services (“GATS”) is the first comprehensive multilateral agreement on trade in services. The GATS contains limited rules to determine the origin of services. These rules differ depending on the mode through which a service is supplied.³ Before the Uruguay Round, very few trade agreements addressed trade in services. As a result of liberalization of markets across the world, trade in services has increased exponentially. In order to regulate such trade, governments appear to ascribe greater importance to rules of origin for services in bilateral trade agreements, to determine the nationality of service suppliers while regulating trade and awarding benefits.⁴

Identifying the origin or nationality of the service or the service supplier is crucial not only for regulating market access, law enforcement, taxation, and regulatory responsibilities etc., but also to navigate the perilous waters of economic sanctions in international trade. For instance, the United States’ sanctions against Iran have driven other countries to ensure that no goods or services

¹ Hoekman, Bernard ‘Rules of Origin for Goods and Services: Conceptual Issues and Economic Considerations’, JOURNAL OF WORLD TRADE, (1993) 82 [hereinafter “Hoekman”] p.81.

² *Id.*

³ There are four modes of service supply under the GATS: “Mode 1” for direct cross-border supply of services; “Mode 2” for the direct consumption of services abroad; “Mode 3” for the supply of services via foreign commercial presence and “Mode 4” for the supply of services associated with the temporary movement of natural persons.

⁴ Wang, Heng. ‘WTO Origin Rules for Services and the Defects: Substantial Input Test as One Way Out?’, Journal of World Trade 44, no. 5 (2010):1085 [hereinafter “Heng Wang”] p.1084.

originating from Iran enter their markets and *vice-versa*.⁵ Such concerns coupled with a general shift away from multilateral service liberalisation towards a bilateral or plurilateral approach to market access commitments and the concomitant need to curb free riders has accentuated the need for governments to develop restrictive rules of origin for services.

With this background, this paper seeks to examine the extant rules of origin for trade in services. It begins by examining the existing models used to regulate the origin for trade in services. It then proceeds to understand how rules of origin are determined under the GATS framework. This is followed by an analysis of India's rules of origin for services negotiated in its FTAs and certain issues that arise in this regard. Finally, the paper concludes with observations on how countries can design their FTAs in line with their policy objectives.

II. EXISTING APPROACHES TO DETERMINE RULES OF ORIGIN IN SERVICES

Rules of origin are used to distinguish between different goods or services nationalities, and may in fact be used to discriminate.⁶ In the case of goods, rules of origin may take the form of tariffs. However, in the case of services, the rules of origin may be exercised through a class of non-tariff measures, ranging from quantitative limitations to regulatory restrictions.⁷ Several such non-uniform rules operating in the international trading system puts the development of international service trade at risk. Therefore, it is necessary to develop certain guiding principles for services nationality identification, which would reduce the discrepancies between various origin rules and help prevent such rules from becoming unfair trade barriers.⁸

Unlike trade in merchandise the origin rules for which focus on processing activities or “substantial transformations” in the product, service rules of origin are predominantly based on nationality.⁹ The nationality of services is of great significance. It is the primary test for regulators to determine whether there is any ‘trade’ in services in the first place. A determination as to the nationality of a service or service supplier is also necessary to adjudicate a claim of violation of the Most-Favoured Nation (“MFN”) or the breach of market access commitments.¹⁰ A nationality based origin rule such as location of incorporation is perhaps the simplest and most transparent procedure, and can be used to determine the origin of both products and providers. There are, however, other means to determine nationality. Various models to determine nationality have developed over time from different trade agreements with the same objective, which is to restrict non-members from gaining access to benefits under the agreement. These include incorporation, ownership and control, substantial business operations and real and continuous link with economy.¹¹ These tests are usually employed in combination with one another while defining the eligibility criteria of the beneficiaries of the agreement.

1. Incorporation and substantive business operations

Incorporation is a simple criterion, most frequently used in international law to identify nationality of a commercial entity. It identifies the territory in which the entity is constituted or registered to

⁵See generally Iran Sanctions available at <<https://www.treasury.gov/resource-center/sanctions/programs/pages/iran.aspx>>, last accessed 31 May 2019.

⁶Hoekman, *supra* Note 1 at p.82.

⁷ Carsten Fink and Deunden Nikomborirak, *Rules of Origin in Services: A Case Study of Five ASEAN Countries*, World Bank Policy Research Working Paper 4130, February 2007, p.3. [hereinafter “Fink and Nikomborirak”]

⁸ Heng Wang, *supra* Note 4 at p.1085.

