

TAX DISPUTES IN INVESTOR-STATE ARBITRATION

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PREFACE

'This thesis, including footnotes, does not exceed the permitted length.'

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ABSTRACT

This thesis examines tax disputes adjudicated by investor-state tribunals. I argue that the nature of taxation - a compulsory levy - is unlike any other state regulatory measure such as an environmental or a public health measure. I suggest that tax-related investment disputes constitute a unique category of foreign investment disputes, and that investment tribunals should recognize them as such. Not all arbitral tribunals, however, acknowledge the distinct character of taxation which leads to inconsistent jurisprudence.

Apart from the nature of tax, tax carve outs are another important factor that distinguish tax-related investment disputes from other investment disputes. I show that tax carve outs are included in IIAs in order to prevent overlap with tax treaties. Tax carve outs determine the scope of the tribunal's jurisdiction, and limit the substantive obligations that are applicable to a state's taxation measures; but since tax carve outs are worded differently and vary in scope, each arbitral tribunal needs to establish its jurisdiction carefully. While some tribunals have been careful to clearly demarcate their jurisdiction, others have been imprecise.

An analysis of the arbitral awards reveals that the approaches of investment tribunals in tax-related investment disputes differ as to expropriation, fair and equitable treatment, and non-discrimination. For expropriation claims, some tribunals regard tax measures as a unique category and correctly set a high threshold for taxation measures to qualify as expropriation. With respect to non-discrimination and fair and equitable treatment claims, investment tribunals tend to assimilate tax measures to all other measures.

These differences reflect not only the distinct nature of the obligations, but also tribunals' failure to recognize that tax-related investment disputes constitute a unique category. In the future, it is likely that the lower threshold for fair and equitable treatment and non-discrimination will lead investors to rely primarily on these standards in tax-related investment disputes.

Additionally, international tax law (ITL) has played a limited role in tax-related investment disputes. Investment tribunals, instead, prefer to rely on WTO jurisprudence in their analysis and findings. I argue that there are general principles of law in ITL which tribunals should include in their analysis.

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LIST OF ABBREVIATIONS

BEPS	Base Erosion and Profit Shifting
BIT	Bilateral Investment Treaty
CETA	Comprehensive Economic and Trade Agreement
CFC	Controlled Foreign Corporation
CFP	Centre for Freedom and Prosperity
CIL	Customary International Law
ECJ	European Court of Justice
ECT	Energy Charter Treaty
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FET	Fair and Equitable Treatment
G-20	Group of Twenty
GAAR	General Anti-Avoidance Rules
HFCS	High Fructose Corn Syrup
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreements
IIL	International Investment Law
ILC	International Law Commission
ITL	International Tax Law
LAFTA	Latin American Free Trade Association

MAI	Multilateral Agreement on Investment
MAP	Mutual Agreement Procedure
MFN	Most Favoured Nation
MNE	Multi National Enterprise
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
PE	Permanent Establishment
Tax Treaties	Double Taxation Avoidance Agreements/Treaties
The League	League of Nations
UK	United Kingdom
UN	United Nations
US	United States
VAT	Value Added Tax
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organisation

CHAPTER 1

INTERNATIONAL TAX LAW AND INTERNATIONAL LAW

I. INTRODUCTION

International tax law (ITL) has traditionally attracted limited attention from international lawyers.¹ International lawyers do not generally consider ITL to be part of international law, even though most of ITL is found in a large and growing network of bilateral treaties.² At the same time, scholarship on ITL focuses on the tax implications of transnational economic transactions. International lawyers, even if they engage with ITL, do not examine the interaction of ITL with other sub-disciplines of international law.³ In this chapter, I show how international law can provide useful insights on various aspects of ITL - its history, development and some of the ongoing challenges in ITL such as tax competition.

To begin with, it is useful to outline two general features of ITL. First, a state's jurisdiction to tax. A state can exercise its jurisdiction to tax only when there exists a nexus with the taxed activity. While there are certain general principles in ITL,⁴ their non-binding nature allows each state to enact its own tax laws and list its own criteria of what constitutes a nexus. This raises the prospect of international double taxation that tax treaties aim to mitigate.⁵ The two most important jurisdictional bases for taxation are the residence and the source principle.⁶ Pursuant to the residence principle, a state may tax a particular economic transaction because the concerned person is a resident in its territory. Simultaneously, another state may advance a competing jurisdictional claim to tax by asserting that the

¹ See generally Diane M. Ring, 'The Promise of International Tax Scholarship and its Implications for Research Design, Theory and Methodology' (2010) 55 Saint Louis Univ L J 307.

² There two major kinds of bilateral treaties in ITL: Double Taxation Avoidance Agreements (tax treaties) and Bilateral Tax Information Exchange Agreements (tax information exchange agreements).

³ There are a few exceptions. For example, see Ali Lazem, 'The Treatment of Tax in Investor-state arbitration of expropriation and national treatment protection' (2014) (PhD Thesis, Brunel University) (Lazem's thesis does not make a case for existence of general principles of law in ITL nor does it expressly endorse the argument that tax-related investment disputes constitute a unique category. Both these claims form a major part of my thesis); See Chapters 3, 4, 5, and 6 below that examine the different aspects of tax-related investment disputes such as admissibility, jurisdiction and substantive obligations of expropriation, fair and equitable treatment and non-discrimination respectively.

⁴ See Section V below.

⁵ See, for example, Peter Harris, David Oliver, *International Commercial Tax* (Cambridge University Press 2010) 45.

⁶ See generally Mogens Rasmussen, *International Double Taxation* (Kluwer Law International 2011).

transaction took place in its territory - relying on the source principle. Tax treaties and the relevant provisions in the domestic tax laws of various states seek to resolve these jurisdictional conflicts. Nevertheless, not all states are signatories to tax treaties. Further the scope of tax treaties is limited - they ordinarily only apply to taxes relating to income and capital. When transactions do not fall within the scope of tax treaties or the relevant states have not entered into tax treaties, no rules of customary law can assist states to resolve competing jurisdictional claims. In the absence of customary norms in ITL, the non-signatory states either resolve the disputes in an ad hoc manner or rely on some of the rules contained in the tax treaties (that do not bind the relevant states formally), to the extent they help to resolve the dispute. In either case, the absence of universally applicable international norms in ITL means that there is considerable ambiguity on the scope of state jurisdiction to tax.

Second, no universal organisation occupies centre stage in ITL, unlike with the World Trade Organisation (the WTO) in the international trade regime. In early 20th century, the League of Nations (the League) played a central role in laying the foundation of ITL.⁷ Since early 1960s, the most prominent and vocal voice in ITL and policy has been the Organisation for Economic Co-operation and Development (the OECD) - an organisation dominated by developed European and North American states.⁸ While the great majority of tax treaties are bilateral, the OECD has been extremely successful in widely disseminating international taxation rules.⁹ The OECD influences and shapes the debate on international tax policy through the extensive use of peer review, consensus building among its members, publishing reports on different aspects of international tax and continually updating the OECD Model Tax Convention.¹⁰ The UN, a generalist and universal international organisation, has not invested time or resources to meaningfully intervene in ITL and guide international tax policy.¹¹

This chapter examines these and other aspects of ITL. Section II discusses arbitral awards and cases dating back to the early 20th century with a view to examine jurisdiction to tax in international law. I argue that lack of customary norms in ITL contributed to lack of

⁷ For details see Section III below.

⁸ See <http://www.oecd.org/about/membersandpartners/> (for details on the membership of the OECD).

⁹ Harold Wurzel, 'Foreign Investment and Extraterritorial Taxation' (1938) 38 Columbia L Rev 809 (Wurzel noted that states no longer ignore the revenue laws of other states and that the bilateral tax treaties had created a common framework enabling the tax officials of different states to interact with each other).

¹⁰ See James Salzman, 'Decentralised Administrative Law in the Organization for Economic Cooperation and Development' (2005) 68 Law & Contemporary Problems 190.

¹¹ See Frances M. Horner, 'Do We Need an International Tax Organisation?' (2001) 24 Tax Notes Int'l 179.

coherence in early arbitral awards.¹² Additionally, I suggest that a focus on jurisdiction can offer a perspective to examine the role of international law in tax. Section III examines the development of ITL - the initial efforts of the League, the role of the OECD as the primary international organisation in ITL and the marginal role of the UN. Section IV looks at the foremost challenge in ITL currently - the issue of tax competition. Thereafter, in Section IV.B, building on Section IV.A, I elaborate the common concern of treaty shopping in ITL and IIL and suggest the possible use of IIL jurisprudence in ITL. In Section V, I engage with Reuven S. Avi-Yonah's view that some principles of tax treaties are customary norms. I instead suggest that the argument about the existence of customary norms is pre-mature but some principles in tax treaties should be viewed as general principles of law; these should in turn be used by investor-state tribunals in tax-related investment disputes. Section VI concludes.

II. STATE JURISDICTION TO TAX

Early jurisprudence on the jurisdiction of a state to tax did not develop in a systemic manner. Still, it offers an interesting perspective on tax as one gets a glimpse into the nature of early disputes. The arbitral awards inform us how tribunals addressed the legal issues such as imposition of retrospective taxes, withdrawal of tax exemptions and the relation between a state's authority to impose taxes and sovereignty, which in turn is related to the exercise of control over territory.¹³

In the *Brewer, Moller & Co* case, the claimants paid taxes on their warehouses. The municipality of San Cristóbal in Venezuela assessed the taxes. Subsequently, the claimants sought to recover the amount paid as taxes by arguing that the taxes were irregular and illegal. The umpire held that there is no ground to sustain the claim and upheld the absolute right of a state to impose tax. He further observed that it is very doubtful that the Republic of Venezuela could under any circumstances be held liable for the irregular or illegal taxes collected by one of its municipal districts.¹⁴ In *George Cook v United Mexican States*, the claimant's building was exempt from a real estate tax under a statute that provided tax

¹² Even though I would not ordinarily expect coherence in the early arbitral awards (especially since they involved interpretation of different legal instruments), my limited point here is to suggest that a lack of customary norms was one of the contributing factors in the lack of coherence.

¹³ See James Crawford, *Brownlie's Principles of Public International Law* (Oxford University Press 2012) 204.

¹⁴ *Brewer, Moller and Co. Case*, (1903) X Reports of Int'l Arbitral Awards 423 (the umpire, however, did acknowledge that if the claimants were able to show that they were unlawfully classified because of their (German) nationality, the claim could be considered to have some merit).

exemption for twenty years. However, before the passage of twenty years, the local municipality collected the tax on the claimant's building. The claimant paid the tax under protest and later challenged the authority of the state to revoke the tax exemption. The umpire rejected the claim and held that:

For tax exemptions, it is necessary to bear in mind the generally accepted standards of construction. The right of the State to levy taxes constitutes an inherent part of its sovereignty. It is a function necessary to its very existence and it has often been alleged, not only in Mexico, but in the United States and other countries that legislatures, whether of states or of the Federation cannot legally create exemptions which restrict the free exercise of the sovereign power of the State in this regard.¹⁵

In both these cases, the right of a state to levy tax was not only interpreted as integral to its sovereignty but it was also interpreted to be unfettered - without any exceptions.¹⁶ This categorical position is incorrect and outdated.¹⁷ Imposing taxes is an important part of the sovereign function but the state cannot act in breach of its own laws or its obligations under an international treaty without facing legal action. In a domestic court, irregular or illegal taxes will ordinarily be refunded. Recent jurisprudence and developments in international law do not support the decisions in *Brewer, Moller & Co* and the *George Cook* cases. For instance, if a promised tax exemption by a state is revoked, the state could either be held liable for breach of a contract or for violation of its obligations under an investment treaty.¹⁸ In fact,

¹⁵ *George Cook v United Mexican States*, (1927) IV Reports of Int'l Arbitral Awards 217.

¹⁶ Also see *Kügele v Polish State* (1932) 6 ILR 69 (the reported facts state that the claimant, a trader, owned a brewery in Upper Polish Silesia. As a result of a series of licence fees successively imposed by the authorities, the claimant's business ceased to be profitable and the claimant was eventually obliged to close it. The tribunal held that the trader did not lose his right to engage in a trade simply because tax (licence fee) increases led him to close his business. The conclusion in the award is questionable for if a right cannot be realised, it is effectively extinguished).

¹⁷ Over the past few decades, states have entered into international agreements such as the WTO, IIAs and tax treaties, which restrict the scope of a state's authority to impose taxes. See, for example, *Japan - Taxes on Alcoholic Beverages* WT/DS8/AB/R, WT/DSB10/AB/R, WT/DS11/AB/R (WTO Appellate Body, 4 October 1999); Ali Lazem, Ilias Bantekas, 'The Treatment of tax as expropriation in Investor-state Arbitration' (2015) 31 Arb Int'l 1; Peter Harris, David Oliver, *supra* note 5.

¹⁸ The liability of the state would depend on factors such as the nature and duration of promised tax exemptions, the manner and circumstances of revocation of tax exemption. See, for instance, *Total S.A. v Argentine Republic* ICSID Case No. ARB/04/1 (Decision on Liability, 27 December 2010) (where Total argued that because Argentina retroactively withdrew the promised exemption from custom duties, it was liable for breach of its substantive obligations such as fair and equitable treatment under the investment treaty). For a detailed discussion on the award see Chapter 5 below.

the above-mentioned awards are not only inconsistent with the recent developments in jurisprudence but they are also not supported by some of the other early 20th century rulings.

In the *Japanese House Tax*, the dispute revolved around the settlements for foreign residents built in certain Japanese ports.¹⁹ The award endorses the view that a state can restrict its ability to tax once it voluntarily agrees to narrow its jurisdiction to tax. Foreign nationals had limited property rights in Japan and they held land under a lease in perpetuity with Japan. A dispute arose about the scope of the tax exemption extended to foreign nationals. Japan argued that it had the right to tax the buildings built on the land since the tax exemption extended only to the land. France, Germany and Britain defended the absolute character of the tax exemptions. Japan argued that fiscal immunity to foreigners was a sovereign act of limited applicability. Granting complete tax immunity would be akin to restricting it from performing a vital sovereign act.²⁰ The tribunal rejected Japan's argument and held that the treaties protected both - the land and the building of any description constructed on the land from any taxes, charges or contributions.²¹ It is arguable whether Japan intended the tax exemption to extend to the land as well as the buildings. However, this restrictive notion of jurisdiction to tax even though articulated in the context of specific treaties shows that even in early 20th century, tribunals did articulate a nuanced view of the sovereign right to impose taxes.

States continue to enjoy discretion about extending tax exemptions. In *Permanent Mission of India v City of New York*, the issue was whether foreign governments were liable to pay taxes on property owned by them and which were used to house diplomatic staff of missions to the UN and staff of consulates in New York.²² The New York District Court held that properties owned by India in New York were subject to taxes. However, thereafter the US State Department under the Foreign Missions Act of 1982 granted India an exemption. The Federal

¹⁹ *France, Germany and Great Britain v Japan* (PCA, Award of the Tribunal, 22 May 1905).

²⁰ The argument was, in part, based on the provisions of the Anglo-Japanese treaty. Article 18 of the Anglo-Japanese Treaty 1894 provided that: 'The several foreign settlements in Japan shall be incorporated with the respected Japanese Commune, and shall thenceforth form part of the general municipal system of Japan.'

²¹ See Arnulf Becker Lorca, *Mestizo International Law A Global Intellectual History 1842-1933* (Cambridge University Press 2015) 171; Contemporary courts have also interpreted terms such as 'land' and 'lease' in tax disputes with a certain degree of elasticity. See *Maierhofer v Finanzamt Augsburg-Land* (Case C-315/10) [2003] ECR I-563 (the court held that even if the structure can be demolished any time within ten days, it still constitutes an immovable property for tax purposes. There was no need for the structure to be inseparably fixed to or in the ground.); *Cottage Holiday Associates Ltd v Customs and Excise Comrs* (Case C-269/00) [1983] QB 735 (where the court held that use of holiday cottage for one week a year over an 80 year period was a legal lease.). Both cases were decided under the UK Value Added Tax Act, 1994.

²² 551 US 193 (2007).

Court of Appeals upheld the decision of the State Department.²³ The decision of the State Department was aimed to gain reciprocal advantage - tax exemptions for US owned property overseas.²⁴ The decisions relating to taxes are an important attribute of sovereignty. Sovereign right to tax also translates into a state's complete authority to impose taxes in the territory under its control. However, once state waives its right to tax a certain category of economic activity or a certain class of persons - it cannot revoke it without a valid reason or without paying compensation to the affected persons.²⁵

Consequently, a permanent loss of territory would entail a permanent loss of right to tax. But, if a state loses and then regains control over a territory, its authority to impose taxes for the intervening period becomes questionable. In the *Guastini* case, the umpire held that the legitimate government when back in power could not enforce a second payment of taxes once paid to revolutionary authorities.²⁶ From May 1898 to May 1900, the Venezuelan government had lost control over large portions of its territory to the Matos revolutionaries. During these two years, the residents and businessmen in the territories controlled by the revolutionaries, paid taxes to them. The Venezuelan government, on regaining the territory sought to levy taxes on the people - even for the period it did not have control over the territory. The businessmen challenged the retrospective imposition of taxes by the Venezuelan government. The umpire observed that when the revolutionaries were in control of the territory, they were, for that period the de facto government.²⁷ The umpire concluded that if the person running his business in that territory paid his taxes to the revolutionaries he cannot be forced to pay the taxes again once the government regains control of the territory.²⁸

In the *Santa Clara Estates* award, the umpire observed that there is no question that the collection of taxes by the government for the period during which it had lost its sovereignty over the territory in question is defensible in law, logic, and ethics.²⁹ It further held that:

²³ *City of New York v Permanent Mission of India* 618 F 3d 172 (2d Cir 2010).

²⁴ *Ibid*; In another dispute in 2009, the US initially refused to pay VAT for goods and services bought in the UK for the construction of its embassy in London. However, the US later agreed to pay the tax. See <http://www.exarone.com/articles/4168/us-agrees-to-pay-vat-for-new-london-embassy>

²⁵ See *John B. Okie (U.S.A.) v United Mexican States* (1926) IV Reports of Int'l Arbitral Awards 54, at 55-57.

²⁶ *Guastini Case (Italy v Venezuela)* (1903) X Reports of Int'l Arbitral Awards 561.

²⁷ *Ibid*.

²⁸ This view was re-affirmed in the same year in the *Santa Clara Estates* award which arose from the same facts as in the *Guastini* case above.

²⁹ *Santa Clara Estates Case (Supplementary Claims)* (1903) IX Reports of Int'l Arbitral Awards 455, at 459.

the effect of the respondent Government in claiming and receiving a payment of taxes for a period of time when it had lost its sovereignty over the district in question, and could neither render protection nor receive obedience, is simply to make the respondent Government liable for a return of those illegally exacted taxes.³⁰

Both the above-mentioned awards recognised a simple underlying principle - that a loss of control of territory implies a co-extensive loss of jurisdiction to impose taxes.³¹ This limitation is especially significant since domestically, the ability of a state to impose taxes retrospectively is widely recognised. The *Guastini* and *Santa Clara Estates* awards suggest that a state's extensive power to tax retrospectively cannot possibly extend back in time when the state did not have control over the territory or during the time period when the state temporarily lost of a certain territory.

The fact that the power to impose taxes is co-terminus with control over the territory is also witnessed in some of the contemporary disputes over territorial control. For example, the power to levy taxes in Palestinian territories is shared between Israel and the Palestinian Authority (PA). The former collects import duties and VAT on goods. Israel collects the taxes on behalf of the PA and then, after certain deductions, transfers the tax collections to the PA at regular intervals. The latter in turn also imposes direct taxes in the Palestinian territories to generate revenue.³² Similarly, in Kashmir - both India and Pakistan impose taxes on persons and property in the territory under their control;³³ even though both the states continue to claim that the territory under other's control is part of their state's territory.³⁴ It is doubtful, however, that if one of the two states gains control over the entire disputed territory, it could levy tax in the newly acquired territory retrospectively.

³⁰ *Ibid.*

³¹ Also see *Minquiers and Ecrehos (France/United Kingdom)* [1953] ICJ 3.

³² See Odd-Helge Fjeldstad, Adel Zagher, 'Taxation and State Formation in Palestine 1994-2000' in Mushtaq Husain Khan, et al (eds.), *State Formation in Palestine Viability and Governance during a Social Transformation* (Routledge Curzon 2004) 192.

³³ In Azad Kashmir (controlled by Pakistan), the taxes are levied by the Azad Government and generally collected by the Azad Kashmir Council consisting almost exclusively of officers from the Pakistan civil service. In Jammu and Kashmir (under Indian control), the taxes are levied by the State Legislature and collection is supervised by the Finance Department of the Government of Jammu and Kashmir. See generally Christopher Snedden, *Kashmir The Unwritten History* (HarperCollins 2013).

³⁴ *Ibid*; Also see Art 370, Constitution of India (provides for autonomous status of Kashmir in the Indian constitutional scheme).

The above mentioned awards suggest that in early 20th century, tribunals and courts failed to articulate the limitations on the state's jurisdiction to tax in a systematic or a cohesive manner. The inconsistency in the above-mentioned decisions and arbitral awards is not surprising. The issues that the courts and tribunals were required to adjudicate on were still pre-dominantly domestic in nature and the claims were based on different legal instruments, such that the inconsistency is more apparent than real. However, the observations of the tribunal in *Brewer, Moller & Co.* and *George Cook* are categorically in favour of an absolute sovereign right to tax unlike in the *Japanese House Tax* case and the *Guastini* case that recognised a more limited right to tax. In my view, it is doubtful if the inconsistency arises merely because different legal instruments were involved. The tribunals, in fact, also endorsed different views on the limitations of a state's right to tax.