⁹ *Id.*

¹⁰ Heng Wang, *supra* Note 4 at p.1084.

¹¹ Hoekman, *supra* Note 1 at. p.89.

establish the nationality of the entity. The GATS also employs this criterion in defining a juridical person of another Member as a juridical person which is either “constituted or otherwise organized under the law of that other Member”.¹² In international law, the *Barcelona Traction* case recognized that the standard tests for ‘nationality’ of a corporation was the place of incorporation favored in common law systems and *siege social*, accepted in civil law systems.¹³

However, the incorporation criterion seldom serves as a standalone requirement and is generally combined with other requirements to ensure adequate safeguards against free – riders. For instance, GATS requires a juridical person to have “substantive business operations” in the territory of the Member in addition to the incorporation as explained above. Notably, the contours of “substantive business operations” remain unclear in the WTO jurisprudence. India has used a combination of the incorporation and the substantive business operations criteria in devising the test for nationality of a juridical person in its trade agreements with Japan, Korea and Singapore.¹⁴

2. Real and Continuous link with the economy

A stricter test for nationality is found in the trilateral trade agreement between Peru, Colombia and the European Union (“Peru-Colombia-EU FTA”). In its definition for the juridical person under Article 108, this agreement requires that the juridical person, in addition to being incorporated in the territory of the party must have “a real and continuous link with the economy of that Party.”¹⁵ The provision reads as follows:

“juridical person of a Party’ means a juridical person set up in accordance with the laws of that Party and *having its registered office, central administration or principal place of business in the territory of that Party*; in case a juridical person has only its registered office or central administration in the territory of a Party, it shall not be considered as a juridical person of that Party, *unless its operations have a real and continuous link with the economy of that Party*”¹⁶

(Emphasis Added)

Thus, the Peru-Colombia-EU FTA adopts a three-fold test; first, the test of incorporation or the requirement to “set up in accordance with the laws of that Party”; second, to have its registered office, central administration or principal place of business in the territory of that Party and finally, for the operations to have a real and continuous link with the economy of that Party.

3. Ownership and control

An ownership or control-based criteria is also used to determine the nationality of the service supplier. The GATS, in prescribing origin rules for supply of service through Mode 3, uses the ownership and control criteria to establish the nationality.¹⁷ The origin of the service supplier is

¹² The General Agreement on Trade in Services [hereinafter “GATS”] Article XXVIII (m).

¹³ *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)* (New Application: 1962), Judgment (Second Phase), [1970] I.C.J. Rep. 3, 39, para. 56 (R-473). In most civil law systems, nationality was determined by reference to domicile, the test of which was a company’s “seat of control” (*siege social*). p.42, para 70.

¹⁴ Comprehensive Economic Partnership Agreement between the Republic of India and Japan [hereinafter “India – Japan CEPA”] Article 3(n); Comprehensive Economic Partnership Agreement between the Republic of India and Republic of Korea [hereinafter “India – Korea CEPA”] Article 6.1; Comprehensive Economic Cooperation Agreement between the Republic of India and Republic of Singapore [hereinafter “India – Singapore CECA”] Article 7.1(e).

¹⁵ Trade Agreement between the European Union and its Member States, of the one part, and Colombia and Peru, of the other part [hereinafter “Peru-Colombia-EU FTA”] Article 108.

¹⁶ Peru – EU – Colombia FTA, *supra* Note 15, Article 108.

¹⁷ GATS Article XXVIII(m), *supra* Note 12.

defined on the basis of the origin of the juridical and/or natural persons that own or control that commercial presence.¹⁸ Therefore, the test for nationality or origin in Mode 3 supply of service goes a step further and examines the nationality of the entity owning or controlling the service supplier. What constitutes such ownership and control is provided under Article XXVIII(n) of the GATS. This provision supplements the definition of “Juridical Person of the Another Member” and states that a juridical person is owned by persons of a Party if they own more than 50 percent of the equity interest in such juridical person. A juridical person is controlled by persons of a Party if such persons are able to name majority of its directors or are otherwise able to legally direct its actions.

Determining nationality on the basis of ownership, control or substantial business operations is often challenging. There is limited guidance in WTO jurisprudence on the interpretation of the elements of the tests. The most relevant issue with regards the ownership and control criteria are instances when corporate veil may be required to be pierced. This aspect has been examined in detail in part IV of the paper below.

III. RULES OF ORIGIN UNDER GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

This part of the paper examines the relevant provisions of the GATS which aid in delineating the rules of origin for trade in services. While the Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations of 1991,¹⁹ i.e. the “Dunkel Draft” envisioned a set of rules of origin for services, negotiations did not culminate into a separate agreement on origin rules for services, comparable to the Agreement on Rules of Origin.²⁰ The GATS contains rules of origin for trade in services, although the term ‘origin’ is not expressly used. It uses the term “from” or “in” to denote origin in the territory of a Member, and the term “by” to refer to a service provider of one Member.²¹

In GATS, the origin rules of services mainly consist of Article XXVIII (Definitions), Article XXVII (Denial of Benefits) and Article V (Economic Integration).²² The mechanism to determine the origin of supply of service using these provisions is twofold; first, the “general rules” of origin which consists of Article XXVIII on ‘Definitions’ which determine the beneficiaries of service commitments; and second comprising of the “special rules” of origin consisting of Article V on ‘Economic Integration’ and Article XXVII on ‘Denial of Benefits’ which supplement the general rules in terms of regulating the situations in which Parties may deny the benefits to a Member. Together, these rules determine the origin of services and the extent to which non-Members benefit from trade preferences that are negotiated among Members.

1. General Rules under Article XXVIII on Definitions

¹⁸ Werner Zdouc, ‘WTO Dispute Settlement Practice Relating to the GATS’, *Journal of International Economic Law* 2, 295 (1999): 329-330.

¹⁹ GATT Trade Negotiations Committee, Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, GATT Document MTN.TNC/W/FA of 20 Dec. 1991.

²⁰Heng Wang, *supra* Note 4 at p.1085.

²¹ GATS Arts I(2)(a) (the supply of a service ‘from’ the territory of one member into the territory of any other Member) and XXVIII(f)(i) (services supplied ‘from’ the territory of that other Member); GATS, Arts I(2)(b) (the supply of a service ‘in’ the territory of one Member to the service consumer of any other member) and XXVIII(f)(i) (services supplied ‘in’ the territory of that other Member); GATS Art. I(2)(c) (the supply of a service ‘by’ as service supplier of ‘by’ a vessel registered. . . or ‘by’ a person of that other Member).

²² Wang, Heng. ‘WTO Origin Rules for Services and the Defects: Substantial Input Test as One Way Out?’, *Journal of World Trade* 44, no. 5 (2010):1086. [Hereinafter “Wang”].

The rules of origin and the extent of its restrictiveness would depend on the definition of the terms “juridical person” and the “juridical person of the other Party”. These concepts, when read with the provision on the Denial of Benefits, clarify the criteria on which the origin of the service/service supplier is established and the situation in which the benefits of the concessions may be denied.

Identification of the origin for services begins from the definition of “service of another Member”.²³ The rules of origin for all modes of service supply can be inferred from this definition. It reads:

- (f) ‘service of another Member’ means a service which is supplied;
- (i) from or in the territory of that other Member, or in the case of maritime transport, by a vessel registered under the laws of that other Member, or by a person of that other Member which supplies the service through the operation of a vessel and/or its use in whole or in part; or
- (ii) in the case of the supply of a service through commercial presence or through the presence of natural persons, by a service supplier of that other Member.²⁴

For the mode of cross-border supply (Mode 1) and consumption abroad (Mode 2), the origin is determined for the “service” that is supplied.²⁵ For Mode 1, the origin is determined on the basis of territory “from” which the service is supplied. The GATS provides no clarity on how to identify such territory from which the service is supplied. Without such guidance, identifying the territory under this mode of supply may prove challenging particularly when the service is supplied over the internet.²⁶ For the supply of service through consumption abroad which is Mode 2, the origin is determined on the basis of territory “in” which the service is consumed. The requirements for determining origin are similar to those under Mode 1 and are ascertained on the basis of the territory wherein the service is consumed.

Origin rules for services supplied through Mode 3 and Mode 4 are slightly more complex. Contrary to the rules for the other modes, the origin of service supplied through commercial presence (Mode 3) and presence of natural persons (Mode 4) are determined based on the nationality of the “service supplier”. The characteristic feature of service under Mode 3 and 4 is that it is supplied in the territory of the consumer.²⁷ Hence, the origin of service supplied through commercial presence and presence of natural persons is dependent on the nationality of the service supplier.