However, in one aspect there is considerable uniformity among all the above discussed arbitral awards - the lack of any reference to customary norms in ITL. Admittedly, the courts and tribunals never had occasion to apply international law directly, but at no point do any of the tribunals or umpires refer or take support or otherwise rely on customary norms, state practice or general principles of international law to decide the disputes. Even in the *Japanese House Tax* case where there was an occasion to refer to international norms - the arbitral tribunal did not mention them. The above-mentioned awards and decisions reveal that in early 20th century, there were no customary norms in ITL.³⁵ The position has changed marginally. While customary norms still do not exist in ITL; I argue in Section V below that some of the principles in tax treaties should now be considered as general principles of law.³⁶

The varied opinions on the extent of state jurisdiction to tax have still not yet been settled conclusively. There is also no unanimity on how to address simultaneous state claims of jurisdiction to tax, especially outside the tax treaty network. It is in part due to the limitations of international law. As far as disputes are within the scope of tax treaties, a fragile consensus exists that the state's power to tax has limits but there is no agreement beyond this general proposition.

³⁵ See generally Rutsel Silvestre J. Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Kluwer Law and Taxation 1989).

³⁶ See generally Asif H. Qureshi (ed.), *Public International Law of Taxation: Text, Cases Materials* (Kluwer Law International 1994).

A focus on jurisdiction to tax would help us to further evaluate the role of international law in taxation.³⁷ For instance, one possible extrapolation from the early patchwork jurisprudence discussed above is that a state's jurisdiction to tax has limits. Constraints on state's jurisdiction to tax are recognised in general international law. Arguably, however, these limits are minimal and do not bind a state in any meaningful way.³⁸ The focus on jurisdiction helps us focus on whether a state's claim to tax a particular income is justified - not just under domestic tax law but also ITL.

Further, a greater emphasis on jurisdiction is also important since tax jurisdiction continues to evolve. First, the International Sea Bed Authority has since 1982 has had the authority to impose taxes despite not being a state.³⁹ Second, the longstanding rule against enforcement of taxation laws of one state in another state is also being challenged.⁴⁰ Third, states like the United States are using their domestic law (e.g. the Foreign Account Tax Compliance Act (FATCA)) to require financial intermediaries - even those located outside US, to divulge information in order to combat international tax evasion.⁴¹ More states are likely to follow the example of US.⁴² In fact, the Common Reporting Standard as proposed by the OECD has similarities with the FATCA, as both require the financial institutions to be important intermediaries in the collection of information.⁴³

³⁷ See generally, Lea Brilmayer, et al, 'A General Look at Jurisdiction' (1988) 66 Texas L Rev 722; Lea Brilmayer, 'Jurisdictional Due Process and Political Theory' (1987) 39 Univ Florida L Rev 293.

³⁸ See generally Rutsel Silvestre J. Martha, *supra* note 35, at 9-11.

³⁹ International Seabed Authority is an intergovernmental body that has been established under the United Nations Convention on the Law of the Sea (UNCLOS). Its mandate is to regulate mineral-related activities in the international seabed area beyond national jurisdiction. The Authority is yet to become operational and has not yet imposed any taxes. One of the reasons that the US has not joined the UNCLOS is that it imposes 'tax' on US development of seabed to be paid to the International Sea Bed Authority. See Frederick E. Snyder, Surakiart Sathirathai, *Third World Attitudes Towards International Law: An Introduction* (Martinus Nijhoff 1987) 482.

⁴⁰ See Jason Sharman, 'Seeing Like the OECD on Tax' (2012) 17 New Pol Eco 17 (arguing that when the tax authority of one state passes information to another state, it amounts to enforcement of tax laws of one state in another or at least amounts to a duty to assist in the administration of tax laws of another state.); Also see Diane M. Ring, 'Transparency and Disclosure' in Alexander Trepelkov, Harry Tonino, et al (eds.), *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (UN 2015) 497.

⁴¹ Allison Christians, 'Putting the Reign back in Sovereign: Advice for the Second Obama Administration' (2013) 40 Pepperdine L Rev 1; Itai Grinberg, 'Taxing Capital Income in Emerging Countries: Will FATCA Open the Door?' (2013) 5 World Tax L J 325.

⁴² Ronen Palan, Duncan Wigan, 'Herding Cats and Taming Tax Havens: The US Strategy of 'Not in my Backyard'' (2014) 5 Global Policy 334.

⁴³ See OECD, *Standard for Automatic Exchange of Financial Information in Tax Matters Implementation Handbook* (2016) 87-101 (containing a comparison of the FATCA and the Common Reporting Standard).

III. THE DEVELOPMENT OF INTERNATIONAL TAX LAW

A. The League of Nations as the Initial Catalyst

In 1919, the newly founded International Chamber of Commerce (ICC) began international efforts to reduce double taxation.⁴⁴ In 1920, the Brussels International Financial Conference also passed a resolution suggesting that the League undertake a study on the issues of capital flight, tax evasion and double taxation.⁴⁵ In 1921, the League commissioned an expert report from its Financial Committee. The Committee further entrusted the task of preparing a theoretical report on double taxation to four economists.⁴⁶ In 1922, the Financial Committee delegated the task of studying double taxation to a group of tax administrators and requested a report from a practical and an administrative viewpoint.⁴⁷ The four economists prepared and submitted a report in 1923.⁴⁸ The tax administrators submitted their report in 1925.⁴⁹ The 1923 report adopted the criteria of economic allegiance that it contended was based on taxpayer's ability to pay.⁵⁰ The report's recommendations favoured the capital exporting or the resident states.⁵¹ The 1925 report, which in part relied on the 1923 report, recommended that due to imbalance in the capital movements between the states the jurisdiction to tax should be shared between the source and the resident states. The 1925 report refrained from offering a single solution to double taxation and stated that in the case of impersonal

⁴⁴ In 1920, the Organisation Meeting of the ICC in Paris considered international double taxation to be one of the most important items on its agenda. See Michael J. Graetz, Michael M. O'Hear, 'The "Original Intent" of US International Taxation' (1997) 51 Duke L J 1021 (stating that the role and contribution of the ICC in ITL is often ignored); Also see Stefano Simontacchi, *Taxation of Capital Gains under the OECD Model Convention* (Kluwer Law International 2007) 1-10.

⁴⁵ See Louis W. Pauly, 'International Financial Institutions and National Economic Governance: Aspects of the New Adjustment Agenda in Historical Perspective' in Marc Flandreau, Carl-Ludwig Holtfrerich, et al (eds.), *International Financial History in the Twentieth Century System and Anarchy* (Cambridge University Press 2003) 239.

⁴⁶ The four economists were called 'Academic Experts.' Their names were: Gijsbert Bruins, Luigi Einaudi, Edwin Seligman and Josiah Stamp.

⁴⁷ The tax administrators were from seven different European states: Belgium, Czechoslovakia, France, Great Britain, Italy, Netherlands and Switzerland.

⁴⁸ League of Nations, *Report on Double Taxation submitted to the Financial Committee by Professors Bivens, Einaudi, Seligman and Sir Josiah Stamp*, Doc. E.F.S.73.F.19 (1923) (hereinafter 1923 report).

⁴⁹ League of Nations, *Report and Resolutions submitted by the Technical Experts to the Financial Committee of the League of Nations*, Doc. F. 212 (1925) (hereinafter 1925 report).

⁵⁰ See 1923 report, *supra* note 48; Also see Peter Harris, David Oliver, *supra* note 5, at 43-86 (discussing that the principle of economic allegiance principle is not related to the ability of a taxpayer to pay but the territory from which benefits are derived); K Vogel, 'Worldwide vs. Source Taxation of Income: A Review and Re-evaluation of Arguments (Part I)' (1988) 16 Intertax 216.

⁵¹ 1923 report, *supra* note 48, at 22.

taxes/schedular taxes⁵² the idea of origin is important while in the case of personal taxes (tax on income or capital) the idea of domicile is of importance.⁵³

After the League accepted the recommendations contained in the 1925 report, the Fiscal Committee then requested the tax administrators/technical experts to prepare preliminary Model Conventions based on the 1925 report. The technical experts issued a report in 1927 which inter alia contained four Model Conventions along with commentaries: the Bilateral Convention for the Prevention of Double Taxation in the Special Matter of Direct Taxes dealing with Income and Property Taxes, the Bilateral Convention for the Prevention of Double Taxation in the Special Matter of Succession Duties, the Bilateral Convention on Administrative Assistance in Matters of Taxation and the Bilateral Convention on Judicial Assistance in the Collection of Taxes.⁵⁴ The 1927 report also mentioned that bilateral tax treaties were preferable to a multilateral treaty for: ‘the fiscal systems of the various countries are so fundamentally different that it seems at present practically impossible to draft a collective convention, unless it were worded in such general terms as to be of no practical value.’⁵⁵

In 1928, the League called for a General Meeting of government experts to discuss the 1927 report. The General Meeting recommended certain changes and prepared three versions of the first 1927 Model Convention. The three Model Conventions prepared in 1928 were - ‘Bilateral Conventions for the Prevention of Double Taxation in the Special Matter of Direct Taxes’, No. 1a, 1b and 1c.⁵⁶ The General Meeting of 1928, in a sense, marked the end of the most influential period of the efforts made by the League. The Model Conventions that were prepared and the reports that were submitted during the period of 1923-1928 laid a very strong foundation for ITL. They continue to influence the texts of contemporary tax treaties. However, the efforts of the League continued thereafter.

⁵² The scheduler taxes were common in Europe during the early 1900s. Under the scheduler system, tax was imposed on different kinds of income classified under the ‘schedule’ of the relevant tax law.

⁵³ 1925 report, *supra* note 49, at 8.

⁵⁴ League of Nations, *Report submitted by the Committee of Technical Experts on Double Taxation and Tax Evasion*

Doc. C. 216.M.85.1927.II (1927)(hereinafter 1927 report).

⁵⁵ *Ibid*, at 26.

⁵⁶ League of Nations, *Report presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion* C.562.M.178.1928.II (1928) (the League mentioned that the first Model Convention proposed in 1927 applied to states which levied impersonal tax and a general personal tax. The two additional versions prepared in 1928 were intended to apply to states which did not distinguish between personal and impersonal taxes).

In 1933, the Fiscal Committee of the League approved the text of a Model Multilateral Tax Convention to eliminate double taxation of the profits of enterprises.⁵⁷ In 1935, the Committee recognised that few states had shown interest in signing the proposed 1933 Model Multilateral Tax Convention.⁵⁸ The Fiscal Committee concluded that the idea of a multilateral tax treaty should be discarded in the favour of bilateral tax treaties.⁵⁹ Thereafter, the Fiscal Committee continued its work on bilateral tax treaties. The Committee drafted a Model Convention in 1943 at Mexico. Due to World War II, mainly Latin American states attended the meeting and it reflected the priorities of capital importing states. Later, in 1946 at London another Model Convention was drafted.⁶⁰ Both capital exporting and capital importing states attended the meeting. The Model Convention that was adopted had a more favourable view of the residence principle.⁶¹ With the League dissolved in April 1946, the London Model Convention was League's final contribution to the development of ITL. In the absence of any customary norms or general principles of law at the time, the efforts of the League were the first significant effort by the international community to develop principles of ITL that had the approval of many states.

The League played a leading role in laying the foundations of modern ITL. The approach of the League has influenced the content and nature of ITL in multiple ways, I shall emphasise two that are relevant to the aim and scope of this thesis - the emphasis on bilateral instruments and the use of Model Conventions. The League prudently recognised the impracticability of formalising a multilateral tax agreement and did not spend too much time or effort in persuading states to adopt a multilateral instrument. The League understood the importance of bilateral approaches in international tax and laid the foundation for 'hegemony of bilateral instruments' in ITL.⁶² The reports submitted to the League stated that the dissimilarities in the tax laws of different states were a reason for the impracticality of a

⁵⁷ See League of Nations, Fiscal Committee, *Report to the Council on the Fourth Session of the Committee* C.399.M.204.1933.II.A (1933).

⁵⁸ See League of Nations, Fiscal Committee, *Report to the Council on the Fifth Session of the Committee* C.252.M.124.1935.II.A (1935) (hereinafter 1935 report).

⁵⁹ *Ibid*, at 3 ('The Committee is of the opinion, however, that progress is more likely to achieved by means of bilateral agreements'. It was further clarified that the state's unwillingness to conclude a multilateral agreement was not due to any disagreement with the Model Conventions, but because of the reason that bilateral treaties were viewed as more appropriate by the states.).

⁶⁰ See League of Nations, Fiscal Committee, *London and Mexico Model Tax Conventions: Commentary and Text*

C.88.M.88.1946.II.A (1946) (hereinafter 1946 report).

⁶¹ *Ibid*.

⁶² Maria Amparo Grau Ruiz, *Mutual Assistance for the Recovery of the Claims* (Kluwer Law International 2002) 104- 115 (describing the presence of huge number of bilateral tax treaties as 'the traditional hegemony of bilateral instruments').

multilateral tax treaty.⁶³ But, the League also realised the importance and advantages of bilateral relations in ITL. It noted that the constant extension of the network of tax treaties was due to their ‘cumulative effect.’⁶⁴ Each time a new clause was incorporated in the Model Convention it was included in the subsequent treaties and states which had entered into treaties earlier sought to amend their treaties.⁶⁵ The frequent amendment of treaties would have been difficult if a multilateral approach was adopted because of the need to convince a larger number of states. Insisting on a multilateral approach in the founding phase of ITL would have impeded its progress and development. The League wisely emphasised on bilateral relations.

Additionally, the soft law approach adopted by the League continues to be a primary tool to address contentious issues in ITL today.⁶⁶ Non-binding Model Conventions have become a characteristic feature of ITL - binding agreements, pre-dominantly bilateral, are usually concluded by relying on a non-binding Model Convention. The use of non-binding Model Conventions by the League ensured that states had the discretion to modify the treaties they eventually signed and ensure protection of their interests. Additionally, as discussed above, the League continually revised the Model Conventions and various drafts were prepared. The Model Conventions, thus, instead of constraining states had the effect of providing states with additional options. The provisions in the bilateral tax treaties vary, to reflect the interests of the signatory states; but, at the same time, reliance on the Model Conventions has ensured a remarkable stability and consistency - in structure, language and aim of the tax treaties. It also needs to be acknowledged that historically the reliance on Model Conventions resulted from the absence of any generally recognised principles in ITL and lack of customary norms. Model Conventions became an important vehicle for the League to articulate the principles on which the states agreed and accommodate the rapidly evolving views of the state by means of revised Model Conventions.

The approach adopted by the League has endured and has to a large extent contributed to successfully address the issue of international double taxation. However, the stability and

⁶³ See, for instance, 1927 report, *supra* note 54.

⁶⁴ See 1935 report, *supra* note 58, at 1-4.

⁶⁵ *Ibid.*

⁶⁶ See generally Diane M. Ring, ‘Who is Making International Tax Policy?: International Organizations as Power Players in a High Stakes World’ (2009) 33 *Fordham Int’l L J* 649.

success of the initial efforts in ITL contains the ‘seeds of its own undermining.’⁶⁷ Thomas Rixen argues that the initial narrow focus in ITL on preventing double taxation led to the problem of international tax evasion and tax competition that acquired prominence in late 1990s.⁶⁸ He further suggests that while the League did foresee the problem of tax avoidance and evasion, it did not give it a priority at the time of establishment of ITL.⁶⁹ Thus, in a way the founding phase of the ITL regime contributed to surfacing of the problem of tax evasion and tax competition addressed that the OECD has focused on from 1996 onwards.⁷⁰

Rixen’s observations are important to understand the difficulty of changing international tax rules. The efforts of the League certainly laid the foundation of ITL and provided a certain measure of continuity and predictability to ITL; it helped to partially overcome the earlier patchwork of arbitral awards and uncertain rules. The compromise between the source and the residence principle in the Model Conventions has, by and large, survived for more than eight decades. However, it is also possible to mistakenly believe that the stability is due to adequate rules. Thomas Rixen suggests that path dependency and inability of states to bring about meaningful change could in fact be the reasons for the continuity and stability of ITL and the continued inability of ITL to successfully address tax competition.

Furthermore, as compared to other sub-disciplines of international economic law, the basic features of ITL have essentially remained unchanged since the interwar period. I suggest that this is due to two reasons: first, due to the League’s leadership and the ICC’s lobbying, the period from 1923-1946 saw an increase in the number of bilateral legal instruments (tax treaties) that aimed to remove a prominent barrier for international commerce in the form of international double taxation on capital and income. On the other hand, the same period in international trade is characterised by protectionism. It was only after World War-II that a comparatively more liberal international trade regime was adopted;⁷¹ second, the post-World War II period witnessed negotiations and attempts to establish new institutions dedicated exclusively to international finance and international trade. A large number of states that

⁶⁷ Thomas Rixen, ‘From Double Tax Avoidance to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance’ (2010) 18 Rev Int’l Pol Eco 197, at 197.

⁶⁸ See Thomas Rixen, Philipp Genschel, ‘Settling and Unsettling the Transnational Legal Order of International Taxation’ in Gregory Shaffer, Terence C. Halliday (eds.), *Transnational Legal Orders* (Cambridge University Press 2015) 154.

⁶⁹ Thomas Rixen, *supra* note 67, at 205.

⁷⁰ For a detailed discussion on tax competition see Section IV.A below.

⁷¹ Thus, in a way, ITL foreshadowed the decisive shift that was seen in international trade and international finance.

participated in the negotiations and the establishment of Bretton Woods institutions attracted considerable attention for it marked an important shift in the trajectory of international economic law.⁷² On the other hand, the passing of the baton in ITL - from the League to the OECD happened in a much quieter manner. The OECD essentially followed the path set by the League and importantly the relatively small and homogenous membership of the OECD has (for a large part) allowed it to avoid major internal conflicts.⁷³

B. The OECD as the Primary Standard-Setter since 1963

The Organisation for European Economic Cooperation (OEEC) was created by 18 members in 1948 under the Marshall Plan.⁷⁴ In 1956, it organized its own Fiscal Committee to address double taxation.⁷⁵ The OEEC was recreated as the OECD in 1961 with the addition of United States and Canada as members.⁷⁶ The OECD continued the OEEC's work on international taxation and its first major success in ITL was in 1963 - the publication of the non-binding OECD Model Convention (OECD Model).⁷⁷

The OECD Model is a modern-day successor of the 1927 Model Conventions drafted by the League. The structure of the Model Convention and its contents - the compromise between the residence and source principle - were borrowed from the League's earlier work. The OECD Model, however, retained the London Model Convention's bias in favour of a greater share of revenue for residence states.⁷⁸ In 1977, relying on the tax treaties concluded during the intervening period and after receiving feedback from the states, the OECD published an

⁷² This comparatively different history of ITL as compared to other sub-disciplines of international economic law is, in my view, another contributory factor in the neglect of ITL in international economic law scholarship.

⁷³ For details on the OECD's role in ITL see Section III.B below.

⁷⁴ For details on the OECD's early history see Robert Wolfe, 'From Reconstructing Europe to Constructing Globalization: The OECD in Historical Perspective' in Rianne Mahon, Stephen McBride (eds.), *The OECD and Transnational Governance* (UBC Press 2008) 77.

⁷⁵ Some authors have suggested that the OEEC constituted the Fiscal Committee at the insistence of the ICC since the UN was unable to offer effective leadership in international tax policy after dissolution of the League. See, for instance, Jason Sharman, *supra* note 40; Also see Section III. C below.

⁷⁶ The goals of the OECD were also reformulated and were no longer confined to the Marshall Plan. See Art 1, OECD Convention (inter alia providing that one of the aims of the OECD is to contribute to expansion of world trade, sound economic expansion in member and non-member states).

⁷⁷ See generally Jeffrey Owens, 'The Main Differences between the OECD and the United Nations' Model Conventions' in Richard Vann (ed.), *OECD Proceedings. Tax Treaties. Linkages between OECD Member Countries and Dynamic Non-Member Economies* (OECD 1996).

⁷⁸ This wasn't a surprising development given that the OECD member states are primarily capital exporting or for tax purposes - resident states. See *supra* note 8.

updated final version of the Model Convention.⁷⁹ Many states have since concluded bilateral tax treaties based on the OECD Model Convention.⁸⁰

One of the reasons why the OECD Model has been influential in ITL is due to lack of any viable alternatives. There were unsuccessful efforts at the regional levels to publish alternative Model Conventions.⁸¹ The Latin American Free Trade Association (LAFTA) in 1976 adopted criteria for avoidance of double taxation between LAFTA member states and states outside the region.⁸² The alternate Model proposed by LAFTA did not gain traction because the OECD member states refused to sign treaties based on the LAFTA Model.⁸³ Currently, there are only two other Models that exist apart from the OECD Model - the UN Model and the US Model. The UN Model, first published in 1980, is essentially designed to be used for negotiating and entering into tax treaties with developing states. The fundamental principles contained in the UN Model are similar to the OECD Model. The vital difference is the greater share of taxes for the source state in the UN Model. In this respect, the UN Model is based on the Mexico Model Convention of 1943.⁸⁴ The drafting of the US Model was inspired more by the desire of the US to aggressively protect its fiscal powers.⁸⁵ The fact that US adopts a unique worldwide taxation system which imposes taxes on US citizens irrespective of their place of residence probably also contributed to its efforts to develop a separate model for itself.⁸⁶ Instead of providing an alternative to the OECD Model, the UN Model and the US Model in fact underline the influence of the OECD Model.⁸⁷

⁷⁹ The OECD Model Convention has since been regularly updated - the first update was in 1994 and the latest in 2010.

⁸⁰ There are more than 3000 bilateral tax treaties in force. See IBFD(ed.), *Tax Treaties Database*, at <http://www.ibfd.org/IBFD-Products/Tax-Treaties-Database>.

⁸¹ UN, Department of Economic & Social Affairs, *United Nations Model Double Taxation Convention between the Developed and Developing Countries* (2001) ST/ESA/PAD/SER.E/21 xix (hereinafter UN Model Convention).

⁸² The Commission of the Cartagena Agreement also adopted a Model Convention to prevent double taxation within the Andean group. *Ibid*, at xx.