In this regard, a service supplier may mean either a juridical person or a natural person.²⁸ A “juridical person” under the GATS means any legal entity duly constituted or otherwise organized under the applicable law, whether privately or governmentally owned, including any corporation or other forms of association.²⁹

Where a service supplier is in the nature of a legal entity, the test for its nationality is provided in clause (m)(ii) of Article XXVIII of GATS. It states as follows:

²³ GATS Article XXVIII(f), *supra* Note 12.

²⁴ *Id.* GATS Article XXVIII (f).

²⁵ Except in the case of maritime transport services, as per Article XXVIII (f)(i), GATS.

²⁶ Heng Wang, *supra* Note 4.

²⁷ Wang, *supra* Note 22 at p.1087-1088.

²⁸ GATS Article XXVIII (g) defines “service supplier” as “any person that supplies a service”; A “person” as per clause (j) “means either a natural person or a juridical person.”

²⁹ GATS Article XXVIII (l) provides that a juridical person means “any legal entity duly constituted or otherwise organized under applicable law, whether for profit or otherwise, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, joint venture, sole proprietorship or association.”²⁹

“juridical person of another Member” means a juridical person which is either:

- (i) constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member; or
- (ii) in the case of the supply of a service through commercial presence, owned or controlled by:
 - 1. natural persons of that Member; or
 - 2. juridical persons of that other Member identified under subparagraph (i).³⁰

Therefore, where a service supplier is a juridical person under mode 3, its nationality is ascertained based on the test of ownership or control over such entity. Such juridical person may be owned or controlled either by a natural person of that Member or a juridical person established under the law of that Member and conducting substantive business operations in any Member. The requirements for ‘ownership’ and ‘control’ are further elaborated in GATS Article XXVIII (n).³¹ The assessment of whether persons of a Member exercise ‘control’ over a juridical person is made on case-by-case basis.³²

Thus, for a service supplier under either of the modes that is a juridical person, the nationality is determined for the entity owning or controlling the service supplier.³³ On the other hand, for service supplier that is a natural person, his nationality is decided by both residence requirement and his status as a national or permanent resident.³⁴

Although GATS prescribes the rules for identifying nationality or origin for the services as explained above, establishing origin under these rules remain complicated as these rules suffer from certain ambiguities. Notably, there appears to be no agreed interpretation for the expressions “substantive business operations”, “more favourable treatment” or “otherwise legally direct its actions.” Additionally, the interplay between (m)(i) and (m)(ii) remains uncertain. If rules specific to determining nationality of service supplier for Mode 3 is stipulated in Article XXVIII (m)(ii), does it necessarily follow that (m)(i) addresses Mode 1, 2 and 4? If so, does it then allow third party owned or controlled entities to supply service through these Modes?

³⁰ *Id.* GATS Article XXVIII (m).

³¹ GATS Article XXVIII (n)(i) states that a juridical person is “owned” by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member; Article XXVIII (n)(ii) provides that a juridical person is “controlled” by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions.

³² Panel Report, *European Union and its Member States — Certain Measures Relating to the Energy Sector* (WTO Doc. No. WT/DS476/R) adopted on 10 August 2018. Para 7.470

³³ GATS Article XXVIII (n)(ii), *supra* Note 31.

³⁴ *Id.* GATS Article XXVIII (k) states “natural person of another Member” means a natural person who resides in the territory of that other Member or any other Member, and who under the law of that other Member:

- (i) is a national of that other Member; or
- (ii) has the right of permanent residence in that other Member, in the case of a Member which:
 - 1. does not have nationals; or
 - 2. accords substantially the same treatment to its permanent residents as it does to its nationals in respect of measures affecting trade in services, as notified in its acceptance of or accession to the WTO Agreement, provided that no Member is obligated to accord to such permanent residents treatment more favourable than would be accorded by that other Member to such permanent residents. Such notification shall include the assurance to assume, with respect to those permanent residents, in accordance with its laws and regulations, the same responsibilities that other Member bears with respect to its nationals;

2. Special Rules under Articles V on Economic Integration and Article XXVII on Denial of Benefits

The special rules of origin in services under GATS include provisions on denial of benefits and economic integration. A Denial of Benefits clause is inserted in a treaty to allow a party to deny the benefits of a treaty to certain persons that lack a sufficient connection to the FTA party in which they are incorporated.³⁵ Denial of Benefits is an exception provision to the obligations stipulated with regard to trade in services under FTAs. The denial of benefit provisions could be described as “backdoor” provisions for addressing the restrictive nature of the exception provisions in such FTAs, or the inflexibility in the FTAs.³⁶

Under the denial of benefits provision, Members are permitted to deny the benefits of GATS to the service supplier or the supply of service that lack a sufficient connection to the Members territory and economy.³⁷ Aside from special rules for denying benefits to the supply of maritime transport services,³⁸ a service provider in the nature of a juridical person may be denied the benefits if it is not a service provider of a Member or a Member to which the denying member does apply the WTO Agreement.³⁹

Article V on Economic Integration embodies another special origin rule specific to preferential trade agreements. GATS Article V allows WTO Members to deviate from their treaty obligations as a consequence of having entered into a preferential trade agreement, provided the FTA establishes a significant degree of economic integration. Paragraph 6 of this provision states that the service suppliers of other Members could enjoy the treatment under the economic integration agreement, if it is a juridical person constituted under the laws of a party to the agreement, and is engaged in ‘substantive business operations’ with the parties to such agreement.⁴⁰

These special rules supplement the general rules of origin in limited situations and serve as a “safety valve” whereby Members are able to deny benefits in order to preclude possible evasion of rules.⁴¹ Therefore, the general rules of origin in GATS, contained in the definitions together with special rules under the denial of benefits provision establish the rules of origin under GATS and restrict the access of the Members’ service suppliers to the benefits accorded under the agreement.

IV. RULES OF ORIGIN UNDER INDIA’S TRADE AGREEMENTS: ISSUES AND CHALLENGES

This part of the paper seeks to analyze how the Members may structure their rules of origin in the chapter on trade in services in their FTAs. In particular, it makes certain observations on the language used in some of India’s FTAs and presents certain general challenges in controlling the extent of liberalization of such origin rules.

An important concern in the design of FTAs covering services is the extent to which non-members benefit from trade preferences that are negotiated among members. The focus of rules of origin in

³⁵ Kenneth J Vandevelde, U.S. International Investment Agreements 105 (2009).

³⁶ WATANABE Shintaro, ‘Denial of Benefit Provisions in FTAs Accompanying the Liberalization of Trade in Services: Does the “Backdoor” Open for Signatory Countries Faced with FTA Inflexibility?’, *Research Institute of Economy, Trade and Industry*, September 2007.

³⁷ GATS, Article XXVII, *supra* Note 12.

³⁸ *Id.*, Article XXVII (b).

³⁹ *Id.*

⁴⁰ GATS Article V:6 states that “A service supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.”

⁴¹ Heng Wang, *supra* Note 4 at p.1090.

services trade agreements delineate the origin of the service or service supplier. A liberal rule of origin enables service providers from non-member countries to benefit from improved market access negotiated under an FTA.⁴² The choice of rule of origin determines who benefits from an FTA i.e., national service suppliers, foreign suppliers already established and foreign suppliers not yet established.

As discussed above, a third party may benefit from an FTA depending on the definition of the terms “juridical person” and “juridical person of another member” read with the provision on the Denial of Benefits. India has mostly followed a GATS-based approach in its FTAs with respect to the determination of the rules of origin in services. Certain observations on the deviation from the GATS practice in India’s FTAs has been made below.⁴³

1. Definition of the term “Juridical Person”

India’s FTAs have followed a consistent approach in the definition of juridical person, in line with the language of the Article XXVIII(l) of the GATS. Except for the India-Singapore FTA, a note has been added to this definition to clarify that a cooperative is a legal entity constituted under the relevant applicable laws in India.

2. Definition of the term “Juridical Person of the other Party”

A deviation from the language of GATS in this definition can be seen in the case of India-Korea CEPA. Article 6.1 defines juridical person of the other Party to mean a juridical person which is constituted or otherwise organized under the law of the other Party, and is engaged in substantive business operations in the territory of the other Party, *or a non Party*. This formulation would essentially cover any a company which is organized under the law of the other Party but may carry out substantive business operations in any other territory, which is not a party to the FTA. The effect of this is that the definition of juridical person is expanded to allow companies to structure themselves in a manner that may be beneficial to them in terms of taxation or other business considerations. The India-Singapore CECA has a separate proviso in the definition for the purposes of supply of audio-visual, education, financial, telecommunication and financial services through commercial presence.