⁸³ See Thomas Rixen, Philipp Genschel, *supra* note 68, at 156.

⁸⁴ *Supra* note 60.

⁸⁵ See generally Reuven S. Avi-Yonah, 'Who Invented the Single Tax Principle?: An Essay on the History of U.S. Treaty Policy' (2014) 59 NYL School L Rev 309; Also see P.D. Reese, 'United States Tax Policy Towards Developing Countries' (1987) 35 UCLA L Rev 369.

⁸⁶ Surrey S. Stanley, 'United Nations Group of Experts and the Guidelines for Tax Treaties between Developing Countries' (1978) 19 Harvard Int'l L J 1.

⁸⁷ See Michael Kobetsky, *International Taxation of Permanent Establishments Principles and Policy* (Cambridge University Press 2011) 152-178.

The influence of the OECD Model can also be explained by path dependency. When new norms are adopted they are included in national policies and there is a tendency towards stasis.⁸⁸ Also, since states invest time and diplomatic resources in concluding treaties, they are rarely inclined to re-negotiate treaties immediately thereafter.⁸⁹ In the context of ITL, it can be argued that states entered into tax treaties relying on the Model Conventions developed by the League over a period of almost two decades - 1927-1946. In the period from 1946 until 1963 - when the OECD Model was first published, states continued to rely on the Models prepared by the League. The OECD Model released in 1963 was based on the earlier League Model of 1946 and thus states did not have to introduce wholesale changes to their tax treaties. Thus, the subsequent UN Model Convention proposed by the UN failed to gain much traction in ITL due to resistance to change. Also, states had accepted the residence-source compromise formula suggested under the aegis of the League. Had the UN proposed a radically different alternative, the international community would almost certainly have rejected it.⁹⁰ For instance, if hypothetically the UN Model Convention had proposed that the source states have exclusive right to tax income of MNEs, capital importing states would have almost certainly not accepted the Convention. Thus, the UN Model proposed the least disruptive option - a greater share in revenue for source states than provided in the OECD Model.

In addition to the wide influence of the OECD Model Convention, the OECD's manner of working has also contributed to its success in shaping ITL. The OECD either adopts recommendations or binding decisions. Recommendations are non-binding agreements that generally represent policy advice and member states generally use recommendations as a means to influence domestic policy and/or as a precursor to a decision. Member states arrive at decisions with consensus.⁹¹ The decisions are binding on the member states though there are no known cases of the OECD imposing sanctions for noncompliance. One of the means through which the OECD has been able to achieve consensus among its member states is

⁸⁸ Paul F. Diehl, Charlotte Ku, *The Dynamics of International Law* (Cambridge University Press 2010) 66.

⁸⁹ *Ibid.*

⁹⁰ See RJ Vann, 'The UN Model and Agents: "Wholly or Almost Wholly"' in Guglielmo Maisto, Angelo Nikolakakis, et al (eds.), *Essays on Tax Treaties: A Tribute to David A. Ward* (IBFD 2012); Also see Henry S. Bloch, Cyril E. Heilemann, 'International Tax Relations' (1946) 55 Yale L J 1158, at 1164 (discussing the role of the UN in developing tax conventions).

⁹¹ Art 6, OECD Convention (requires consensus for adoption of Recommendations and Decisions, though members may abstain and thereby enter the equivalent of a reservation); For a criticism of OECD's consensus approach see Hugh Ault, 'Reflections on the Role of the OECD in Developing International Tax Norms' (2009) 34 Brook J Int'l L 757, at 763 ('... if a country A says the world is flat and country B says the world is round, after a long discussion, the OECD issues a report that says the world is an attractive shape and declares a consensus has been reached...').

through peer review.⁹² The OECD uses peer review extensively which ‘has been facilitated by the homogeneous membership and the high degree of trust shared among the member countries.’⁹³ The membership of the OECD makes it a unique international organisation. It is more diverse than other regional groupings like the Association of Southeast Asian Nations (ASEAN) but less diverse than the UN.⁹⁴

It reflects the OECD’s uniqueness that that its standards are neither utopian in nature nor a mere re-statement of the existing national practices of its various members.⁹⁵ The OECD sets standards which are generally incorporated and adhered to by the member states. JC Sharman observes that the ‘very process of having its principles adopted as ‘the international standard’ by other international institutions simultaneously strengthens and disguises the OECD’s policy influence’.⁹⁶ There are various reasons for the success of the OECD in ITL - first, the OECD effectively became the successor organisation to the League. It benefitted from the earlier pioneering work done by various experts and administrators and consolidated their efforts. The most visible source of benefit is the OECD Model Tax Convention. Second, in 1955 when the OECD (then the OEEC) began working on ITL, a significant number of tax treaties had already been signed by the states based on the League’s models treaties.

Thus, the principles proposed in the Model Conventions of the League had begun to be accepted by the states. The OECD benefitted from the increasing state acceptance of the residence-source compromise formula contained in the tax treaties. Thus, in its initial efforts in ITL, the OECD could rely on the treaties in force and the increasing acceptance of the source-residence compromise and did not have to propose any radical new rules; unlike the League, it did not have to start from scratch. The flipside of the OECD following in the footsteps of the League is that like the League, the OECD views ITL as a self-contained world of technical tax rules and there is little engagement with international law. The League’s view of ITL - as a discipline that was insulated from general international law was partly out

⁹² Peer reviews are also adopted by other international organisations such as the Financial Action Task Force. See http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc%28fatf_releasedate%29

⁹³ Pagini Fabrizio, ‘Peer Review: A Tool for Co-operation and Change’ (2002) 1 Directorate of Legal Affairs OECD. SG/LEG, available at www.oecd.org

⁹⁴ See James Salzman, *supra* note 10.

⁹⁵ Jason Sharman, *supra* note 40; Also see Anne-Marie Slaughter, ‘The Real New World Order’ (1997) 76 Foreign Aff. 183, at 196 (arguing that the next generation of international institutions are likely to look like Basel Committee and the OECD as they provide a forum for transnational problem-solving and harmonisation of national laws); Anne-Marie Slaughter, *A New World Order* (Princeton University Press 2004).

⁹⁶ Jason Sharman, *supra* note 40, at 23; Also see Rianne Mahon, Stephen McBride, ‘Standardizing and Disseminating Knowledge: The Role of the OECD in Global Governance’ (2009) 1 Eur Pol Sci Rev 83.

of necessity since there were no customary norms or general principles of ITL to rely on. The OECD, on the other hand, has paid little attention to the fact that the principles contained in tax treaties have been in force for more than seven decades; and whether during this period, some of the provisions of the tax treaties have acquired the nature of soft law or general principles of law or even customary norms.⁹⁷ The OECD, however, continues to be a highly successful standard-setter in ITL.⁹⁸

The nature of the OECD as an organisation has contributed to its success and eventually its virtual monopoly in setting standards for international tax policy. First, the membership of the OECD is homogenous and allows for a more focused approach. All member states of the OECD are democracies and a significant number of member states are capital exporters. Thus, the interests of member states are mostly aligned. For instance, all the OECD member states have a common interest that the resident states have a greater share in taxing international income of multinational enterprises (MNEs).⁹⁹ Second, it is in part due to the image of the OECD as a rich club of liberal democracies that its views have influence beyond the member states.¹⁰⁰ The OECD's decisions, reports and recommendations cannot impose legal obligations on non-member states¹⁰¹ but they can comply with the OECD endorsed rules as a matter of choice - and non-member states have increasingly done so. In my view, the adoption of rules and tax practices suggested by the OECD helps in shaping the identity of the non-member states as market friendly and receptive to business.¹⁰² The adoption of the OECD recommended practices by non-member states further solidifies the OECD's status as the primary standard setting organisation in ITL.

⁹⁷ Like the OECD, investor-state tribunals have rarely referred to the provisions of tax treaties or principles of ITL. For details, see Chapters 4, 5, and 6 below.

⁹⁸ It is arguable if the success of the OECD is because of ignoring the nature of principles in tax treaties and ITL in general or despite it. In my view, there is little to suggest that the OECD has willfully ignored ITL.

⁹⁹ This is not to suggest that there are no differences in the member states. The OECD states certainly have different views on policy implementation and their interests do not converge on all matters.

¹⁰⁰ See generally Judith Clifton, Daniel Diaz-Fuentes, 'From Club of the Rich to Globalization à la carte? Evaluating Reform at the OECD' (2011) 2 *Global Policy* 300.

¹⁰¹ As far as member states are concerned only the decisions are binding on them unless the member state abstains at the time the decision is adopted. See *supra* note 91.

¹⁰² See Ajay Kumar, 'International Tax Coherence: A Development Perspective' (2014) 53 (PhD Thesis, School of Law, University of Manchester) (where the author observes that by dominating the interpretation of tax rules through the OECD, developed states have acquired a 'symbolic' power in ITL); Also see B.S. Chimni, 'International Institutions Today: An Imperial Global State in the Making' (2004) 15 *EJIL* 1.

C. The UN's Marginal Role since 1945

After drafting the Model Convention at London in 1946, the Fiscal Committee of the League observed in its report that 'that the work done both in Mexico and in London could be usefully reviewed and developed by a balanced group of tax administrators and experts from both capital-importing and capital exporting countries and from economically-advanced and less-advanced countries, when the League work on international problems is taken over by the United Nations.'¹⁰³ It was against this background that the Economic and Social Council of the UN, in its resolution 2 (III) of 1 October 1946, set up a Fiscal Commission which was requested to '[S]tudy and advise the Council in the field of public finance, particularly in its legal, administrative and technical aspects.'¹⁰⁴ The Fiscal Commission on International Tax Relations, however, stopped functioning in 1954. It is unknown if the working of the Commission was stopped due to lack of resources, expertise or any other reason.¹⁰⁵ Nonetheless, it is undeniable that since the end of World War II, the UN has played a marginal and insignificant role in international taxation policy. The contribution of the UN to ITL has essentially been limited to the publication of the UN Model Convention. However, since 2001 the UN attempted to participate more actively in discussions on international taxation issues. It has initiated a Financing for Development initiative.

The First International Conference on Financing for Development (held in 2002 at Monterrey, Mexico) pushed for improvements in international tax co-operation.¹⁰⁶ The Second International Conference (held in 2008 at Doha) reviewed the progress made since 2002 and produced some general statements which included an acknowledgment of the need to increase co-operation in international taxation matters.¹⁰⁷ The Third Conference (held in 2015 at Addis Ababa) reiterated the need to increase national regulation and greater international co-operation.¹⁰⁸ The reports produced at the above mentioned conferences suggest that the

¹⁰³ League of Nations, *Fiscal Committee Report on the work of the Tenth Session of the Committee*

C.37.M37.1946.II.A) (1946) 8.

¹⁰⁴ Cited in the UN Model Convention, *supra* note 81, xvii, at para 26.

¹⁰⁵ It has been suggested that the UN could not play a leading role in setting the agenda for international tax policy because it fell victim to Cold War politics. See JC Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation* (Cornell University Press 2006).

¹⁰⁶ See UN, *Monterrey Consensus on Financing for Development* (2002) 7-10, at paras 15-21.

¹⁰⁷ See UN, *Doha Declaration on Financing for Development* (2008) 8-9, at paras 15-16 (the conference was held in the backdrop of global financial crisis and the UN addressed the need to review international financial system and international taxation was, by and large, ignored).

¹⁰⁸ UN, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development* (2015) 10- 11, at paras 22-23. The report is available at <http://www.un.org/esa/ffd/ffd3/>

focus of the UN is more on domestic resource mobilization and increasing the effectiveness and efficiency of domestic tax systems. While the objective is laudable, ITL only appears as one of the UN's many concerns and that is visible mainly in language on the need to increase co-operation among states to prevent evasion.

In 2015, at Addis Ababa, the proposal for an intergovernmental committee on tax under the aegis of the UN did not materialise.¹⁰⁹ The United Kingdom (UK) and US blocked the proposal claiming that the OECD was taking the lead on tax issues.¹¹⁰ The UN Secretary-General in 2011 had endorsed the need for a representative international body in ITL.¹¹¹ The proposal for an intergovernmental body under the aegis of the UN was a step forward in that direction.¹¹² The Committee of Experts that is currently responsible for taxation matters at the UN has limited resources and a narrow mandate. However, preventing the shifting of the venue from the OECD to the UN, represents the desire of the developed states to let the OECD be the exclusive standard setter in ITL. It reflects the desire of influential states to preserve the current structure of standard-setting in ITL that is more responsive to their needs.

Benvenisti and Downs have analysed that powerful states adopt four 'fragmentation strategies' in order to maintain and exercise disproportionate influence in international regulatory agenda.¹¹³ They argue that one strategy adopted by the developed states is to shift to or create an alternate venue when the original one becomes responsive to the interest of weaker states and their agents.¹¹⁴ In the context of ITL, the failed negotiations at Addis Ababa suggest that the fragmentation strategy of developed states is to *prevent* the shifting to an alternative venue; for an intergovernmental body at the UN may be more responsive to and representative of the needs and priorities of the developing states and would thereby entail a

¹⁰⁹ The intergovernmental committee was proposed to have a broader mandate than the current Committee of Experts which limits itself to updating the UN Model Convention. The intergovernmental committee was envisaged as a body that would actively promote international tax co-operation and greater participation of developing states. The intergovernmental committee would have also had a more dedicated resource allocation instead of UN's current reliance on voluntary contributions.

¹¹⁰ See UN, *Resolution adopted by the General Assembly on 27 July 2015: Addis Ababa Action Agenda of the Third International Conference on Financing for Development*, (A/RES/69/313); Also see <http://www.theguardian.com/global-development/2015/jul/14/financing-for-development-conference-addis-ababa-rich-countries-accused-poorer-nations-voice-tax>

¹¹¹ UN, Economic and Social Council, *Strengthening of Institutional Arrangements to Promote International Co-operation in Tax Matters, including the Committee of Experts on International Co-operation in Tax Matters* E/2011/76 (2011), paras 35-77.

¹¹² *Ibid*, at paras 63-71.

¹¹³ Eyal Benvenisti, George W. Downs, 'The Empire's New Clothes: Political Economy and the Fragmentation of International Law' (2007) 60 *Stanford L Rev* 595.

¹¹⁴ *Ibid*, at 614-619.

decrease in the influence of the OECD and the developed states.¹¹⁵ Given its membership, the OECD is unlikely to prioritise concerns of developing states. States like the UK and the US have an interest in preserving the OECD's pre-eminence in ITL. In view of the above described scenario, Arthur J Cockfield's observation that the OECD is an informal 'World Tax Organisation'¹¹⁶ is accurate and likely to remain true in the near future.

IV. THE CONTINUING CHALLENGE OF TAX COMPETITION IN INTERNATIONAL TAX LAW

Tax competition or the competition between states to offer low tax rates or tax incentives to investors, constitutes one of the foremost challenges in ITL today.¹¹⁷ Tax competition leads to tax arbitrage and is also a contributing cause to tax evasion by MNEs.¹¹⁸ Section IV.A below elaborates the past and ongoing efforts of the OECD to address the issue of tax evasion and under taxation of MNEs.¹¹⁹ Several states, individually and collectively, are still developing legislative and policy responses to address tax evasion. I intend to discuss the issue of tax competition among states and tax evasion to foreground my discussion of tax evasion in IIL. In investor-state arbitration the issue of tax evasion arises in two forms: first, when investors challenge a host state's tax measures as violative of substantive obligations in IIAs,¹²⁰ but the state takes the defence that the tax measures in questions aim to curb tax evasion; secondly, host states raising counterclaims that an investor has not complied with its tax laws and is guilty of tax evasion.¹²¹ Also, I argue that there is a common concern of treaty shopping in ITL

¹¹⁵ See Tim Büthe, Walter Mattli, *The New Global Rulers The Privatisation of Regulation in the World Economy* (Princeton University Press 2011) 12 (observing that while the language that accompanies international standardisation is technical, the 'essence of global rule-making, however, is political.').

¹¹⁶ Arthur J. Cockfield, 'The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-Commerce Tax Challenges (2006) 8 Yale J L & Tech 136, at 139; Also see John F. Avery Jones, 'Are Tax Treaties Necessary?' (1999) 53 Tax L Rev 1, at 2 (arguing that the OECD is a 'world body').

¹¹⁷ Banking secrecy and corporate laws in so far as they relate to registration of companies are also sometimes considered to be within the scope of tax competition. Nevertheless, in this thesis, I limit the discussion only to tax rates and tax related incentives.

¹¹⁸ High net worth individuals, trusts also tax advantage of tax competition; but the scope of this thesis is limited and discusses only MNEs.

¹¹⁹ Section III above elaborated the role of the OECD in ITL in general. This Section shall focus only on the work of the OECD in the area of tax competition and international tax evasion - its reports, recommendations and Model Convention on Tax Information Exchange - which Section III did not discuss in detail.

¹²⁰ This thesis uses the term, IIA, to refer to investment agreements. The term, BIT, is only used when referring to a specific bilateral investment agreement.

¹²¹ For details on this aspect, see Chapter 3 below.

and IIL and the jurisprudence of latter can be used meaningfully in the former. I discuss the latter aspect in Section IV.B below.¹²²

A. The OECD and Harmful Tax Competition

Until the early 1990s, tax evasion was pre-dominantly a national concern. The US' adoption of measures relating to foreign sales corporations in 1962 was one of the most prominent efforts by a state to tackle tax evasion.¹²³ Even the OECD in 1984 suggested that its member states should adopt unilateral anti-avoidance measures.¹²⁴ Ronen Palan argues that in the early 1990s left-of-center governments came to power in major industrialized states and while these governments were committed to socialised education and healthcare, they were not prepared to sacrifice the goal of low taxation and hence combating tax evasion became a political priority.¹²⁵ The newly appointed governments' aim to preserve their tax base in order to maintain low tax rates combined with Clinton administration's identification of direct links between money laundering and tax evasion. This led to serious international and multilateral efforts to address tax evasion and tax competition.¹²⁶ The OECD led the most significant international effort.

In May 1996, an OECD Ministerial Communiqué stated the need to develop measures to counter the effects of harmful tax competition on investment and financial decisions.¹²⁷ In September 1996, Heads of States of the G-7 'strongly urge[d]' the OECD to vigorously pursue its work in the field of harmful tax competition.¹²⁸ In October 1996, the European Union (EU)

¹²² The other two aspects are discussed in Chapter 4, 5, and Chapter 3 respectively.

¹²³ The US Internal Revenue Code and the measures relating to foreign sales corporations formed the centre of a long WTO dispute. The history of the US tax measures and the subsequent changes are described in detail in the WTO Reports, See, for example, Panel Report, *United States- Tax Treatment for "Foreign Sales Corporations"* WT/DS108/R, 8 October 1999; Appellate Body Report, *United States- Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, 24 February 2000; Brenda O' Leary, 'The Continued Viability of Foreign Sales Corporations (FSCs): An Analysis of the WTO Decision Declaring FSCs Incompatible with GATT Trading Rules' (2001) 2 San Diego Int'l L J 149; CA Von Hoff, 'Avoiding a Nuclear Trade War: Strategies for Retaining Tax Incentives for US Corporations in a post-FSC World' (2002) 35 Vanderbilt J Tran L 1349.

¹²⁴ See generally OECD, *Transfer Pricing and Multinational Enterprises - Three Taxation Issues* (1984) (hereinafter 1984 Transfer Pricing Report).

¹²⁵ See Ronen Palan et al., *Tax Havens How Globalization Really Works* (Cornell University Press 2010) 191-225.

¹²⁶ *Ibid*, at 210.

¹²⁷ Council of the OECD, Ministerial Communiqué (1996) OECD Observer I, at III; Also see Reuven S. Avi-Yonah, 'Globalization, Tax Competition and the Fiscal Crisis of the Welfare State' (2000) 113 Harv L Rev 1573, at 1603 (stating that Japan and France were primary movers for this initiative).

¹²⁸ Statement of G7 Finance Ministers and Central Bank Governors, at <http://www.g8.utoronto.ca/finance/fm970920.htm>

issued a report on the development of tax systems in Europe.¹²⁹ The report endorsed the need to eliminate harmful tax competition and supported the need to work with the OECD.¹³⁰ Due to the above mentioned developments, the OECD began its harmful tax competition project.

In 1998, the OECD published a report that developed criteria to identify harmful tax competition and preferential regimes.¹³¹ It was followed by subsequent related reports.¹³² Even though the OECD's reports were not binding on the non-member states, the OECD curiously adopted an unusually aggressive approach in its harmful tax competition project. In the 2000 report, the OECD listed a set of defensive measures that the member states may take against jurisdictions that do not co-operate to eliminate their harmful tax practices.¹³³ The targeted jurisdictions, identified as 'harmful', questioned the legitimacy of the OECD's initiative and termed them as undue interference with their national tax sovereignty.¹³⁴ Later in 2000, a newly established organisation - the Centre for Freedom and Prosperity (CFP) - began lobbying the US Congress against participation in the OECD project.¹³⁵

Partly as a result of extensive lobbying by the CFP, in May 2001, U.S. Secretary of the Treasury Paul O'Neill stated that: 'The United States does not support efforts to dictate to any country what its own tax rates or tax systems should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments - like businesses—to create efficiencies.'¹³⁶ The statement is widely believed to have contributed to undercutting the OECD's efforts and marked an effective end to the OECD project.¹³⁷ Thereafter, the OECD narrowed the focus of its efforts and concentrated on increasing transparency in jurisdictions and began stressing

¹²⁹ Commission of the European Communities, *Taxation in the European Union Report on the Development of Tax Systems* (1996), COM (96) 546 Final.

¹³⁰ *Ibid*, at para 3.15.

¹³¹ OECD, *Harmful Tax Competition: An Emerging Global Issue* (1998) (hereinafter 1998 Tax

Competition Report). ¹³² OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs* (2000) (hereinafter 2000 report); OECD, *The OECD's Project on Harmful Tax Practices: the 2001 Progress Report* (2001) (hereinafter 2001 report); OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (2004); OECD, *The OECD's Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries* (2006); Also see www.oecd.org (the website contains other related press briefings, notes and presentations).