3. Provision on Denial of Benefit

The benefits that a third party may avail from an FTA, which is an extension of the restrictiveness of the rules of origin also depends on the Denial of Benefits clause. This provision gives an FTA Member the right to deny the benefits of the chapter in certain cases. Generally, the denial of benefits clause should address the aspect of a service supplier in addition to the supply of a service. Most of India’s FTAs follow a common thread of denying the benefits of the chapter on trade in services where the Party establishes that the service is being provided by a juridical person owned or controlled by a person of a non-Party or the Party establishes that the service supplier is owned or controlled by a person of the denying party. The India-Korea CEPA in Article 6.22 goes a step further in case of ownership and control to include the aspects of real and continuous business activities and substantive business operations to deny the benefits of the chapter. India should devise

⁴²Fink and Nikomborirak, *supra* Note 7 at p.116.

⁴³ The FTAs examined in this section include India-Japan CEPA, India-Korea CEPA, India-Singapore CECA and Comprehensive Economic Cooperation Agreement between the Government of Malaysia and the Government of the Republic of India [hereinafter “India-Malaysia CECA”].

a uniform formulation of the language of the provision in order to cover all instances in which it may deny the benefits in line with its policy rationale.

Based on the above observations, it may be inferred that while India has deviated from the GATS language in certain FTAs, it should reconcile its policy objective of the extent of liberalisation it would like to achieve through its FTAs. Accordingly, India should negotiate the formulation of the language of the above-mentioned provisions which aid in determining the rules of origin for trade in services.

There are a number of challenges that arise with regards the determination of the rules of origin in case of a potential dispute. Chief amongst them is ability to circumvent or water down restrictive rules of origin through corporate restructuring.

4. Corporate restructuring to water down the restrictive rules of origin

The definition of the terms “owned”, “controlled” and “affiliated” in India’s FTAs have consistently followed the GATS language. Despite the definitions in FTAs which ensure that the benefits of the agreement are availed by juridical persons who are owned or controlled by natural persons or juridical persons of the other Party, there may be instances where these provisions may not be adequate. Piercing the corporate veil essentially means disregarding the separation between entities organized in a corporate form with limited liability of shareholders.⁴⁴ The current jurisprudence on piercing the corporate veil across international fora and the possibility of a corporate restructuring are examined below.

(i) WTO jurisprudence

The panel in *EC-Bananas-III* stated that for suppliers commercially present in the EC, such as Del Monte Mexico, “it would not matter under Article XVII(m) of GATS whether Del Monte Mexico was owned or controlled by natural or juridical persons of Jordan, i.e., a WTO non-Member, as long as Del Monte Mexico was incorporated in Mexico and engaged in substantive business operations in the territory of Mexico or any other member.⁴⁵ However, the panel did note that a list of companies owned or controlled by the service supplier without formal records of company registrations might suffice as evidence of the element of “controlled.”⁴⁶ The Panel in *Canada-Autos* held that ‘in order to define a “juridical person of another Member” Article XVIII(m) of GATS does not require the identification of the ultimate controlling juridical or natural person: it is sufficient to establish ownership or control by a juridical person of another Member, defined according to the criteria set out in subparagraph (i).’⁴⁷ The panel’s rationale in this case effectively dispenses with the requirement of ownership and control altogether where the requirement of incorporation is adequately met.

(ii) International law

⁴⁴ Yaroslau Kryvoi, ‘Piercing the Corporate Veil in International Arbitration’, 1 Global Bus.L.Rev. 169(2010-11), pg. 173.

⁴⁵ Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas III*, (WTO Doc. No. WT/DS27/R) adopted on 22 May 1997, para 7.318, footnote 487. [hereinafter “EC – Bananas”]

⁴⁶ *Id.* para 7.331, AB, para 239 declined to rule on this point, characterizing it as a factual conclusion.

⁴⁷ Panel Report, *Canada – Certain Measures affecting the Automotive Industry*, (WTO Doc. No. WT/DS139/R) adopted 11 February 2000, para 10.357; See Panel Report, *EC-Bananas*, paras 7.328-7.329.