¹³³ See 2000 Report, *supra* note 132, at 24.

¹³⁴ Jason Sharman, *Havens in a Storm*, *supra* note 105, at 83-86.

¹³⁵ See Robert Goulder, 'New Coalition Strikes Back at OECD Tax Havens Campaign' (2000) 21 *Tax Notes Int'l* 2650; For more details see <http://freedomandprosperity.org/>

¹³⁶ A copy of the Treasury press release is available at <http://www.treasury.gov/press/releases/po366.htm>

¹³⁷ The inability of the OECD to convince some of its own member states to cease harmful tax practices in their jurisdictions was also a major contributing factor. See Thomas F. Field, 'Tax Competition in Europe and America' (2003) 29 *Tax Notes Int'l* 1235; Also see Jason Sharman, *Havens in a Storm*, *supra* note 105.

the need for better exchange of tax-related information between states to curb international tax evasion.¹³⁸

Allison Christians argues that the harmful tax competition project was the first time that the OECD articulated the existence of a global social contract among states.¹³⁹ In other words, in trying to persuade states not to adopt harmful tax practices, the OECD was urging states to recognise their international responsibility towards other states. Allison Christians' argument is convincing and highlights the change in the OECD's vocabulary. OECD's language, however, still falls short of acknowledging that ITL is part of general international law. Thus, to reiterate, that there is one constant feature of ITL that has continued from the League to the present-day work of the OECD - a limited engagement of ITL with general international law, the lack of any reference to customary norms or general principles of law in ITL, existing or emerging.

Given the original aims and the actual achievement - the OECD harmful tax competition project is widely (and correctly) believed to have fallen short of its goals. The project nonetheless, due to its timing and the OECD's approach was an important development in ITL. I argue that the OECD's harmful tax competition project significantly shifted the nature and trajectory of ITL. Additionally, I also suggest that the harmful tax competition project has altered the OECD's approach and its position in international tax policy.

First, due to harmful tax competition, the focus in ITL since 1998 has changed significantly. ITL's primary aim moved from the prevention of international double taxation to the prevention of tax evasion. In the 1927 report, the League had emphasised on the importance of the principle - that incomes should be taxed once.¹⁴⁰ But, for seven decades, the prevention of tax evasion was ancillary to the goal of preventing double taxation. Provisions relating to exchange of tax information were included in tax treaties, but tax evasion was effectively relegated to the domestic sphere - the fight against it was perceived to be the individual responsibility of national tax authorities. Also, the League and states did not foresee the importance that intangibles such as intellectual property would acquire in

¹³⁸ See 2001 Report, *supra* note 132.

¹³⁹ Allison Christians, 'Sovereignty, Taxation and Global Contract' (2009) 19 *Minnesota J Int'l L* 99; Also see Edwin van der Bruggen, 'State Responsibility under Customary International Law in Matters of Taxation and Tax Competition' (2001) 29 *Intertax* 115.

¹⁴⁰ 1927 report, *supra* note 54, at 23.

international taxation.¹⁴¹ The shift of focus was evident when in 2002 the OECD released a Model Tax Convention on Tax Information Exchange. Since 2002, various states have entered into standalone bilateral tax information exchange agreements based on the aforementioned Model. In 2013, the OECD has also launched the Base Erosion and Profit Shifting (BEPS) project with a view to comprehensively address international tax evasion. The OECD has since released comprehensive reports detailing the changes required to curb international tax evasion.¹⁴² Thus, while states gave primacy from 1923-1998 to curb international double taxation, the fight against international tax evasion became ITL's dominant concern from 1998 onwards.

Second, the reactions to the OECD's harmful tax competition project have once again brought sovereignty-related argument in ITL to the fore. States framed their opposition to the OECD-led project primarily framed in sovereignty terms.¹⁴³ The failure of the OECD's harmful tax competition project has lent additional credibility to the argument that states possess wide, if not complete discretion, in taxation policy. In my view, the inability of the OECD's harmful tax competition project to achieve its immediate aims also means that bilateral efforts in ITL will continue to be the norm and states will continue to resist any multilateral efforts by claiming that the sovereign right to tax is unfettered by any international norms. In fact, the OECD's post-2002 emphasis on tax information exchange mirrors the pre-1998 strategy used in ITL - a non-binding OECD Model Convention has been released and states are entering into an increasing number of bilateral tax information exchange treaties based on the Model Convention.¹⁴⁴ Thomas Rixen observes that while the challenges before ITL 'lead us to expect reform efforts in the direction of multilateralism, but due to systemic rigidity change will only

¹⁴¹ Intangibles like patents, trademarks constitute an important part of international tax evasion due to the ease with which they are re-located in different jurisdictions. See Section IV.B below.

¹⁴² The reports are available at, <http://www.oecd.org/ctp/beps-about.htm>

¹⁴³ See Vaughn E. James, 'Twenty-First Century Pirates of the Caribbean: How the Organisation for Economic Co-operation and Development Robbed Fourteen CARICOM Countries of their Tax and Economic Policy Sovereignty' (2002) 34 Univ Miami Inter-Am L Rev 1; Also see Michael Littlewood, 'Tax Competition: Harmful to Whom?' (2004) 26 Mich J Int'l L 411.

¹⁴⁴ To facilitate tax information exchange among states, the OECD has also introduced the Common Reporting Standard (CRS) - the 'global standard' for Automatic Exchange of (Tax) Information. CRS can be implemented either bilaterally or multilaterally. States are at liberty to enter into bilateral competent authority agreements or multilateral competent authority agreements and exchange information accordingly. See <http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/>

be partial and incremental.’¹⁴⁵ Tax competition continues to remain an important challenge partly because of the increased prominence of sovereignty in international tax relations.

Third, the harmful tax competition project has also altered the OECD’s subsequent *modus operandi*. Whether this change in the OECD’s approach is permanent or temporary remains to be seen, but two important developments are evident. First, as a result of the severe criticism and backlash it received from civil society and non-member states on its harmful tax competition project, the OECD has tried to engage non member states in its recent initiatives. One of the OECD’s earlier initiatives - a proposal for a Multilateral Agreement on Investment (MAI) was unsuccessful partly due to successful lobbying by civil society against the OECD.¹⁴⁶ On the other hand, the harmful tax competition failed, in part, due to lack of proper communication with the non-member states which were targeted for supporting harmful tax practices. While the MAI experience underlined the importance of engaging with the civil society, the harmful tax competition project has made the OECD aware of the need to engage with non-member states. The Global Forum on Transparency and Exchange of Information for Tax Purposes represents the OECD’s efforts to engage with more states beyond Europe and North America.¹⁴⁷ It is doubtful, however, if the engagement that has taken place to date is meaningful. Even though the OECD mentions that all members of the Forum have ‘an equal footing’, the role of Forum is to ensure implementation of transparency standards.¹⁴⁸ Non-member states are unlikely to influence the content of the transparency standards.

Second, the OECD is now working closely with other organisations like the G-20 on combating international tax evasion.¹⁴⁹ The OECD and the G-20 are both closely involved in the BEPS project. The exact nature of the OECD/G-20 collaboration is unclear: it is uncertain if the

¹⁴⁵ Thomas Rixen, *supra* note 67.

¹⁴⁶ There were of course other reasons for the failure of the MAI such as the opposition of MNEs once the terms of the MAI became clear. See Eric Neumayer, ‘Multilateral Agreement on Investment: Lessons for the WTO from the failed OECD-negotiations’ (1999) 46 *WirtschaftspolitischeBlätter* 618; Richard Woodward, ‘Towards Complex Multilateralism? Civil Society and the OECD’ in Rianne Mahon, Stephen McBride, *supra* note 74, at 77-85 (stating that the experience with MAI gave the OECD a reason to take civil society seriously).

¹⁴⁷ The Global Forum established in 2000, has a self-standing Secretariat and is based in the OECD Centre for Tax Policy and Administration. The Forum lists 129 states as members and 15 states as observers. See <http://www.oecd.org/tax/transparency/abouttheglobalforum.htm>

¹⁴⁸ *Ibid.*

¹⁴⁹ See generally Jan Wouters, Sven Van Kerckhoven, ‘The OECD and the G-20: An Ever Closer Relationship?’ (2011) 43 *Geo Wash Int’l L Rev* 346.

OECD will hereafter work with the G-20 on a permanent basis or only on certain projects. The implications of the OECD/G-20 partnership are discussed below.

The G-20 is marginally more representative than the OECD, because it includes developed and developing states. Thus certain states like China, India, Russia and South Africa which are not members of the OECD can contribute to developments in ITL by using their G-20 membership. Also, it is likely that that the partnership will have a complementary effect - the OECD's technical expertise and the political leadership of the G-20 can together drive the reform process in ITL. Critically, the OECD/G-20 partnership is likely to help ITL emerge as a more prominent sub-discipline of international economic law. This is because even though the G-20 engages with general international law only to a limited extent, it currently influences the work of various other organisations that contribute to international economic governance - the Basel Committee, the Financial Action Task Force (FATF) and the International Organisation of Securities Commission among others.¹⁵⁰ The aforementioned organisations are standard setters in international finance. The inclusion of the OECD alongside the above-mentioned organisations that work with the G-20 would bring a greater focus on the role of the OECD in ITL. The OECD has previously worked with organisations like the FATF but its importance in international economic governance, especially in ITL, is not emphasised enough.¹⁵¹

The nature of the OECD/G-20 partnership is uncertain but it is likely to be beneficial to the OECD. By working closely with the G-20, even if temporarily, the OECD is benefitting from the political salience that international tax evasion has recently acquired.¹⁵² The OECD has been careful to maintain its central position in ITL and has ensured that the G-20 does not become the sole and more important player in ITL. Currently, it seems the partnership with the G-20 is likely to strengthen the OECDs' position as the primary standard setting organisation in ITL and remain the pre-dominant organisation in ITL.

¹⁵⁰ For details, see Chris Brummer, *Soft Law and the Global Financial System Rule Making in the 21st Century* (Cambridge University Press 2012).

¹⁵¹ *Ibid*, at 86-88 (Chris Brummer identifies the OECD as a 'specialist standard setter' without mentioning the role of the OECD in international tax policy); Also see Rianne Mahon, Stephen McBride, *supra* note 74 (ignoring the role of the OECD in ITL).

¹⁵² For an example of the increasing political concern over corporate tax evasion, see House of Commons (UK), Committee of Public Accounts, *Tax Avoidance - Google* (2013) HC 112.

Beyond the efforts of the OECD and the G-20, there are also proposals for a multilateral tax treaty.¹⁵³ It is argued that bilateral tax treaties cannot adequately curtail international tax evasion and a multilateral agreement would be more effective.¹⁵⁴ However, in almost all the recommendations and proposals advocating a multilateral tax treaty, one witnesses a lack of reference to either general international law or other sub-disciplines of international economic law.¹⁵⁵ I suggest that viewing ITL as a discipline that is completely removed from general international law is not appropriate. In particular, I suggest that taking into account the jurisprudence in other sub-disciplines such as IIL, could add useful insights on how to address tax competition and the related problem of tax evasion.

B. The Common Concern of Treaty Shopping in International Investment Law and International Tax Law¹⁵⁶

Investors incorporate companies in certain jurisdictions to benefit from favourable tax policies and tax treaties. Additionally, investors are also attracted by the possibility of seeking IIA protection. The tribunal in *Aguas del Tunari* has observed that absent a particular limitation, it is ‘not illegal to locate one’s operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.’¹⁵⁷ However, some IIAs do provide certain limitations and contracting states reserve the right to deny an investor the benefits of the IIA. These limitations are contained in so-called denial-of-benefits clauses.

Article 17 of the ECT provides that a contracting state may deny benefits to ‘a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no

¹⁵³ See Diane M. Ring, ‘Prospects for a Multilateral Tax Treaty’ (2001) 26 Brooklyn J Int’l L 1699; Michael Lang, et al (eds.), *Multilateral Tax Treaties New Developments in International Tax Law* (Kluwer Law International 1998) 197 (contains a proposed draft of a multilateral tax treaty).

¹⁵⁴ See, for instance, Richard J Vann, ‘A Model Tax Treaty for the Asian-Pacific Region (Part 1 and 2)’ (1991) 45 Bull’n Int’l Fisc Doc 99, at 103.

¹⁵⁵ OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* (2014) (a report endorsed by the G- 20, which concluded that a multilateral instrument is desirable and feasible); OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - Final Report* (2015).

¹⁵⁶ See Jorun Baumgartner, *Treaty Shopping in International Investment Law* (Oxford University Press 2016) 7 (the author suggests that treaty shopping is a well-known problem in ITL and has increasingly started to appear in investor-state arbitration as well).

¹⁵⁷ *Aguas del Tunari S.A. v Republic of Bolivia* ICSID Case No. ARB/02/3 (Decision on Jurisdiction, 21 October 2005) para 330.

substantial business activities in the Area of the Contracting Party in which it is organized.’¹⁵⁸ The above mentioned provision endorses the principle that an investor seeking protection of an IIA needs to have an economic connection with the state whose nationality it claims.¹⁵⁹ The failure to prove an economic connection can disqualify the investor from seeking the benefit of the relevant IIA. The denial of benefits clause is not part of every IIA and tribunals have stated that it is a deliberate choice of the state parties.¹⁶⁰ At the same time, there is no single test to define the link required between the legal person seeking protection under an IIA and the contracting state under whose IIA the investor asks for protection.¹⁶¹ There is no consistent jurisprudence of investor-state tribunals on denial-of-benefits clause, though the tribunals in various awards have recognised the undesirability of treaty shopping by investors and their use of shell companies.

In *Mobil v Venezuela*, the tribunal observed that restructuring by an investor in order to gain access to ICSID arbitration was a perfectly legitimate goal.¹⁶² However, the tribunal added that held that restructuring was legitimate only in respect of disputes arising after the restructuring and not in respect of disputes predating the restructuring and declined jurisdiction over the latter.¹⁶³ In *Phoenix Action*, share transactions were conducted where an Israeli company purchased shares in a Czech company to file claim under the Czech Republic-Israel BIT. The tribunal declined jurisdiction and held that investment was made in bad faith, was an attempt to gain jurisdiction under the BIT and such disputes constitute an ‘abusive manipulation of the system of international investment protection under the ICSID Convention

¹⁵⁸ In *Plama Consortium Ltd v Republic of Bulgaria* ICSID Case No. ARB/03/24 (Award on Jurisdiction, 8 February 2005) (the tribunal clarified that Art 17 only applies to substantive provisions and not dispute resolution provisions); Also see Art 17, US Model BIT (2012).

¹⁵⁹ See Rudolf Dolzer, Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2008) 55; Anthony C. Sinclair, ‘The Substance of Nationality Requirement in Investment Arbitration’ (2005) 20 ICSID-Rev FILJ 357, at 388 (observing that the denial of benefits provisions in some IIAs are designed to limit the exposure of states from ‘mailbox’ companies).

¹⁶⁰ *Tokios Tokelés v Ukraine* ICSID Case No. ARB/02/18 (Decision on Jurisdiction, 29 April 2004) para 36; Also see *Yukos Universal Limited (Isle of Man) v The Russian Federation* PCA Case No. AA 227 (Final Award, 18 July 2014) para 435.

¹⁶¹ See generally Rachel Thorn, Jennifer Doucleff, ‘Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of “Investor”’ in Michael Waibel, et al (eds.), *The Backlash against Investment Arbitration Perceptions and Reality* (Kluwer Law International 2010) 3; Also see Lindsay Gastrell, Paul- Jean Le Cannu, ‘Procedural Requirements of ‘Denial-of-Benefits’ Clauses in Investment Treaties: A Review of Arbitral Decisions (2015) 30 ICSID-Rev FILJ 78.

¹⁶² *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petroleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petroleos, Inc. v Bolivarian Republic of Venezuela* ICSID Case No. ARB/07/27 (Decision on Jurisdiction, 10 June 2010) para 204.

¹⁶³ *Ibid*, at para 205.

and the BITs'.¹⁶⁴ Other tribunals have shown 'sympathy' for the argument that shell companies should not be allowed to invoke provisions of IIAs but have respected the intention of the contracting states and treaty provisions.¹⁶⁵ There are several other aspects of denial of benefits clause such as whether they can be applied retrospectively and whether they are related to jurisdiction or admissibility.¹⁶⁶ It is not within the scope of this thesis to highlight all the aspects. The purpose of this section is to highlight that the tribunals have recognised and supported the underlying rationale for the denial of benefits clause - the prevention of treaty shopping.

Treaty shopping is a prominent concern in ITL too. MNEs use the tax treaty network to their advantage and practice tax arbitrage. Typically, the strategy of tax treaty shopping is similar to IIL - a holding company is incorporated in a third jurisdiction to take advantage of a bilateral tax treaty which would not be possible otherwise. MNEs often use intra-group arrangements to shift profits from high-tax jurisdictions to low-tax jurisdictions.¹⁶⁷ This practice is considered problematic because the profits reported in both jurisdictions are not commensurate with real economic activity in either of the two jurisdictions. Ordinarily, MNEs conduct a significant part of their business in bigger economies that are generally also high-tax jurisdictions but are able to report profits in a low-tax jurisdiction where a subsidiary is incorporated. The OECD has acknowledged that the wide network of tax treaties provides opportunities for treaty shopping in ITL.¹⁶⁸ It has recommended that states can either characterise abuse of tax treaty provisions as abuse of provisions of domestic law or states may treat treaty shopping as an abuse of the tax treaty itself. States have adopted various approaches such as piercing of corporate veil or 'look through' approach or the 'substantial interest' test. However, the OECD has stated that the various approaches adopted by the states are unsatisfactory.¹⁶⁹

¹⁶⁴ *Phoenix Action Ltd. v Czech Republic* ICSID Case No. ARB/06/5 (Award, 15 April 2009) para 100.

¹⁶⁵ *Saluka Investments B.V. v The Czech Republic* (UNCITRAL, Partial Award, 17 March 2006) paras 240-241; Also see *Waste Management, Inc. v United Mexican States* ICSID Case No. ARB (AF)/00/3 (Final Award, 30 April 2004) para 80 (in these disputes the tribunals did not deny the investor access to the IIA since there was no denial of benefit clause in the relevant investment treaty but expressed concern about treaty shopping).

¹⁶⁶ See Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press 2009) 468-472.

¹⁶⁷ See generally M.C. Webb, 'Reconciling Practice and Structure: US Regulation of Transfer Pricing by Transnational Firms' in T.J. Sinclair, K.P. Thomas (eds.), *Structure and Agency in International Capital Mobility* (Palgrave Macmillan 2001) 129.

¹⁶⁸ OECD, *Commentaries on the Articles of the Model Tax Convention* (2010) paras 9-26 (hereinafter OECD Commentary).

¹⁶⁹ *Ibid*, at para 17.

The inability of the domestic tax laws and tax treaties to prevent profit shifting forms the core concern of the OECD BEPS project.¹⁷⁰ To curb international tax evasion, the OECD, inter alia, has proposed country-by-country reporting.¹⁷¹ The OECD's proposal, in effect, suggests that profits declared in jurisdictions should be commensurate with the economic activity in the jurisdiction. Similar principle informs the denial-of-benefits clause in IIAs.¹⁷² Additionally, treaty shopping undermines the reciprocity that informs various tax treaties and IIAs. A state whose nationals can take advantage of treaties signed by other states has a less reason to conclude its own treaties.¹⁷³

The common concern of treaty shopping in ITL and IIL can be utilised in a meaningful manner. The purpose of this section is not to suggest that the approach in IIL to minimise treaty shopping can be adopted in ITL as is. Instead, the purpose is to highlight that the OECD's approach to curb BEPS need not contain itself only to the limited universe of tax treaties. Other sub-disciplines of international law such as IIL can offer a useful insight and play a complementary role in curbing tax evasion. As elaborated above, the notion of states insisting on economic allegiance with the state whose nationality is claimed by an investor is not entirely novel in international law. It has been included in several IIAs and applied by tribunals. The OECD through its BEPS project is also trying to emphasise that MNEs should declare profits in jurisdictions where business is conducted. The jurisprudence of IIL can lend additional support to OECD's proposals and efforts to curb international tax evasion and profit shifting. The OECD can anchor its suggestions in international law principles that are already recognised by states though in a different context.¹⁷⁴

V. GENERAL PRINCIPLES OF LAW IN INTERNATIONAL TAX LAW

In this Section, I engage with but disagree with Reuven S. Avi-Yonah's argument that some principles in tax treaties have acquired the nature of customary norms. I suggest that viewing some of the principles in the tax treaties as customary norms is premature; instead it would

¹⁷⁰ See OECD, *Addressing Base Erosion and Profit Shifting* (2013).

¹⁷¹ See OECD, *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: 2014 Deliverable* (2014); OECD, *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting* (2015).

¹⁷² The nature of treaty shopping in ITL however can be broader in scope as compared to treaty shopping in IIL. The former tends to include concealment of income in certain jurisdictions and not merely profit shifting.

¹⁷³ See Rachel Thorn, Jennifer Doucleff, *supra* note 161, at 21.

¹⁷⁴ International law can be used in addition to anti-avoidance rules adopted by the states in their domestic tax laws.

be more appropriate to view them as general principles of law. I further suggest that these principles, though not customary norms, should be taken into account to resolve and adjudicate international tax disputes such as tax-related investment disputes. For instance, the tribunals in the *Burlington* and the *Feldman* awards referred to customary international law and taxation powers of a state without examining whether there are customary norms in ITL.¹⁷⁵ Similarly, when addressing arguments on non-discrimination, tribunals can engage with the concept of non-discrimination as developed under ITL and how it constrains state behaviour.¹⁷⁶ This could improve the accuracy of the awards, the reasoning and thereby influence the conclusions of the tribunals.

Avi-Yonah argues that ITL can and should be understood as international law, and that parts of ITL are customary international law.¹⁷⁷ Avi-Yonah observes that ‘we should not pretend that there are no binding, widely accepted international tax norms that we should flout only when significant national interests are at stake.’¹⁷⁸ Avi-Yonah views ITL as a genuine sub-discipline of international law. He was the first to elaborately argue and conclude that the ‘international tax regime rises to the level of customary international law.’¹⁷⁹ More specifically, in his view the following are customary ITL norms: the principle of non-discrimination - that nationals of a treaty partner should not be treated worse than its own nationals is part of CIL;¹⁸⁰ the arm’s length standard applied to transfer pricing by MNEs; and the restrictions on state jurisdiction to tax non-residents who have no connection with the state.¹⁸¹

Yet I argue that there is no evidence of a sufficiently uniform state practice or *opinio juris* to acknowledge that some of the principles in tax treaties now have the nature of customary norms. To begin with, the existence of thousands of similar tax treaties alone does not

¹⁷⁵ For details, see Chapter 4 below.

¹⁷⁶ For details, see Chapter 6 below.

¹⁷⁷ Reuven S. Avi-Yonah, *International Tax as International Law An Analysis of the International Tax Regime* (Cambridge University Press 2007).

¹⁷⁸ *Ibid*, at 8.

¹⁷⁹ *Ibid*, at 5 (he considers the various bilateral tax treaties and domestic tax laws of various jurisdictions as part of the international tax regime).

¹⁸⁰ *Ibid*.

¹⁸¹ *Ibid*; Also see Nancy H. Kaufman, ‘Fairness and the Taxation of International Income’ (1998) 29 *Law & Pol’y Int’l Bus* 145, at 169 (arguing that the right to tax based either on source or residence principle constitute customary norms in ITL).

warrant the conclusion that some of their principles are customary.¹⁸² On the other hand, the widespread presence of tax treaties may suggest that there are certain general principles of law in ITL. Second, Avi-Yonah does not discuss *opinio juris*- the other element of custom.¹⁸³ Whether states act out of a legal obligation when not bound by bilateral tax treaties is an open question. I highlight the lack of uniform state practice and absence of *opinio juris* in the paragraphs below.

The attribution of motives to states is a notoriously difficult.¹⁸⁴ This makes the task of analysing *opinio juris* difficult. *Opinio juris* is the psychological element associated with the formation of a customary rule and helps characterise state practice - to determine whether states view it as binding or not.¹⁸⁵ It has been acknowledged that the conduct of states is only an evidence of the subjectivities;¹⁸⁶ since we cannot rethink what states will, we are stuck with the physical manifestations thereof.¹⁸⁷ There is, however, no other way than to ascertain the existence of *opinio juris* from the fact of external existence.

The belief of a state being under a legal obligation is absent in ITL. For instance, the fact that a particular state complies with the 'single tax principle' by granting foreign tax credits, deductions or exemptions, even in the absence of a tax treaties, does not necessarily mean that the state considers itself legally obliged to grant it. The context in which such tax reliefs are granted is vital to determine the existence of a legal obligation.¹⁸⁸ In the absence of a tax treaty, a person seeking tax exemption from a non-signatory state typically does so under a provision of the domestic tax law of that particular state. The state can alleviate the burden

¹⁸² Reuven S. Avi-Yonah, *supra* note 177, at 3 ('The treaties are of course remarkably similar (even to the order of the articles), being based on the same Organisation for Economic Co-operation and Development (OECD) and UN models.').

¹⁸³ The ICJ described these two requirements as axiomatic in its decision in *Continental Shelf Case (Libyan/Arab/Jmamahiriya/Malta)* (1982) ICJ Rep 13 ('It is of course axiomatic that the material of customary international law is to be looked for primarily in the actual practice and *opinio juris* of States.');

See generally Anthea Elizabeth Roberts, 'Traditional and Modern Approaches to Customary International Law: A Reconciliation' (2001) 95 Am J Int'l L 757; Maurice Mendelson, 'The Subjective Element in Customary International Law' (1995) 66 Brit Yb'k Int'l L 177.

¹⁸⁴ James Crawford, Thomas Viles, 'International Law on a Given Day' in James Crawford (ed.), *International Law as an Open System* (Cameron May 2002) 91.

¹⁸⁵ Anthony D'Amato, 'Trashing Customary International Law' (1987) 81 AJIL 101, at 102; Also see Maurice Mendelson, *supra* note 183, at 177.

¹⁸⁶ Maurice Mendelson, *supra* note 183, at 178.

¹⁸⁷ Jörg Kammerhofer, 'Uncertainty in the Formal Sources of International Law: Customary International Law and Some of Its Problems' (2004) 15 EJIL 523, at 529.

¹⁸⁸ Maurice Mendelson, *supra* note 183, at 200-207.

of the taxpayer by not imposing a tax the second time, but it also retains the discretion to not grant the relief.

Let us consider a case where the state is a signatory to a tax treaty. Certain tax treaties provide for the maximum tax rate that a source state can apply to certain incomes such as royalties and technical fees. The resident state also imposes a tax on the same income. Strictly speaking, the same income is taxed twice.¹⁸⁹ Thus, the single tax principle is not followed by states in all circumstances and for all incomes. In such a scenario, the argument that the single tax principle is a customary norm does not seem convincing.¹⁹⁰

There is, however, room for states to enter into special relationships in matters relating to international under-taxation or non-taxation.¹⁹¹ For instance, in certain states like India a substantial part of foreign investment is channelled through Mauritius and a similar relationship exists between China and Hong Kong. In these situations, the 'single tax principle' - that every international transaction should be taxed at least once can either be reiterated or dispensed with by states. Thus, states that share a special or close economic relationship can enter into an arrangement to tax certain transactions only once and the same principle can over time attain the status of a regional or a special customary norm binding on the relevant states or jurisdictions.¹⁹²

The other element of customary norms is state practice found, among others, in executive statements, legislations and court decisions of states.¹⁹³ Domestic legislations that throw light on the manner of implementation of tax treaties are relevant and instructive. For instance, in the United Kingdom, rights and obligations contained in a constitutive treaty do not have

¹⁸⁹ See Art 13, UK-India tax treaty (1993) (Para 1 states that 'royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.'; Para 2 of the same provision states that 'However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State...' (emphasis added) The provision thereafter provides for the maximum tax rate that the Contracting State may apply to the above stated income).

¹⁹⁰ Avi-Yonah, *supra* note 177, at 8. (Avi-Yonah states that - single tax principle means that income from cross-border transactions should be subject to tax once i.e. neither more nor less than once. He argues that the single tax principle is a part of CIL.).

¹⁹¹ See generally Anthony D' Amato, 'The Concept of Special Custom in International Law' (1969) 63 *American J Int'l L* 211; Also see *Asylum Case (Columbia v Peru* [1950] ICJ 6) (where a regional custom was discussed by the ICJ).

¹⁹² A special or regional customary norm only binds the states concerned. Otherwise, Art 38 of the ICJ statute places regional and general customary law on the same footing in terms of their psychological element. The formation of regional customary law does not include any element that is absent in the formation of general customary law. See Alexander Orakhelashvili, *The Interpretation of Acts and Rules in Public International Law* (Oxford University Press 2008) 92-93.

¹⁹³ Only the conduct of those entitled to express state's consent to be bound by international legal obligations should be considered relevant for the formation of customary norms. See generally A. Mark Weisburd, 'The International Court of Justice and the Concept of State Practice' (2009) 31 *Univ Pa. J Int'l L* 295.

effect unless an implementing legislation is enacted. However, the provisions of a declaratory treaty will be applied automatically by domestic courts (*qua* customary law) even in the absence of specific incorporation by a statute.¹⁹⁴ There are no known instances where provisions of tax treaties enforced in UK without an implementing legislation.

Vik Kanwar accurately observes that national courts and administrative agencies are the central actors in ITL whereas international tribunals rarely deal with tax law; tax disputes reach the international plane only incidentally as part of a larger dispute involving other elements.¹⁹⁵ Thus, in the absence of international tax jurisprudence,¹⁹⁶ national court decisions are a central type of state practice in considering whether ITL represents customary international law.¹⁹⁷

Examining the role of national courts in creation of custom involves considering the status of courts interpreting international law, the composition of the courts and the possibility of inconsistency with other branches of government - legislature and executive.¹⁹⁸ It is also important to examine the jurisprudence of a several states and not just a few dominant states. Avi-Yonah does not address the role of national courts in ITL, their jurisprudence or their interpretive approaches to tax treaties. Also, Avi-Yonah's argument could be strengthened by greater reliance on the state practice of states other than the United States.

Additionally, it needs to be noted that numerous international tax relations between states, treaty-based or otherwise, are unique and specific to those states. Admittedly, many bilateral tax treaties have identical provisions that could potentially amount to customary

¹⁹⁴ Yoram Dinstein, 'The Interaction between Customary International Law and Treaties' (2006) 322 *Recueil De Cours* 243, at 347.

¹⁹⁵ Vik Kanwar, 'Treaty Interpretation in Indian Courts: Adherence, Coherence, and Convergence' in Helmut Philipp Aust, George Nolte (eds.), *The Interpretation of International Law by Domestic Courts Uniformity, Diversity, Convergence* (Oxford University Press 2016)239.

¹⁹⁶ The lack of international jurisprudence in ITL contrasts with the position that exists under IIL. A significant number of awards by investor-state tribunals are publicly available and shape the IIL regime. Arbitral decisions contribute to convergence even though the particular investment regime is constituted mainly by bilateral treaties. See Stephan W. Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009); Stephen W. Schill, 'System-Building in Investment Treaty Arbitration and Lawmaking' (2011) 12 *Ger L J* 1083, at 1086 ('arbitral tribunals are thus in a position to craft and develop treaty overarching standards for investor-state relations that are hardly pre-determined by the texts of the specific investment treaty at issue.').

¹⁹⁷ See, for example, *Arrest Warrant Case (Democratic Republic of Congo v Belgium)* (2002) ICJ Rep1, at para 60 (where the ICJ looked at decisions of national courts to discern state practice).

¹⁹⁸ A. Mark Weisburd, *supra* note 193; A. Nollkaemper, 'The Role of Domestic Courts in the Case of the International Court of Justice' (2006) 5 *Chinese J Int'l L* 301.

international law.¹⁹⁹ However, a closer look may suggest that the provisions in tax treaties may be insufficiently similar to constitute uniform state practice. For example, let us consider the definition of the Permanent Establishment (PE). The UK-Italy tax treaty, for instance, states that a PE shall include a building site which exists for more than 12 months;²⁰⁰ the UK-India tax treaty however states that a PE shall include a building site which continues for a period not exceeding 6 months.²⁰¹ The lower threshold for a PE is beneficial for the source state. Being a net capital importer it would serve its interests better for it would give it a right to tax an economic transaction even though the same took place on its territory for a comparatively short period; a net capital exporter on the other hand would prefer a higher threshold for a PE to preserve a greater scope for taxation as a residence state. Thus, the fact that the UN Model (to which India subscribes) prescribes a lower threshold for a PE led to a deviation from the OECD Model (to which the UK subscribes) in the eventual UK-India tax treaty that was finally concluded. The above mentioned provisions illustrate that amongst the tax treaties there are lots of variations driven by the *quid pro quo* nature of some of the provisions. The relation between two states often produces a specific kind of treaty introducing variations among tax treaties.²⁰² The variations among tax treaties underscore the lack of uniformity among tax treaties.

Furthermore, the absence of MFN clauses in tax treaties indicates the intention of the states to keep international tax relations strictly bilateral in nature - a notable difference to IIAs. Stephan Schill has argued that the presence of the MFN clause in BITs prevents a state from entering into bilateral *quid pro quo* bargains that extend preferential treatment to certain states and exclude its other treaty partners.²⁰³ Thus, he argues, MFN clauses contribute to multilateralizing the bilateral treaty relationships in IIL.²⁰⁴ Moreover, MFN clauses in IIAs are

¹⁹⁹ Reuven Avi-Yonah, 'The Structure of International Taxation: A Proposal for Simplification' (1996) 74 Texas L Rev 1301, at 1303, at 1023 ('Indeed, the fundamental structure for international taxation of income announced nearly seven decades ago in the 1928 League of Nations Model Treaty forms the common basis for ... bilateral tax treaties in force throughout the world.');

See Michael J. Graetz, Michael M. O'Hear, *supra* note 44, at 1033 ('OECD model tax treaty is a direct descendant of the League of Nations model treaty developed in the mid-1920s.')

²⁰⁰ Art 5, UK-Italy tax treaty (1988).

²⁰¹ Art 5, UK-India tax treaty (1993).

²⁰² Each state has its own interest to protect and thus certain provisions in the treaties are markedly different. For instance, no US tax treaty includes tax sparring provisions i.e. the taxpayer is not exempted from paying the tax in US if the other signatory state has waived tax or not imposed it. The other state may have suspended application of tax laws for certain activities for the purposes of attracting greater investment. In most non-US treaties such provisions are commonplace. See, for instance, Art 25 (4), India-Cyprus tax treaty (1994).

²⁰³ See Stephen W. Schill, *The Multilateralization of International Investment Law*, *supra* note 196, at 121-134.

²⁰⁴ *Ibid.*

not applicable to taxation measures of states; this is because states wish to preserve their autonomy to extend tax incentives to certain states while excluding other states.²⁰⁵

While bilateralism has contributed to many tax treaties that are identically worded, national courts may not interpret them in similar fashion. And, crucially, the differently worded provisions in bilateral treaties prevent the emergence of sufficient uniformity among the tax treaties. As discussed above in Section III, bilateralism is pre-dominant in ITL primarily through the legal instrument of tax treaties. Due to more than 3000 bilateral tax treaties, certain principles of ITL are found in many legal systems.²⁰⁶

The above discussion does establish that there is certainly a widespread presence of tax treaties. Also, certain principles of tax treaties are part of many domestic tax laws. In view of these factors, I suggest that certain principles should be accepted as general principles of law.²⁰⁷ Article 38(1), Statute of the ICJ recognizes 'the general principles of law recognized by civilized nations' as one of the sources of law. The general principles are generally understood as the principles found in almost all legal systems of the world.²⁰⁸ For instance, the principle of non-discrimination is applied in almost all jurisdictions to ensure the demands of justice are met in tax disputes. Similarly, a large majority of states accept that tax liability cannot be imposed without identifying a nexus - either source based or residence based.

Certain elements of ITL are common to the tax laws of many due to the wide presence of tax treaties and their interpretation by domestic courts. This, in my view, leads to two conclusions: first, that with many bilateral treaties, ITL constitutes a sub-discipline of international law; second, that there are some general principles in ITL though they are yet to attain the nature of customary norms. As I elaborate in the latter part of this thesis, both these features of ITL should inform deliberations of investor-state tribunals in tax-related investment disputes.

²⁰⁵ See Diane M. Ring, *supra* note 153.

²⁰⁶ Peter Harris, David Oliver, *supra* note 5.

²⁰⁷ Antoine Fabiani (1905) 10 RIAA 83, at 117 (the general principles of law are rules that are common to most legislations).

²⁰⁸ *Ibid*; See generally H. Lauterpacht, 'Decisions of Municipal Courts as a Source of International Law' (1929) 10 British Y'bk l Int'l L 65; Anthea Roberts, 'Comparative International Law? The Role of National Courts in Creating and Enforcing International Law' (2011) 60 ICLQ 57.

VI. CONCLUSION

ITL has a long history, more than two thousand tax treaties, an increasing number of tax information exchange agreements, soft law in the form of Model Conventions and yet it has, by and large, escaped the attention of international lawyers. This chapter looked at ITL from the perspective of public international law. In the absence of any customary norms, the League, a trailblazer in ITL, extrapolated certain principles from domestic tax laws and invited its members to formulate rules to prevent international double taxation. The tax treaties signed by states thereafter have to a large extent managed to combat international double taxation, but, addressing international tax evasion continues to be a challenge.

The OECD is currently the dominant organisation in ITL and the successor of the League. Due to the UN's own incapability and developed states pursuing their own interests, the UN has been unable to make any major impact on international tax policy. The OECD's position as the sole standard setter in ITL has been further strengthened due to its recent partnership with the G-20 in the Global Transparency and the BEPS project. It may provide the OECD more visibility in international economic governance and bring a greater focus on its role in ITL. Additionally, the OECD is looking to find a solution to international tax evasion. I suggest that the OECD should address one major shortcoming in its approach - viewing ITL in isolation and instead should consider it as part of the broader discipline of international law. In my view, correcting its perspective may make the OECD's efforts more effective. I suggest that there is a common concern of treaty shopping in ITL and IIL - and that the jurisprudence of latter can prove useful in ITL.

I argue that the principle underlying the denial of benefits clauses in IIAs and the jurisprudence in IIL can be meaningfully used in ITL. A coherent approach of preventing treaty shopping anchored in international law can be proposed by the OECD as part of its BEPS project aimed at addressing international tax evasion. By taking cognizance of other sub-disciplines of international law, it is argued, a comprehensive solution to international tax evasion can be proposed. Thereafter, I discuss the argument of Reuven S. Avi-Yonah that some of the principles contained in tax treaties have acquired the nature of customary norms. I highlight the limitations of Avi-Yonah's argument and point out that the principles contained in tax treaties have acquired the nature of general principles of law. These principles, I suggest, should inform our understanding of ITL especially by investor-state tribunals when adjudicating on tax-related investment disputes.

CHAPTER 2

COMPARING DISPUTE RESOLUTION UNDER TAX TREATIES AND INTERNATIONAL INVESTMENT AGREEMENTS

I. INTRODUCTION

This chapter compares and examines dispute resolution mechanisms under tax treaties and IIAs i.e. the Mutual Agreement Procedure (the MAP) and tax arbitration as provided under the former and investor-state arbitration under the latter. Taxpayers and tax practitioners have widely criticised the MAP for it involves delays, lacks transparency and does not offer the assurance that the dispute will eventually be resolved.²⁰⁹ To overcome some of the limitations of the MAP, certain states have incorporated tax arbitration in their tax treaties.²¹⁰ Additionally, tax-related disputes have also arisen under IIAs.²¹¹ While the nature and kind of disputes that arise under IIAs are different from the ones that arise under tax treaties,²¹² I suggest that comparing dispute resolution mechanisms of tax treaties and IIAs is instructive to examine the role provided in each for the states and private parties.²¹³

Under the MAP, competent authorities of the contracting states can resolve a dispute through administrative negotiations. A taxpayer (resident of either of the contracting states) can initiate the MAP if in its opinion the tax imposed or likely to be imposed contravenes the tax treaty. Recognising that the authorities are not always able to arrive at an agreement under the MAP, certain states have also introduced the additional remedy of tax arbitration.²¹⁴ If unresolved under the MAP, either the taxpayer or the competent authorities refer the dispute, or unresolved elements of the dispute to arbitration.²¹⁵ Under tax arbitration, the arbitrator's jurisdiction is limited to choosing the positions presented by the parties with each side making its 'last best offer.'

²⁰⁹ See Hugh J. Ault, 'Dispute Resolution: The Mutual Agreement Procedure', in Alexander Trepelkov, et al. (eds.), *United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (UN 2013) 309.

²¹⁰ Art 25, US-Germany tax treaty (1989) (the provision relating to tax arbitration was added in 2007 by an amendment to the treaty); Art 24(7), US-Belgium tax treaty (2006).

²¹¹ See, for instance, *Occidental v Ecuador* LCIA Case No. UN 3467; *EnCana v Ecuador* LCIA Case UN 3481.

²¹² For details see Section III.B below.

²¹³ See generally W. Michael Reisman, *Systems of Control in International Adjudication and Arbitration Breakdown and Repair* (Duke University Press 1992).

²¹⁴ See generally Gustaf Lindencrona, Nils Mattson, *Arbitration in Taxation* (Kluwer Law International 1981).

²¹⁵ For details see Section II.C and II.D below.

Under IIAs, investor-state arbitration is the primary method to resolve tax-related investment disputes. If the investor believes that a certain tax measure or interpretation of a tax law or administration of tax law violates the substantive obligations of the state under an IIA, it can argue its case before the arbitral tribunal. The characteristic feature of investor-state arbitration is the ability of an investor to directly initiate proceedings against the host state. The investor does not have to depend on its home state to begin the arbitral proceedings. However, the crucial difference between tax-related investment disputes and other investment disputes is the tax veto. In tax-related investment disputes, the tax veto is an important procedural step that involves filtering of arbitration claims by the competent authorities of the contracting states.²¹⁶

There are significant differences in the dispute resolution mechanisms provided under tax treaties and IIAs. To begin with, the MAP is a consultative mechanism and is at best an administrative remedy; while, arbitral awards by investor-state arbitral tribunals are binding on the states and investors. Further, states dominate dispute resolution under tax treaties through their 'competent authorities'.²¹⁷ Under tax treaties, the taxpayer only has the right to initiate the MAP proceedings; whereas competent authorities of the signatory states control the duration and pace of the entire dispute resolution process. Under IIAs, states have a pre-dominant role in exercising the tax veto, but during arbitral proceedings, the investor can fully participate in the proceedings. However, there are also certain commonalities and overlaps in the dispute resolution mechanisms of tax treaties and IIAs. For example, certain IIAs provide that investor-state tribunals can adjudicate disputes arising under tax treaties under certain circumstances.²¹⁸

There is an increasing emphasis in IIL on the need for a more balanced and nuanced interpretive approach by the investor-state tribunals. Tribunals have been criticised for their inclination towards protection of the investor.²¹⁹ In addition, investors have greater control over the dispute resolution process under IIAs since they can independently initiate and fully participate in proceedings before investor-state tribunals. To recalibrate the balance between the states and investors, it has been argued that states must exercise their ongoing role in the interpretation of IIAs and ensure a greater involvement of the states in the

²¹⁶ See Section III.A below.

²¹⁷ See, for instance, Art 27, UK-Austria tax treaty (1968).