In the case of *Barcelona Traction* the ICJ held that the veil is lifted, for instance to prevent the misuse of the privileges of legal personality, as in certain cases of fraud or malfeasance, to protect third persons such as a creditor or purchaser, or to prevent the evasion of legal requirements or of obligations.⁴⁸ In a Separate Opinion to this judgement, it was recognised that the standard tests for ‘nationality’ of a corporation was place of incorporation favoured in common law systems and siege social, accepted in civil law systems.⁴⁹

(iii) *International investment arbitration*

The ICSID jurisprudence has demonstrated the increasing willingness of the tribunals to pierce the corporate veil. Tribunals have pierced the corporate veil to make an objective existence of the foreign control.⁵⁰ Further in the case of *CMS Gas Transmission Co. v. Argentina*, the tribunal pointed out that the principle of separation of legal entities of *Barcelona Traction* was not directly relevant to protection of shareholders.⁵¹ The Tribunal ruled that the Convention did not require control over a locally-incorporated company in order to qualify under the Convention. It also ruled that the Convention does not bar a claim brought by a minority non-controlling shareholder such as CMS, observing that previous ICSID tribunals, in also finding jurisdiction had “not been concerned with the question of majority [ownership] or control but rather, whether the shareholders can claim independently from the corporate entity”.

From the above, it can be seen that the existing jurisprudence of the issue of lifting the corporate veil varies across different tribunals and the applicable law. This issue would be determined on a case-to-case basis. It is significant to note that WTO panels have not been very keen on piercing the corporate veil in order to determine the ultimate controlling interest in the case of corporations.

The intention to avoid third parties from benefitting from the FTA may be undermined where a chain of legal entities, or rather ‘juridical persons’ are involved. The corporate entity may be structured in a way that would satisfy the legal requirements under the FTA but the effective ownership or control could still be with persons of a third party. The effective link to the juridical person of the other Party gets watered down. The same criticism may apply to the power to name the majority of directors, which is relatively weaker link than the link of ownership.⁵²

Thus, a careful examination of the rules of origin that apply to juridical persons is necessary to determine the extent to which a non-member may benefit from an FTA. Countries may design liberal or restrictive rules of origin in their FTAs depending on their policy objective. This may be achieved by modifying the language of “juridical person of the other Party” or tweaking the aspects of ownership and control. Further, the Denial of Benefits provision may be used in order to strictly interpret the situations in which the benefits of the negotiated concessions may be denied.

⁴⁸ *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)* (New Application: 1962), Judgment (Second Phase), [1970] I.C.J. Rep. 3, 39, para. 56 (R-473).

⁴⁹ *Barcelona Traction*, p.42, para 70; In most civil law systems, nationality was determined by reference to domicile, the test of which was a company’s “seat of control” (siege social).

⁵⁰ *Vacuum Salt Products Ltd. v. Republic of Ghana*, ICSID Case No. ARB/92/1, para30 (Feb. 16, 1994) (Award), reprinted in 4 ICSID 329 (1997); *TSA Spectrum de Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, para147 (Dec. 19, 2008) (Award).

⁵¹ *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/8, para. 48 (July 17, 2003) (Decision of the Tribunal on Objections to Jurisdiction).

⁵² Nellie Munin, *LEGAL GUIDE TO GATS*, (Kluwer Law International, 2008), p. 98.

V. CONCLUSION

The GATS is the first comprehensive multilateral agreement establishing legal parameters for trade in services. While it suffers from many deficiencies, it serves as a model for ambitious FTA chapters of services. Of particular importance is the concept of rules of origin in services, which governs the extent to which non-Members may benefit from a negotiated liberalization commitment. Rules of origin in services determine the extent of preferences entailed in market opening commitments that countries undertake in FTAs. In this regard, the definition of certain key terminologies, such as, “juridical person”, “juridical person of the other Party” and the formulation of the Denial of Benefits clause regulate the scope of beneficiaries.

However, despite these provisions, the restrictions to qualify as beneficiaries under the agreement may be circumvented through targeted corporate restructuring. The current jurisprudence on piercing the corporate veil is varied, depending on the tribunals and applicable law. In particular, the WTO panels and Appellate Body have not been very keen on piercing the corporate veil to determine the ultimate controlling interest. In such a case, mere incorporation as per Party’s law may suffice to show entitlement to benefits. Notwithstanding, the issue would have to be examined on a case-by-case basis. Countries would benefit from modifying the language of certain clauses to ensure either a liberal or restrictive approach, depending on their policy objectives. This may be achieved by modifying the aspect of “control” in the definitions, which would allow only persons with a true controlling interest to benefit from the FTA. Further, the denial of benefits clause may also be strengthened to ensure that the benefits are availed only by parties to the Agreement. With the increase in trade in services across the world, countries would benefit from paying special attention to the rules of origin for trade in services.