²¹⁸ Art X, US-Ecuador BIT (1993).

²¹⁹ Michael Waibel, 'International Investment Law and Treaty Interpretation', in Rainer Hofmann, Christian J. Tams (eds.), *International Investment Law and General International Law from Clinical Isolation to Systemic Integration?* (Nomos 2011) 29.

adjudicative process.²²⁰ In contrast, in ITL, the pendulum has started to swing towards more involvement of taxpayers in dispute resolution. The recent introduction of tax arbitration in some tax treaties represents a partial recognition of the need for greater involvement of taxpayers in the dispute resolution process. The ICC has also proposed a tax arbitration system whereby taxpayers are given direct access to arbitration.²²¹ The ‘direct’ form of tax arbitration that the ICC proposed has yet to be implemented, partly because the OECD member states disagree on the need and desirability of providing a remedy whereby a taxpayer may directly initiate a claim against a state in an international forum.²²² In an attempt to examine and compare the dispute resolution under tax treaties and IIAs, this chapter proceeds as follows:

Section II critically examines the dispute resolution mechanisms provided under the tax treaties - the MAP and tax arbitration, and highlights their shortcomings. In Section III, I examine tax veto, a special procedural mechanism under IIAs for tax-related investment disputes. Tax veto, I argue, is unduly balanced in favour of states, especially when compared to the advantages that investor-state arbitration provides to investors in disputes that are not tax related. I also compare tax veto with the MAP to bring out their differences and similarities. Additionally, I examine the provision in certain IIAs that allows taxpayers direct access to investor-state arbitral tribunals for disputes arising under tax treaties. Section IV discusses the possible role that states can play in disputes relating to international tax. I examine the role of joint interpretive statements in ITL and suggest that state-state

²²⁰ Anthea Roberts, ‘Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States’ (2010) 104 *American J Int’l L* 179.

²²¹ ICC Commission on Taxation, *Arbitration in International Tax Matters* (180/438 Rev. 2, 3 May 2000), available at <http://www.iccwbo.org/Data/Policies/2000/Arbitration-in-international-tax-matters/>. (recommending that binding and compulsory arbitration in international tax matters should be adopted in bilateral and multilateral tax conventions); ICC on Taxation, *Arbitration in International Tax Matters* (180/455 Rev.2, 6 February 2002), available at <http://www.iccwbo.org/Data/Policies/2002/Arbitration-in-International-Tax-Matters--Bilateral-Convention-Article/> (containing a model article to assist in the implementation of arbitration in tax matters effectively providing the taxpayer direct access to arbitration if the MAP does not resolve the dispute within two years) (hereinafter collectively referred to as ICC Tax Arbitration Reports); Also see William W. Park, David R. Tillinghast, *Income Tax Treaty Arbitration* (SduFiscale&Financie le Uitgevers 2004).

²²² The ICC favours a tax arbitration that allows taxpayers to directly initiate claims against states. The OECD member states support a different form of arbitration - arbitration as an extension of the MAP and arbitration initiated only at the behest of the competent authorities of states. States such as the US and Germany have included tax arbitration in their tax treaties. Canada, France, Switzerland have indicated that they want to include tax arbitration clauses in their tax treaties, but not immediately. However, none of the states have either included or expressly supported the form of tax arbitration proposed by the ICC. See, ICC Commission on Taxation, Policy Statement, *Arbitration in International Tax Matters* (Document No. 180/438, 3 May 2000).

arbitration could be a better alternative to tax arbitration (as it currently exists) for international tax disputes. Section V concludes.

II. DISPUTE RESOLUTION UNDER TAX TREATIES

The UN Charter requires parties to any dispute to seek a solution by negotiation, enquiry, mediation, conciliation, arbitration, judicial settlement, resort to regional agencies or arrangements, or other peaceful means of their own choice.²²³ Tax treaties provide for a combination of these various possible means to settle disputes. The pre-dominant form of dispute resolution mechanism in tax treaties - the MAP - is a form of consultative mechanism between the competent authorities of the contracting states. In 2008, the OECD also incorporated a provision for tax arbitration in the OECD Model.²²⁴ The UN also subsequently incorporated arbitration in the UN Model.²²⁵ The introduction of tax arbitration has prompted speculation about the impact and role of arbitration in international tax disputes.²²⁶ In the sub-sections below, I examine the nature of both the MAP and tax arbitration.

A. Absence of Dispute Resolution Provisions in 19th century Tax Treaties

The earliest international agreement relating to international taxation was signed in 1843 between Belgium and France.²²⁷ The agreement did not contain a dispute resolution provision

²²³ Art 33, UN Charter, available at <http://www.un.org/en/documents/charter/index.shtml>

²²⁴ Art 25(5), OECD Model Tax Convention on Income and Capital; Currently, only a handful of states such as Belgium, Germany and US have incorporate tax arbitration in some of their tax treaties. See OECD Commentary, *supra* note 168.

²²⁵ The UN introduced the provision of tax arbitration in its model in 2011 which is essentially similar to the provision for tax arbitration in the OECD Model. See Art 25, UN Model Tax Convention on Income and Capital; Also see UN Committee of Experts on International Co-operation in Tax Matters, *Report by the Sub-Committee on Dispute Resolution: Arbitration as an Additional Mechanism to Improve the Mutual Agreement Procedure* (2010) 6, available at http://www.un.org/esa/ffd/tax/sixthsession/Report_DisputeResolution.pdf ('sovereignty does not prevent States from agreeing in a tax convention to be bound by the decision of an arbitration board (private tax experts) where their competent authorities cannot reach an agreement on a tax issue.').

²²⁶ See, for instance, Chloe Burnett, 'International Tax Arbitration' (2007) 36 *Australian Tax Rev* 173; Marcus Desax, Marc Veit, 'Arbitration of Tax Treaty Disputes: The OECD Proposal' (2007) 23 *J London Court Int'l Arb* 405; Ilias Bantekas, 'The Mutual Agreement Procedure and Arbitration of Double Taxation Disputes' (2008) 1 *Colombian Yb'k Int'l L* 182; Charles R. Irish, 'Private and Public Dispute Resolution in International Taxation' (2011) 4 *Contemporary Asia Arb J* 121.

²²⁷ Convention Regulating the Relations between the Administrative Services of France and Belgium (1843) reproduced in League of Nations, *Double Taxation and Fiscal Evasion: Collection of International Agreements and International Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion* (League of Nations 1928) (a compilation of the various tax treaties from 1843 onwards); Also see UN, *International Tax Agreements: World Guide to International Tax Agreements 1843-1951* (UN Publications 1951).

and only referred to mutual assistance and co-operation among the contracting states.²²⁸ States signed a number of treaties on mutual assistance during this period but they did not contain a dispute resolution mechanism in the strict sense of the term.²²⁹ Even the agreements concerning income tax merely provided that any potential dispute may be resolved by an understanding between the parties and thereafter steps may be taken in accordance with the understanding.²³⁰ There was no specific mention of the taxpayer's right to petition any of the states or an obligation on the states that required them to arrive at an understanding.²³¹

B. Dispute Resolution Provisions in the Model Conventions of the League

In 1927, the League prepared four Model Conventions. Article 14 of the Bilateral Convention for the Prevention of Double Taxation provided for the resolution of disputes for the first time.²³² It provided that the two contracting states should directly settle a dispute regarding the interpretation or application of the convention. If the states failed to settle the dispute, they could submit it to a technical body which the Council of the League may appoint. The technical body would give an advisory opinion after hearing the states and arrange a meeting between them if necessary. The provision further provided that the states may agree, beforehand, to regard the advisory opinion given by the technical body as final. In the absence of such an agreement, the opinion was non-binding and states were free to have further recourse to any arbitral or judicial procedure.²³³ In 1928, the League prepared three versions of the above mentioned Model Convention and in each version retained the same dispute resolution provision mentioned above.²³⁴ The Model Convention revised in 1935 also retained the same dispute resolution provision.²³⁵

²²⁸ *Ibid*; Also see Sunita Jogarajan, 'The Conclusion and Termination of the "First" Double Taxation Treaty' (2012) 3 British Tax Rev 283.

²²⁹ See, for instance, Belgium-Netherlands Agreement on Reciprocal Administrative Assistance (1845); France- United Kingdom Agreement on Reciprocal Administrative Assistance (1907).

²³⁰ See, for instance, Austria-Liechtenstein Agreement on General Income and Property Tax (1901).

²³¹ *Ibid*.

²³² The provision was modelled on Art 22, International Convention Relating to the Simplification of Customs Formalities (1923) (the dispute resolution provision in this Convention and the Model Convention of the League were almost a verbatim copy of each other).

²³³ The League included a similar provision for dispute settlement in another Model Convention. See Art 6, the Draft Bilateral Convention for the Prevention of Double Taxation in the Special Matter of Succession Duties (1927).²³⁴ See Art 14, Text of Draft Convention No. 1a (1928); Art 5, Text of Draft Convention No. 1b (1928); Art 13, Text of Draft Convention No. 1c (1928).

²³⁵ Art 8, Revised Text of the Draft Convention for the Allocation of Business Income between States for the Purposes of Taxation (1935).

Some of the earlier tax treaties incorporated interesting dispute resolution provisions. The 1926 treaty between United Kingdom and Irish Free State provided that any dispute in relation to the interpretation of the agreement shall be determined by such tribunal as may be agreed by the parties and that the decision of the tribunal shall be binding on the parties.²³⁶ In a similar fashion, a treaty between Romania and Czechoslovak Republic in 1934 on succession duties required that the states shall submit the dispute to such technical organisation that the Fiscal Committee of the League may determine and the award shall be binding without any right of appeal.²³⁷ The agreement among the parties agreeing to be bound by the decision of an independent tribunal on a tax dispute was exceptional. It reflected a certain degree of trust reposed by states in the tribunals and the League.²³⁸ As Chapter 1 showed, from 1921-1946 the League played a central role in the development of ITL. It is perhaps a reflection of the League's prominence in international tax policy from 1921 onwards that a treaty signed by states in 1934 involved the League in the dispute resolution process.²³⁹ The above-mentioned dispute resolution provisions of the Model Conventions and the treaties, however, later gave way to the MAP.

The MAP appeared in the Model Conventions of the League for the first time in the Mexico Model Convention of 1943. Article XVI of the Model Bilateral Convention for the Prevention of the Double Taxation of Income provided that when a taxpayer shows proof that the action of the tax administration of one of the contracting states has resulted in double taxation, he shall be entitled to lodge a claim with the tax administration of the state in which he has his fiscal domicile or of which he is a national. If the claim was admitted, the competent tax administration of that state shall consult directly with the competent authority of the other state with a view to reaching an agreement for an equitable avoidance of double taxation. The provision in the Mexico Model Convention prepared in 1943 was retained in the London Model Convention prepared in 1946 (Art XVII). Essentially the same provision is part of every modern bilateral tax treaty and tax information exchange agreement.

²³⁶ Art 7, UK-Irish Free State Agreement in Respect of Double Income Tax (1926) (there is no record of this dispute resolution mechanism having actually been used); Also see Zvi Daniel Altman, *Dispute Resolution under Tax Treaties* (IBFD 2006) 15-18.

²³⁷ Art 6, Romania-Czechoslovakia Republic Convention concerning Double Taxation in connection with Succession Duties (1934).

²³⁸ In the case of the UK-Irish Free State Agreement, it has been suggested that the identical tax systems of the two states were a reason for the uniqueness of the agreement. Subsequently, however, UK was unable to persuade any other state to agree to a similar agreement. See John F. Avery Jones, 'Corporate Residence in Common Law: The Origins and Current Issues' in Guglielmo Maisto (ed.), *Residence of Companies Under Tax Treaties and EC Law* (IBFD 2009) 162-163.

²³⁹ See Romania-Czechoslovakia Agreement, *supra* note 237.

The Commentaries to the London and the Mexico Model Conventions do not provide any insight or explain the reason for the change in the dispute resolution provision. The removal of the earlier provision which provided that a technical body may give an advisory opinion is puzzling.²⁴⁰ This is especially because states had the discretion to agree beforehand whether they would be bound by the opinion of the technical body or not. The Commentaries to the London and Mexico Model Conventions emphasise two aspects of the dispute resolution mechanisms contained in the Model Conventions: first, the League emphasised that the taxpayers' right to appeal to the tax administration was intended to supplement and not replace the judicial remedies available domestically; second, the League clarified that the dispute settlement procedure provided in the Model Conventions was designed as a consultation between the two tax administrations and not as a judicial procedure.²⁴¹

Since 1946, states have rarely agreed to be bound by the award of an independent tribunal in international tax disputes.²⁴² The norm has been that in relation to any dispute under a tax treaty, both states will seek to arrive at an understanding to resolve the dispute.

C. The Mutual Agreement Procedure and its Limitations²⁴³

Tax treaties typically provide that any person who is a resident of either contracting state can initiate the MAP if it considers that the actions of one or both of the contracting states result or will result for that person in taxation not in accordance with the tax treaty.²⁴⁴ There are various in-built filters in this provision that ensure state control over the MAP: firstly, the competent authority of the residence state can reject the request if it deems it to be unqualified; secondly, the competent authority can arrive at a solution unilaterally - unilateral solution is generally possible where the complaint relating to double taxation is due

²⁴⁰ Zvi Daniel Altman speculates that since and that the London and Mexico Conventions were finalized during and immediately after the Second World War - the 'special reality of the time' marked by low reputation of international institutions particularly the League's inability to prevent the war - may have contributed to the change in the dispute resolution provisions. See Zvi Daniel Altman, *supra* note 236, at 56-57.

²⁴¹ 1946 report, *supra* note 60, at 31-32.

²⁴² See Lotfi Maktouf, 'Resolving International Tax Disputes through Arbitration' (2014) 4 Arb Int'l 32; Michael Lang, Jeffrey Owens (eds.), *International Arbitration in Tax Matters* (IBFD 2016); Art 12, Convention on the Elimination of Double Taxation in connection with the Adjustment of Profits of Associated Enterprises (1990) (the competent authorities are required to take a decision that eliminates double taxation within six months after advisory commission issues its opinion. If the competent authorities cannot arrive at an alternate solution within six months, they are bound by advisory commission's opinion).

²⁴³ This sub-section does not aim to be an exhaustive critique of the MAP. Instead, the aim is to highlight the main features of the MAP along with the shortcomings of the MAP. The discussion about the MAP will provide a context for its comparison with dispute resolution of tax-related investment disputes under IIAs.

²⁴⁴ See, for instance, Art 27, India-UK tax treaty (1993); Art 24, US-Belgium tax treaty (2006).

to the actions or measures of the residence state itself; thirdly, if the competent authority is unable to resolve the case unilaterally, the obligation is to endeavour to resolve the case by mutual agreement with the competent authority of the other contracting state; fourthly, the obligation on the competent authorities is that they ‘shall endeavour’ to arrive at a satisfactory solution. Put differently, the competent authorities are not bound to resolve the dispute, or to do so within a specified period. Further, the MAP lacks transparency as no case studies are publicly available.

At the outset of the MAP, the competent authority of the resident state decides whether the complaint is justified.²⁴⁵ A unilateral decision is generally not possible because if the measures of the resident state are responsible for double taxation then it is unlikely to undo its own decision unless it is a blatantly erroneous imposition of tax. In this respect, the OECD has recommended that taxpayers can initially approach the competent authority of either of the two contracting states, rather than just the resident state.²⁴⁶ Thus, at the initial stage itself both the authorities can give their opinion on the legality or otherwise of the tax liability. The OECD has clarified that in such a scenario, the initial opinions of both the competent authorities will be independent assessments of the complaint of the taxpayer. Thus, the next stage - consultations between the two authorities would still be an option even if both authorities are approached at the initial stage.²⁴⁷ It is a welcome suggestion and should be incorporated in the tax treaties. It will help improve access to the MAP.

The OECD has also stressed other additional measures to better access to the MAP.²⁴⁸ It has recommended that states should publish rules, guidelines, and procedures to provide better access to the MAP. According to the OECD, it is important that states should draft the rules in plain language, make them transparent and readily accessible to the public.²⁴⁹ The OECD’s emphasis on providing a better access to the MAP is to increase awareness of the competent authorities of states on the importance of the MAP and prevent them from casually rejecting

²⁴⁵ Hugh J. Ault, *supra* note 209, at 317 (observes that while the language gives wide discretion to the competent authority of the resident state, in practice, the grounds on which a request has been denied are quite limited).

²⁴⁶ See OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report* (2015) 16 (hereinafter 2015 report).

²⁴⁷ *Ibid.*

²⁴⁸ *Ibid.*, at 17.

²⁴⁹ *Ibid.*, at 18.

a taxpayer's request. The OECD's suggestions if incorporated by states will certainly improve access to the MAP.²⁵⁰

If the dispute is not resolved at the first stage, the competent authorities are required to address it mutually. However, it is possible for the other competent authority to refuse to enter into negotiations and also it is not under any obligation to disclose the reasons for the refusal. It is only when both the competent authorities agree to negotiate the dispute, that the obligation to *endeavour to resolve* the dispute is triggered.²⁵¹ This obligation is, however, without a corresponding obligation to *actually arrive* at a decision. Thus, the MAP, as it exists today, can be understood by the League's original characterisation of the dispute settlement in tax treaties - a consultative mechanism and not an adjudication of the dispute.

Apart from the lack of an obligation to arrive at a joint decision, the lack of any definite period for the consultation between the competent authorities of two states is another major limitation of the MAP. The OECD has suggested that states should commit to a timely resolution of the MAP cases. It has proposed that states should commit to resolution of the MAP disputes within an average time frame of 24 months.²⁵² This again is a useful suggestion by the OECD and the time period recommended is adequate. The states should consider committing to this period; it will be a significant contribution in improving the MAP.

Another shortcoming of the MAP is the continuing lack of transparency. The demand for publishing the agreements reached under the MAP is a long standing one and bodies like the International Fiscal Association have highlighted it repeatedly.²⁵³ It has been argued that since states 'club different cases' and frequently resolve disputes together it prevents publishing of

²⁵⁰ While some tax treaties have recently included other suggestions of the OECD, such as bilateral Advance Pricing Arrangements, the provision on the MAP remains unchanged. See India-South Korea tax treaty (1985, revised in 2015); Australia-Germany tax treaty (1972, revised in 2015).

²⁵¹ The disputes relating to transfer pricing form a majority of the cases. The questions may involve a determination of the 'residency' of the taxpayer. Both the contracting states may treat the taxpayer as a resident under the tax treaty thus exposing him to double taxation. In such a case a mutual agreement can resolve the issue and prevent double taxation. See OECD, *Manual on Effective Mutual Agreement Procedures* (2007) 9 (hereinafter OECD Manual).

²⁵² 2015 report, *supra* note 246, at 15; The OECD has also suggested that states should utilise the Forum of Tax Administration (located in the OECD Secretariat) to develop a global response to tax administration in a collaborative fashion. It remains to be seen if states, especially non-member states will take this suggestion seriously. For further details on the Forum see <http://www.oecd.org/tax/forum-on-tax-administration/>

²⁵³ See International Fiscal Association, *Cahiers de Droit Fiscal International* (1957) 34, at 219-230; International Fiscal Association, *Cahiers de Droit Fiscal International* (1981) 66a, at 93-100.

results.²⁵⁴ Unless there is unprincipled trading of favours during the MAP negotiations, clubbing or bundling of cases should not stop states from publishing the results of the MAP. Nonetheless, there is little progress on this front.

Apart from the opaque functioning of the competent authorities, the marginalisation of the taxpayer is another serious drawback of the MAP. The aggrieved taxpayer has no control over the proceedings.²⁵⁵ The taxpayer can only make a complaint to the competent authorities and initiate the MAP, but this is ordinarily where the involvement of the taxpayer starts and ends. The only concession for this limited role of the taxpayer seems to be that if a mutually acceptable solution is finally arrived at - it is not binding on the taxpayer. The taxpayer may choose to reject the final solution proposed, in which case, the taxpayer either negotiates with both the states individually or pursues the remedies in the national courts of the states. Because of limited participation in the proceedings, the taxpayer remains in the dark about the result of the dispute that may continue for a lengthy period.²⁵⁶ Further, because the taxpayer learns of the decision on an informal basis, it does not result in the formation of a reliable precedent for other taxpayers.²⁵⁷ If the competent authorities arrive at a decision, they need to publish it. In my view, the major drawbacks of the MAP are that states have an almost complete control of the dispute resolution process and the corresponding lack of transparency.²⁵⁸

Additionally, the MAP is so structured that it does not incentivize either the taxpayer or the competent authorities to actively seek a solution. A taxpayer is not formally part of the process and is not completely invested in the process. It is an avenue that a taxpayer avails to

²⁵⁴ Irene Salvi, Jacqueline Hess et al, 'Competent Authority Functions and Procedures in Switzerland' (2009) 38 *Tax Mgmt Int'l J* 3.

²⁵⁵ Sarah G. Nowland, 'Three's (Not) a Crowd in International Tax Arbitration: International Tax Arbitration as a Development of International Commercial Arbitration Rather than a MAP Fix' (2014) 37 *Hastings Int'l & Comp L Rev* 183, at 189; A. E. Gildemeister, 'Arbitration of Tax Treaty Disputes - The 2008 OECD Model for Income Tax Treaties will contain an Arbitration Clause' (2007) 1 *Transnat'l Dispute Mgmt*, available at [http://tax-arbitration.com/Gildemeister%20-%20Tax%20Treaty%20Arbitration%20\(TDM\)](http://tax-arbitration.com/Gildemeister%20-%20Tax%20Treaty%20Arbitration%20(TDM))

²⁵⁶ OECD, *Improving the Process for Resolving International Tax Disputes* (2004) para 9 (stating that the business community perceives the MAP as a 'black box' into which the taxpayers dispute disappeared and no solution emerged, or a solution emerged long after the event had taken place, or the basis of the solution was either not explained to the taxpayer or is not made clear to the taxpayer).

²⁵⁷ The only guidance available to the taxpayers are the OECD and UN Commentaries on the Model Conventions. See OECD Commentary, *supra* note 168; Also see UN, *United Nations Model Double Taxation Convention between Developed and Developing Countries* (UN 2011) (hereinafter UN Commentary).

²⁵⁸ Allison Christians, 'How Nations Share' (2012) 87 *Indiana L J* 1407 (arguing for an access to actual decision through which governments are actually engaging in allocation of global wealth and not the soft law contained in the guidelines, best practices, etc.); Also see Maya Ganguly, 'Tribunals and Taxation: An Investigation of Arbitration in recent US Tax Conventions' (2012) 29 *Wisconsin Int'l L J* 735.

seek a solution but apart from a few informal discussions and presenting the facts of the case, a taxpayer is not truly part of dispute resolution. Similarly, the competent authorities are unlikely to pursue the disputes with enthusiasm if they are aware that the taxpayer has the power to reject the eventual solution. William P. Park, writing in 2001-02 observed:

At present, neither taxpayers nor governments possess any reliable way to resolve tax treaty disputes. National judicial proceedings lack political neutrality, and efforts at mutual agreement among competent authorities are fraught with delays, uncertainty and gamesmanship.²⁵⁹

In a similar vein, Sol Picciotto has remarked that while the international coordination of taxation has increasingly relied on administrative cooperation, the basis for this cooperation is still seriously inadequate. He further notes that the larger problem is that administrative assistance is viewed narrowly as means of reciprocal resolution of conflicts not to enforce the effectiveness of national taxation as applied to international business. Sol Picciotto's remarks underline the nature of the MAP as an administrative remedy (unlike the remedy provided to investors in IIAs) and how the competent authorities under the MAP have not prioritised the broader picture of improving the national tax systems. Instead, the MAP has become susceptible to trading favours between the authorities in charge.²⁶⁰ Viewed either as a consultative mechanism or as an administrative remedy, there is little disagreement that the MAP remains an inadequate remedy.

To conclude this section, the MAP as means of resolving disputes under tax treaties suffers from serious deficiencies. The shortcomings in the MAP mentioned in the above paragraphs show that there is enough room for improvement in the dispute resolution mechanism of the tax treaties. In partial recognition of these concerns, and as mentioned above, the OECD introduced the provision of tax arbitration in its Model Tax Convention. The following section examines tax arbitration, as proposed by the OECD and implemented in certain tax treaties, and the manner in which it addresses the shortcomings of the MAP.

²⁵⁹ William W. Park, 'Income Tax Treaty Arbitration' (2002) 10 *George Mason L Rev* 803, at 862; Also see Mario Züger, *Arbitration under Tax Treaties Improving Legal Protection in International Tax Law* (IBFD 2001).

²⁶⁰ Sol Picciotto, *International Business Taxation A Study in the Internationalization of Business Regulation* (Cambridge University Press 1992) 305.

D. The Promise of Tax Arbitration

In 1984, the OECD in its report on transfer pricing decided against recommending compulsory arbitration for the resolution of transfer pricing disputes between tax authorities.²⁶¹ The OECD opined that the introduction of mandatory tax arbitration would involve ‘an unprecedented surrender of fiscal sovereignty’;²⁶² and that any system of dispute resolution such as arbitration will need to ‘provide adequately for the interests of both taxpayers and tax authorities.’²⁶³ The OECD pointed out that various issues will need to be considered before introducing tax arbitration - the confidentiality of the proceedings, the relation of arbitration with the domestic law of the contracting states, the finality of the arbitration, the appeal process and whether tax arbitration is a mere extension of the MAP or an independent dispute resolution mechanism.²⁶⁴ The proposal for introducing arbitration for international tax disputes continued to be discussed by the International Fiscal Association especially in the Congress of 1993.²⁶⁵

In 2000 (and later in 2002), the ICC suggested arbitration in taxation matters. It recommended that if tax authorities are unable to resolve a particular tax dispute, it should be transferred to an arbitral tribunal independent of the control of the parties.²⁶⁶ In 2004, the OECD released a progress report for public comment - ‘Improving the Process for Resolving International Tax Disputes’. In this report, the OECD expressly recognised the need to improve the MAP and also more significantly the need for a supplementary dispute resolution mechanism.²⁶⁷ In 2006, in its public discussion draft entitled ‘Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes’, it reiterated the need to supplement the MAP with an additional dispute resolution mechanism.²⁶⁸ Eventually, the OECD unequivocally supported arbitration as an additional dispute resolution technique.

²⁶¹ 1984 Transfer Pricing Report, *supra* note 124, at 25.

²⁶² *Ibid*, at 23.

²⁶³ *Ibid*, at 21.

²⁶⁴ *Ibid*.

²⁶⁵ International Fiscal Association, *Resolution of Tax Treaty Conflicts by Arbitration*, 18th IFA Congress Seminar Series (Kluwer 1993); Also see Congress of the International Fiscal Association, Eilat 1999 (Kluwer Law International 1999).

²⁶⁶ ICC Tax Arbitration Reports, *supra* note 221.

²⁶⁷ In this report the OECD recognised the concerns about the effectiveness of the MAP while simultaneously stating that the ‘existing procedures generally are able to resolve outstanding disputes.’ The OECD did not provide any statistics to back its claim that international tax disputes are ‘generally’ resolved by the MAP. See OECD, *Improving the Process for Resolving International Tax Disputes* (2004) para 2.

²⁶⁸ The report was eventually adopted by the OECD Committee on Fiscal Affairs. See OECD, *Improving the Resolution of Tax Treaty Disputes* (2007).

In 2008, the OECD added paragraph 5 to Article 25 of its Model Convention that provided for arbitration of disputes under tax treaties. The provision states that if the competent authorities are unable to resolve a dispute within two years, any unresolved issue shall be submitted to arbitration if the taxpayer so requests.²⁶⁹ Further, if the person directly affected by the case accepts the arbitration decision, the decision shall be binding on both contracting states and shall be implemented notwithstanding any time limits in the domestic laws of the contracting states. The provision is only aimed to be a 'model provision' and is subject to negotiation between the contracting parties. However, it leaves many issues unresolved - balancing the involvement of states and the taxpayer in the dispute resolution proceedings, relation with domestic remedies, jurisdiction of the arbitration panel, independence of the arbitrators and the issue of transparency of the proceedings among other issues.

One of the central concerns about the MAP has been that taxpayers have not been given an adequate procedural 'voice'. A taxpayer cannot participate in the proceedings beyond the initiation of the dispute resolution. The tax arbitration proposal by the OECD addresses this aspect. The OECD Model Convention envisages that the initiation of arbitration shall be at the request of the taxpayer if the competent authorities fail to resolve the case under the MAP within two years. This is understood as mandatory arbitration since the onus on commencing the arbitration is on the taxpayer and not the competent authorities of the states. However, several tax treaties have only introduced voluntary arbitration and provided that the reference of dispute to arbitration shall occur only if the competent authorities so desire.²⁷⁰ The OECD Model recommending mandatory arbitration is, in my opinion, a better alternative to voluntary arbitration. It allows the taxpayer to make an important decision regarding the resolution of the dispute and is an improvement over the MAP.

Additionally, it needs to be pointed out that preventing double taxation is only one of the two broad aims of tax treaties.²⁷¹ The other aim is prevention of international double non-

²⁶⁹ See OECD Commentary, *supra* note 168.

²⁷⁰ See, for instance, Art 25, US-Germany tax treaty (1989); Also see Art 25, UN Model (which provides that a dispute shall be submitted to arbitration only if competent authorities are unable to resolve the dispute for 3 years and the case shall be submitted to arbitration only if the competent authorities so desire); John Harrington, 'No Dispute about the Increasing Importance of Arbitration in Tax Matters' (6 September 2010) Tax Notes Int'l 753.

²⁷¹ This criticism however need not be directed only at tax arbitration. At times even the aim of the MAP is understood as merely preventing international double taxation - the issue of international non-taxation or under taxation is ignored. See, for instance, UN, *Guide to the Mutual Agreement Procedure under the Tax Treaties* (2012) 4, available at <http://www.un.org/esa/ffd/tax/gmap/> (It states that - the MAP ensures that the disputes do not disturb the treaty's 'goal' of preventing international double taxation and in order to reach that 'goal' competent authorities should make a timely agreement to resolve the issues submitted to the MAP).

taxation. Ideally, dispute resolution mechanism should serve both purposes is ignored. However, it seems the second purpose of preventing tax evasion is ignored. McIntyre argues that mandatory and binding arbitration could in fact facilitate double non-taxation.²⁷² The rationale for his argument is that an arbitration panel will only implement the existing international tax laws which are the root cause of international tax evasion.

Since these are the same rules that taxpayers utilize to achieve double non-taxation, acceptance of the position of the taxpayer in certain cases will eventually result in the enforcement of double non-taxation. Given the post-2002 focus in ITL on international tax evasion, the OECD needs to take into account if tax arbitration as proposed in the OECD Model Convention can adequately curb international tax evasion.²⁷³ Currently, it does not seem to be the case.²⁷⁴ In this respect, it is also instructive to look at the dispute resolution provision incorporated in tax information exchange agreements - legal instruments that the OECD has supported in its attempt to curb international tax evasion.

In 2002, the OECD released the OECD Model Tax Information Exchange Agreement. Article 13 of the Model provides that 'Where difficulties or doubts arise between the Contracting Parties regarding the implementation or interpretation of this Agreement, the competent authorities shall endeavour to resolve the matter by mutual agreement.' This provision is similar to the MAP contained in tax treaties. Tax information exchange agreements have gained prominence relatively recently and it is not possible to state with certainty the nature and frequency of disputes that arise with respect to tax information exchange requests. It is thus difficult to suggest if arbitration is the adequate dispute resolution mechanism for tax information exchange agreements. However, the OECD should certainly invite suggestions from states on the adequacy of dispute resolution provisions in tax information exchange agreements and whether the current mechanism is serving the intended purpose of the agreements.

In respect of tax arbitration in tax treaties, another aspect is unclear. It is doubtful if tax arbitration, as proposed by the OECD, will be useful to resolve triangular cases in ITL. Triangular cases in tax typically involve a taxpayer who is resident in more than one state (dual resident for tax purposes) and has financial interest or income sourced in a third state.

²⁷² Michael J. McIntyre, 'Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes', (2006) 7 Florida Tax Rev 622.

²⁷³ For details on the post-2002 focus of ITL on international tax evasion see Chapter 1, Section IV.A above.

²⁷⁴ In my view, the absence of transparency and lack of requirement for reasoned decisions hampers the effectiveness of tax arbitration for international tax evasion. International rules need to be developed, in part, through jurisprudence to successfully tackle international tax evasion.

Here all the three states may claim jurisdiction to tax on the basis of residence and source respectively. Co-ordinating the consultations of the competent authorities of the three states to avoid multiple taxation is in the interest of the taxpayer. But, bilateral tax treaties have been unable to provide an adequate framework for resolving such triangular disputes.²⁷⁵ The OECD has suggested that states need to include and develop guidelines on multilateral MAPs.²⁷⁶ The OECD has indicated that it in its next update of the OECD Commentary it will address the issue of multilateral cases that arise before the MAPs.²⁷⁷ It is, however, unclear if the OECD will also address the ability/inability of tax arbitration to resolve triangular or multilateral cases.

The question of independence of arbitrators in tax arbitration is also unresolved, not least because of the opaqueness that surrounds the dispute resolution process in tax treaties.²⁷⁸ The arbitrators shall be experts in tax which is likely to pose another problem in international tax dispute resolution.²⁷⁹ The problem of finding tax experts in arbitration is contentious. Many international tax disputes are related to transfer pricing that involve MNEs and most tax experts lend their expertise to the potential parties of international tax arbitration. In such cases, it may be difficult to find experts who are not 'also connected in some way with the relevant enterprise.'²⁸⁰ Even if it may be possible to find tax arbitrators with no conflicts of interest, they are more likely to be from the developed world - a potentially disadvantageous situation for the developing states. This is not to suggest that tax experts from developed states are likely to be immune to the concerns of the developing states, but there may not be adequate representation of developing states.²⁸¹

Another drawback of the provision in the OECD Model on tax arbitration is that the arbitrators have limited jurisdiction. Article 25(5) of the OECD Model provides that the taxpayer can only

²⁷⁵ See OECD, '*Triangular Cases*' in *Model Tax Convention: Four Related Studies* (1992).

²⁷⁶ 2015 report, *supra* note 246, at 37.

²⁷⁷ *Ibid.*

²⁷⁸ Michael J. McIntyre, *supra* note 272, at 639 (full disclosure of real or apparent conflicts is a minimum obligation that is not mandated by the OECD).

²⁷⁹ *Ibid.*

²⁸⁰ 1984 Transfer Pricing Report, *supra* note 124, at para 24; Also see William W. Park, 'Arbitrator Integrity: The Transient and the Permanent' (2009) 46 San Diego L Rev 629; Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press 2007) 152-153 (questioning the independence of arbitrators in the context of investor-state arbitration); Jan Paulsson, *The Idea of Arbitration* (Oxford University Press 2013) 147 (stating that confidence in the ethical standards of arbitrators and arbitral institutions is essential for legitimacy of arbitration).

²⁸¹ See Michael Lennard, 'International Tax Arbitration and Developing Countries' in Arthur W. Rovine (ed.), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (BRILL 2015) 437; Amr A. Shalakany, 'Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism' (2000) 41 Harvard Int'l L J 419.

refer unresolved issues to the arbitrators - not the entire dispute. It is doubtful if a complete demarcation of the various issues of the dispute will be possible in every case. If the unresolved issues are linked to the issues on which competent authorities have agreed - should arbitrators decline to adjudicate? This issue assumes more importance because in certain tax treaties a simplistic form of arbitration - 'baseball arbitration' has been adopted and the scope of duties of an arbitrator is to make an either/or choice.²⁸² The arbitration board is to resolve the issue by simply choosing the position of one of the parties to the dispute.²⁸³ This approach also called a 'last best offer' approach, narrows the function of arbitration and the role of arbitrators. This is markedly different from the kind of arbitration typically included under other international agreements such as IIAs.²⁸⁴

The nature of tax arbitration included in the OECD Model Convention also raises the question if it is really arbitration or is it an expert determination? Allison Christians suggests that the non-binding nature of arbitration makes it more akin to expert determination.²⁸⁵ But tax arbitration is not purely factual and requires application of legal rules, making it akin to arbitration.²⁸⁶ However, in baseball arbitration, incorporated in some tax treaties, there are unlikely to be any reasoned decisions and also the decisions are not binding unless specifically agreed to. In my opinion, the provision for tax arbitration in the OECD Model is an updated version of the dispute resolution provision initially incorporated in the 1927 Model Convention of the League mentioned above. Instead of the term 'technical body' used by the League, the OECD has used the term 'arbitration' but tax arbitration does not have all the elements of an adjudicative mechanism. The discretion of the parties to follow the decision has been retained and the essential character of the procedure as a consultative mechanism (as originally envisaged by the League) has also remained unaltered.

The issue of tax arbitration being akin to expert determination also arises partially because in the OECD's design, tax arbitration has always been viewed as a supplement to the MAP and

²⁸² Under this form of arbitration both sides shall present the arbitration panel with what they consider is the appropriate amount of tax and the task of the panel is simply to choose one of the two amounts presented. See Art XXVI, US-Canada tax treaty (1980); Art 24, US-Belgium tax treaty (2006).

²⁸³ Michelle S. Bertolini, Pamela W. Weaver, 'Mandatory Arbitration within Tax Treaties: A Need for a Coherent International Standard' (2013) 11 ATA J Legal Tax Research 1.

²⁸⁴ John Harrington, *supra* note 270, at 756.

²⁸⁵ Allison Christians, 'Putting Arbitration on the the MAP: Thoughts on the New UN Model Tax Convention' (23 April 2012) Tax Notes Int'l 351.

²⁸⁶ See Michael Waibel, 'Steering Sovereign Debt Restructurings through the CDS Quicksand' (2014) 15 J Banking Regulation 14 (discussing the distinction between arbitration and expert determination in the context of determination committees convened under the auspices of International Swaps and Derivatives Association).

not its replacement. In 1984, the view of the OECD was that arbitration ‘must be an integral part of the mutual agreement procedure and should not constitute an alternative route to solving tax treaty disputes between States, which would risk undermining the effectiveness of the mutual agreement procedure.’²⁸⁷ This remains OECD’s view even today.²⁸⁸ Adopting the view that tax arbitration is an extension of the MAP has prevented a swing from one extreme of complete state control over dispute resolution to another of no state control.²⁸⁹ On the flipside, it has also meant that tax arbitration inherits some of the drawbacks of the MAP. Most of the limitations of tax arbitration arise because arbitration of tax disputes is contingent upon the failure of the competent authorities to negotiate an agreement under the MAP and because ‘arbitration is an extension of the MAP and not an independent procedure.’²⁹⁰ A contrary opinion is that the inclusion of mandatory arbitration will only pressurise the competent authorities to arrive at a solution - ensuring disputes are not resolved by arbitration at all. In my view, the argument that inclusion of mandatory arbitration will ensure a speedy resolution of disputes under the MAP over-simplifies the complexity of disputes, the varied nature of bilateral tax relations between states and consequently the ability/inclination of competent authorities of the states to efficiently resolve tax disputes that arise under the tax treaties.²⁹¹

To summarise, the inclusion of tax arbitration has only multiplied unresolved issues relating to international tax dispute resolution. There are certain positive developments such as the insistence on a two-year time period for consultation between the competent authorities under the MAP and a provision for mandatory arbitration. Overall, even though tax arbitration holds some promise, it raises more questions and provides few answers. The experience of the arbitral process will over a period of time lead to ironing out of some of the procedural issues, but the basic concerns in the MAP such as lack of transparency and absence of reasoned decisions have not been addressed. Tax arbitration is only a marginal improvement

²⁸⁷ 1984 Transfer Pricing Report, *supra* note 124, at para 10.

²⁸⁸ See, for instance, OECD Commentary, *supra* note 168, at 354 (stating that tax arbitration is ‘an integral part of the mutual agreement procedure and does not constitute an alternative route to solving disputes concerning the application of the Convention.’).

²⁸⁹ Sharon A. Reece, ‘Arbitration in Income Tax Treaties: “To Be or Not to Be”’ (1992) 7 Florida J Int’l L 277, at 289 (stating that a supplementary role for arbitration reflects a conflict between a desire for certainty in resolving international tax disputes and the apparent reticence of sovereign states to cede jurisdiction of claims which may impact fiscal matters).

²⁹⁰ Ehab Farah, ‘Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem’ (2009) 8 Florida Tax Rev 703, at 714.

²⁹¹ See Micah Burch, Luke Nottage, ‘Novel Treaty-Based Approaches to Resolving International Investment and Tax Disputes in the Asia-Pacific Region’ (2011) 18 Aust. Int’l L J 127.

over the MAP and not a significant step forward to improve dispute resolution under tax treaties.

III. DISPUTE RESOLUTION UNDER INTERNATIONAL INVESTMENT AGREEMENTS

Tax-related investment disputes differ from other investment disputes in two respects: first, there is a special procedure prescribed for tax-related investment disputes - a claim cannot ordinarily be filed before an investor-state tribunal unless it is first referred to the competent authorities of the contracting states;²⁹² second, due to tax carve outs only certain substantive obligations such as those relating to expropriation are applicable to tax-related measures adopted by a state. The combined effect of tax veto and tax carve outs is that tax-related investment disputes are placed in a different category from other investment disputes arising from state measures such as environmental or labour laws. The following section examines only the special procedural aspects of tax-related investment disputes.

A. Investor-State Arbitration and Tax Veto

For tax-related investment disputes many IIAs expressly recognise an interpretive role for states. A typical provision provides that no investor can invoke the provisions of an IIA and allege expropriation if the competent authorities have jointly determined that it is not an expropriation.²⁹³ This implies that the investor in the first instance has to refer the question of whether the taxation measure is an expropriation to the competent authorities of the contracting states. The competent authorities may consider it but may not agree that the measure is not an expropriation in which case the investor may then submit its claim for arbitration. This may be viewed as akin to the ability of the states to issue a joint interpretive statement under Chapter 11 of the NAFTA.²⁹⁴ There are, however, three crucial differences in the interpretive authority prescribed under Chapter 11 of the NAFTA and that contemplated in relation to tax-related investment disputes.

²⁹² See Abba Kolo, 'Tax "Veto" as a Special Jurisdictional and a Substantive Issue in Investor-State Arbitration: Need for Reassessment?' (2008) 32 *Suffolk Transnat'l L Rev* 475; Abba Kolo, Thomas Wälde, 'Investor-State Disputes: The Interface between Treaty-Based International Investment Protection and Fiscal Sovereignty' (2007) 35 *Intertax* 424.

²⁹³ See, for instance, Art 2103(6), NAFTA; Art 8, Switzerland- Columbia BIT (2006); Art 14, Canada- China BIT (2012); Art 6, US Model BIT (2012).

²⁹⁴ The joint interpretive statement issued by the NAFTA under the auspices of the Free Trade Commission has attracted significant academic attention. See William W. Park, 'The New Face of Investment Arbitration: NAFTA Chapter 11' (2003) 28 *Yale J Int'l L* 365; Tod Weiler, 'NAFTA Investment Arbitration and the Growth of International Economic Law' (2002) 36 *Canadian Business L J* 405; Anthea Roberts, *supra* note 220.

First, in tax-related investment disputes, the investor is required to first refer the dispute to the competent authorities of the state.²⁹⁵ This requirement is generally couched in a mandatory language and the investor cannot bypass it. If the investor does not refer the dispute to the competent authorities in the first place, the investor-state tribunal can potentially reject the claim on grounds of admissibility.²⁹⁶ Second, the states through their competent authorities are generally given a specific time period of 6 or 9 months to make a joint determination. Once the specified time period lapses and the states fail to make any determination, it is open for the investor to proceed with its claim before an arbitral tribunal. This marks a clear demarcation of the role of a state - it is empowered to influence the fate of the dispute as a treaty party but it ceases to act so once it becomes a respondent/potential respondent in the dispute.²⁹⁷ Thus, it avoids the possible confusion that could be created with a state being a respondent in a dispute and simultaneously being able to issue a joint determination (in its capacity as a signatory to a treaty) that the taxation measures complained of do not amount to expropriation. A state cannot ordinarily assume the role of an interpreter during arbitral proceedings. Third, in tax-related investment disputes the states can only give a negative interpretation i.e. the joint statement issued by the states can only say that the taxation measures do not amount to expropriation. There is no scope for the states to clarify the scope of tax carve outs included in the IIA or otherwise issue a detailed interpretive note. However, it needs to be noted that some aspects of tax veto are still unclear.

To begin with, if the authorities arrive at a joint determination after the prescribed period of 6 or 9 months, as the case may be, is the arbitral tribunal obliged to take into account such determination? If so, what is the extent to which such determination should guide the findings of the tribunal? The ECT expressly mentions such a situation. It provides that where the

²⁹⁵ See, for instance, Art XII, Canada-Ecuador BIT (1997). The Canadian Model BIT requires that the investor refer the dispute to the competent authorities *at the same time* as it files an arbitration claim. However, the claim for breach of agreement will only be considered if the taxation authorities within 6 months do not determine that the measure is not in breach of an agreement. See Art 16(3), Canada Model BIT (2004).

²⁹⁶ *Plama Consortium Ltd v Republic of Bulgaria* (Final Award, 27 August 2008) para 266 (the tribunal observed that under Article 21 of the ECT if an investor claims that a 'tax constitutes or is alleged to constitute an expropriation or is discriminatory, the Investor must refer the issue to the competent tax authority, which Claimant did not do.' The tribunal, however, dismissed the claim of investor on merits).

²⁹⁷ The ECT makes a departure in this regard from other BITs. It provides that the adjudicating bodies 'may also take into account any conclusions arrived at by the competent tax authorities after the expiry of the six-month period.' See Art 21(5)(b)(iii), ECT; Also see Anthea Roberts, *supra* note 220 (The author argues that instead of being limited to interpretive bodies such as those provided under the NAFTA, if tribunals take into account subsequent agreements and practice it would greatly benefit investment treaty interpretation).

authorities arrive at a joint determination after the prescribed period, such joint determinations have a persuasive value before the tribunal.²⁹⁸ Thus, once the prescribed period is over, the arbitral tribunal is under no obligation to adhere to the conclusions of the competent tax authorities - the obligation is only to take the joint determination into account. In *Yukos Universal*, the tribunal went a step ahead and observed that the mechanism of referral to competent authorities is designed to assist the tribunals to distinguish between normal and abusive taxes. The tribunal added that if there was no possibility that the competent authorities would be able to come to some timely and meaningful conclusion on the dispute - referring the dispute to the competent authorities would be futile.²⁹⁹ The observations of the tribunal are not supported by Article 21 of the ECT which clearly provides that if the investor does not refer the dispute to the competent authorities, the adjudicating bodies called to settle the dispute 'shall make a referral to the relevant Competent Tax Authorities.'³⁰⁰

Agreements like the Comprehensive Economic and Trade Agreement (CETA) have incorporated the provision for referral to the competent authorities, but it is not mandatory and the onus is on the respondent.³⁰¹ The CETA provides that when the investor submits a request that the taxation measure of a state violates substantive obligations, 'the *respondent may refer* the matter for consultation and joint determination by the Parties'.³⁰² Further, the request by the respondent cannot be made later than the date the tribunal fixes for the respondent to submit its counter memorial.³⁰³ Additionally, the CETA provides that the joint determination by competent authorities must be between 180 days, but like most IIAs is silent about the value of a joint determination if it is arrived after 180 days. A clearer position on this aspect is required to prevent unnecessary complexity in arbitration proceedings. States need to clarify whether after the prescribed time period, the competent authorities no longer have the authority to issue a joint determination or whether a joint determination can still be issued but shall remain only of persuasive value. In my view, the former approach is better -

²⁹⁸ Art 21, ECT.

²⁹⁹ *Yukos Universal Award*, *supra* note 160, at paras 1417-1429. The other awards that resulted from the same fact situation are: *Veteran Petroleum Ltd (Cyprus) v The Russian Federation* PCA Case No. AA 228 (Final Award, 18 July 2014); *Hulley Enterprises Ltd v The Russian Federation* PCA Case No. AA 226 (Final Award, 18 July 2014); *Quasar De Valores SICA SA, Orgor De Valores SICA SA, GBI 9000 SICA SA and Alos 34 SL v The Russian Federation*, SCC No. 24/2007 (Award, 20 July 2012); *RosInvest UK Ltd v The Russian Federation* (Final Award, 12 September 2010) (collectively referred to as the 'Yukos awards' in this thesis).

³⁰⁰ Art 21(5)(b)(i), ECT.

³⁰¹ The text is available at <http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/>

³⁰² Art X 06, para 7 (emphasis added).

³⁰³ *Ibid.*

it shall clearly demarcate the authority of the competent authorities and the time period within which they can exercise it.

With respect to another aspect of tax-related investment disputes, the Canadian Model BIT provides that ‘if an issue arises as to whether a measure of a Party is a taxation measure, a Party may refer the issue to the taxation authorities of the Parties.’³⁰⁴ It is provided that the decision of the tax authorities shall bind the arbitral tribunal and in case they do not arrive at a decision within 6 months of the referral, the arbitral tribunal shall decide the issue. It is interesting to note that in this case, the power to refer to the taxation authorities is given to ‘a Party’ - the contracting states and not the investor. Thus, a respondent state can refer the dispute to the competent authorities even after the commencement of the arbitral proceedings. The rationale of the provision is unclear. Once arbitral proceedings have begun, why should the competent authorities be allowed to determine whether the complained measure is a taxation measure? In addition, why should their opinion be binding on the tribunal? If the intent is to get an expert opinion of the tax authorities, opinions of tax experts can be provided during the arbitral proceedings itself. If the intent is to give the competent authorities additional time to form their opinion about the complained measures - the time period when the measure is first referred to them can be extended.

The above mentioned provision of the Canadian Model BIT casts suspicion on the ability of an arbitral tribunal to distinguish taxation measures from non-taxation measures. If tribunals can distinguish regulatory measures from expropriatory measures, they can certainly distinguish taxation measures from non-taxation measures or taxation measures disguised as expropriation. The above mentioned provision also gives the respondent state the ability to delay the arbitration proceedings. More often than not, especially in indirect expropriation, the state will affirm that the measure in dispute is a bona fide taxation measure. This provision allows the state to pursue delay tactics and unjustifiably increases state control over tax-related investment disputes - unjustifiably.

The provisions relating to tax vetoes are also silent on the scope of jurisdiction vested in the competent authorities. It is unclear that if the authorities jointly determine that the measure does not amount to expropriation - can the investor still file a claim before the investor-state tribunal for denial of fair and equitable treatment and/or breach of non-discrimination? The

³⁰⁴ Art 16(6), Canadian Model BIT (2004); Also see Art 36(6), 2009 ASEAN Comprehensive Investment Agreement (gives power to representatives of tax administrations of the contracting states to determine if the subject measure is a ‘taxation measure’).

provisions of the IIAs do not provide a clear answer to this question.³⁰⁵ Alternately, if the investor only claims a violation of fair and equitable treatment and no expropriation claim - is it still obliged to first refer the dispute to the competent authorities. IIAs commonly only mention that the competent authorities can jointly determine that the measure is not an expropriation - there is no mention of other substantive obligations that are applicable to taxation measures. The dispute between Gottlieb and Canada illustrates this aspect.

In October 2007, Gottlieb Investors Group issued a Notice of Intent under the NAFTA to Canada.³⁰⁶ Gottlieb claimed that due to Canada's change in the tax treatment of income trusts in the energy sector, investors experienced capital losses. Gottlieb alleged that Canada's actions were arbitrary, discriminatory and inconsistent with the obligations of Canada under the NAFTA to provide national treatment, fair and equitable treatment and to not expropriate an investment. In April 2008, the competent authorities of US and Canada reached a conclusion that the taxation measures of Canada cited in Gottlieb's Notice of Intent are not an expropriation under Article 1110 NAFTA.³⁰⁷ Subsequent to the joint determination, Gottlieb did not pursue the arbitration against Canada.

The above mentioned dispute between Gottlieb and Canada sheds some light on the provision of tax veto, at least in respect of the NAFTA. First, even though Gottlieb in its Notice of Intent alleged violation of various substantive obligations, the joint determination by US and Canada that there was no expropriation effectively ended the investor-state arbitration initiated by Gottlieb. It is possible to extrapolate from the above mentioned dispute that a joint determination by competent authorities effectively extinguishes an investor's claim in tax-related investment dispute even if it relates to substantive obligations other than expropriation. However, the text of the NAFTA does not support the fact that an investor cannot pursue claims apart from expropriation even after a joint determination by the competent authorities.³⁰⁸ The joint determination is only applicable to expropriation. Secondly, the joint determination reveals that in exercising their power of tax veto, the

³⁰⁵ The Canadian Model BIT is an exception where it separately mentions the authority of the taxation authorities to determine that a measure is not in contravention of the BIT and the authority to determine that it is not an expropriation. See Art 16(3) and Art 16(4), Canada Model BIT (2004).

³⁰⁶ *Gottlieb et al v Govt of Canada* (Notice of Intent, 30 October 2007). All the documents cited in relation to this dispute are available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gottlieb.aspx?lang=eng>

³⁰⁷ Letter to US authority (22 April 2008); Response from US authority (23 April 2008).

³⁰⁸ See Response from US authority, *supra* note 307 (stating that the taxation of measures listed in the Notice of Intent do not constitute expropriation, but adding that 'I understand that this determination by the competent authorities results in no prejudice to the Gottliebs' remaining claims in their notice of intent.').

competent authorities need not provide any reasons for their conclusion.³⁰⁹ The competent authorities may just simply term that the state measure in dispute does not amount to expropriation. Thirdly, it is unclear that the exercise of tax veto is only limited to investor-state arbitration. It needs to be clarified that the exercise of tax veto does not (and should not) prejudice the investor from seeking compensation in domestic courts of the host state. It is well-established that an expropriation, lawful or otherwise, triggers an obligation on the state to pay compensation.³¹⁰ Unless the state merely imposes a tax, using tax veto to decide that the alleged action of the host state does not amount to expropriation can prejudice the lawful claim of the investor to seek compensation for the loss of its property.³¹¹ This aspect needs more clarity to determine the effect of tax veto.

Whether States exercise tax veto and arrive at a joint determination is influenced by various factors. Authorities can arrive at a joint determination due to the alignment of the interests of the home state and the investor, the alignment of the interests of the home state and the host state or due to the nature of the measure in question. Where the interests of the home state and investor align, the home state may not go to the extent of giving a joint determination, for it will scuttle the claim of the investor. Political circumstances permitting, the home state may attempt to negotiate and resolve the dispute but may not go beyond negotiations. Where the interest of the home state concurs with the host state - a joint determination may be more probable. For instance, where the home state anticipates that a similar claim can be made against it in the future, it may seek to co-operate with the host state in order to seek similar co-operation from it in the future. Thus unless a common interest is involved, joint determinations may not materialise. In addition to this, the nature of the measure complained of can also impact the probability of a joint determination. For instance, the facts may be insufficiently clear, the tax claim may be intertwined with other measures such as those relating to foreign exchange regulations or environment laws in such cases the competent authorities may simply be incapable of arriving at a joint determination due to complexity of facts.

³⁰⁹ Letter to Gottlieb Investors Group Indicating Determination (29 April 2008) (merely stating that the competent authorities of US and Canada have jointly determined that Canada's measures are not expropriation. No reasons or other details are provided).

³¹⁰ See generally Sergey Ripinsky, Kevin Williams, *Damages in International Investment Law* (British Institute of International and Comparative Law 2008).

³¹¹ Although the amount of compensation in lawful expropriation may be less than in an unlawful expropriation. See James Crawford, *supra* note 13, at 573.

There are two implications of tax veto I would like to state before concluding this subsection. Tax veto ensures state control. The underlying theme of tax veto is that as compared to other investment disputes there is a greater degree of state control in a tax-related investment dispute.³¹² The special procedural requirement for tax-related investment disputes has an ambivalent effect: it can be used as a cooling off provision to allow the competent authorities of both states to resolve the issue bilaterally and screen frivolous complaints; but since it also provides the power to block the arbitration - it can also be detrimental to the interests of the investors. This concern is amplified by the competent authorities' lack of obligation to provide reasons for their joint determination - leaving it susceptible to misuse. The interpretive authority provided to the competent authorities does have certain advantages as compared to the general interpretive powers provided in the IIAs such as the prescription of a specific time period within which to exercise the power of tax veto, the limited interpretive authority to decide if the measure is expropriation or not; but it leaves several aspects unaddressed and uncertain.

Also, IIAs provide for a procedural step like tax veto only for tax-related investment disputes. Thus, tax veto contributes to the uniqueness of tax-related investment disputes and distinguishes it from non-tax related investment disputes.³¹³

B. Tax Veto and the Mutual Agreement Procedure

Having examined the institutions of the tax veto and the MAP, I now compare tax veto under IIAs with the MAP under tax treaties. It will help us better understand the relative advantages and disadvantages of both the dispute resolution mechanisms. Table 1 below summarizes the comparison between tax veto and the MAP on aspects such as transparency, nature of tax disputes, the time limit prescribed for each of the remedies.

³¹² See Andreas Kulick (ed.), *Reassertion of Control over the Investment Treaty Regime* (Cambridge University Press 2016) (for a detailed discussion on the various means through which states assert actually assert or try to assert control over the interpretation and application of IIAs. Withdrawal from IIAs, state-state arbitration, joint treaty interpretation and arbitrator selection are some of the means used by states to assert control in IIL.).

³¹³ For a detailed argument on the uniqueness of tax-related investment disputes, see Chapters 3, 4, and 5 below.

TABLE 1: A COMPARISON OF TAX VETO AND THE MAP

Element of Comparison	Tax Veto	The MAP
Nature of the Remedy	A filter for arbitrations	A consultative mechanism between states
Nature of Tax Disputes	Disputes relate to double taxation under tax treaties	Disputes relate to state obligations under IIAs
Transparency	No obligation to provide reasons	No access to decisions
Role of the States	Investor does not participate	Taxpayer is marginal to the proceedings
Duration of Proceedings	6-9 months	As a rule, there is no prescribed time limit
Relationship to Arbitration	Independent of investor-state arbitration	Tax arbitration extends the MAP

As mentioned in the previous Section II.C, I understand the MAP as a consultative mechanism or at best an administrative remedy. The tax veto, on the other hand, is a procedural step, and ordinarily a mandatory step before initiating investor-arbitration in a tax-related investment dispute. If successfully exercised, it can filter arbitration claims. Under tax treaties, if no decision is reached under the MAP then the complainant can approach the domestic courts of the relevant state or alternately resolve the dispute under tax arbitration.

The complainant retains the option of choosing either of the two paths even if an unsatisfactory decision is reached under the MAP. However, a tax veto, if successfully exercised, scuttles arbitration claims. Only if a tax veto is not exercised that the investor usually proceeds with the claim before an investor-state tribunal. Thus, while both the MAP and tax veto can be viewed as a step towards a judicial remedy or arbitration, the crucial difference is that tax veto has the power to scuttle arbitration claims.

The second distinguishing factor is the nature of disputes that are handled under both dispute resolution mechanisms. It has been suggested that the disputes under tax treaties can be called indirect international disputes since they usually do not start with an international character.³¹⁴ Usually it is the unresolved domestic tax disputes that become international tax disputes between the states.³¹⁵ The persuasive value of such an argument aside, it is nonetheless undeniable that disputes under tax treaties relate to actual or potential double taxation, while in IIAs - the dispute centres around the protection of the investment, rights of the investor and protection of the investment. Thus, while tax is a common element, the nature of disputes that are handled under tax treaties and IIAs are very different.

The previous Sections reveal that the prominent limitations of both the MAP and tax veto are the lack of transparency and the fact that there is a greater control by the states while the taxpayer/investor is marginalised. Both accord pre-eminence to the state authorities or competent authorities and ensure significant state control over the dispute resolution mechanisms under the respective treaties. And, there is little access to the decisions under the MAP while the decisions under tax veto are unaccompanied by any reasoning.

With respect to arbitration, the form of arbitration proposed and incorporated in some of the tax treaties is fundamentally different from investor-state arbitration that is part of IIAs. An investor has greater control and participation in arbitral proceedings before an investor-state tribunal. While, this is not the case in tax arbitration which has not been incorporated as an independent remedy but rather an extension of the MAP. Investor-state arbitration is, however, not an extension of tax veto - both mechanisms have a distinct role in resolving a tax-related investment dispute under the relevant IIA. The only time tax veto and investor-state arbitration overlap is when the state authorities arrive at a decision after the prescribed

³¹⁴ Nii Lante Wallace-Bruce, *The Settlement of International Disputes: The Contribution of Australia and New Zealand* (Martinus Nijhoff 1998) 13.

³¹⁵ Gerrit Groen, 'Arbitration in Bilateral Tax Treaties', *Intertax*, 30/1 (2002) 3.

period and the relevant IIA provides that the decision will have a persuasive value before the arbitral tribunal.

C. Disputes under Tax Treaties and Investor-State Arbitration

Certain IIAs contemplate that some disputes that arise under tax treaties can be adjudicated under IIAs. For instance, the Ecuador-US BIT provides that the dispute settlement provisions in the BIT do not apply to tax matters ‘to the extent they are not subject to the dispute settlement provisions of a tax treaty, or, if so subject, have been raised under a tax treaty’s dispute settlement procedures and are not resolved in a reasonable period of time.’³¹⁶ The implication of such a provision is that disputes under tax treaties can theoretically be argued before an investor-state tribunal. There are no publicly known awards where this route has been utilised by a taxpayer, but it presents interesting possibilities.

First, it suggests that there is a category of tax disputes that can be argued before an investor-state tribunal but need not be first subjected to the tax veto power of the competent authorities. The above mentioned provision states that if a taxpayer refers a dispute to the competent authorities under a tax treaty and the same is not resolved within a reasonable time, the additional option is to initiate investor-state arbitration. Before initiating investor-state arbitration, should a taxpayer again refer the claim to the competent authorities, but in their interpretive capacity prescribed under the IIA? If the intent of the above provision is to prevent further delay in the resolution of the dispute, it makes little sense to subject it to a procedural path that will further involve a minimum delay of 6-9 months. If the intent of the provision is to provide an alternative dispute resolution forum for the tax dispute, it will be negated if the competent authorities under the tax treaty and the IIA are the same. In both scenarios, the reasonable option should be to allow the taxpayer to directly file a claim before an investor-state tribunal without insisting on the procedural requisite of tax veto.³¹⁷

Second, taxpayers may have recourse to investor-state arbitration when the dispute under the tax treaty has not been settled in a reasonable period of time. As pointed out in Section II.C above, most tax treaties only provide for the MAP under which the competent authorities are

³¹⁶ Art X, US-Ecuador BIT (1993).

³¹⁷ It is also possible that the investor may seek to avail investor-state arbitration if it is confident that tax veto will not be unjustly exercised since a successful exercise of tax veto will require the consent of investor’s home state. At the same time, if a tax veto has been exercised, the investor may not be able to initiate arbitration under the relevant BIT.

under no time-related obligations to arrive at an agreement. What should then be a reasonable period of time and who should decide if it is reasonable? Tax treaties that incorporate the provision of tax arbitration provide us a clue as to what could be construed as a reasonable period of time. Typically, tax treaties provide for tax arbitration if a dispute has not been resolved within 2 years by the competent authorities.³¹⁸ A similar yardstick can be applied by an investor-state tribunal if a claim under the above mentioned provision is brought before it. The provision can then be interpreted to mean that if a claim under the MAP is not resolved within 2 years - the aggrieved taxpayer can then choose to file a claim before investor-state arbitration or to resolve the dispute under tax arbitration, if provided in the relevant tax treaty. Another possibility is to simultaneously pursue tax arbitration and investor-arbitration, which may bring with it the challenge to co-ordinate both the arbitration proceedings.³¹⁹

There is no known instance where a taxpayer has resorted to investor-state arbitration for a dispute arising under a tax treaty, but a possibility for the exercise of such an option remains open. The absence of any such claims by investors under IIAs should not be understood as their inability to actually bring such claims. This is especially when investor-state arbitration is being increasingly utilised for a wide scope of claims that were not earlier foreseeable.³²⁰ Given that dispute resolution under tax treaties is controlled by the states and the taxpayer has little control and influence over proceedings - recourse to investor-state arbitration under the above mentioned provision is likely to be viewed with favour by many taxpayers who bring arbitration claims.

To conclude this Section, there is state control of the dispute resolution mechanisms under both tax treaties and IIAs. While state control is pervasive under the former, the latter prescribe a procedural rule whereby states can pre-empt third part adjudication in tax-related investment disputes. A greater role for states in tax-related investment disputes is at times justified by reference to sovereignty considerations, but its counter-argument is that threats to a state's sovereignty due to loss of power to make environmental regulations

³¹⁸ See, for instance, Art 25, US-Germany tax treaty (1989).

³¹⁹ See Joost Pauwelyn, 'Adding Sweeteners to Softwood Lumber: The WTO-NAFTA Spaghetti Bowl is Cooking', (2006) 9 J Int'l Eco L 197 (For a discussion on the complications that can arise from simultaneous proceedings on a dispute that arises from the same set of facts).

³²⁰ Investor-state arbitration has recently been used to secure protection of IP rights such as patents and trademarks. See Henning Grosse Ruse-Khan, 'A Conflict-of-Laws Approach to Competing Rationalities in International Law: The Case of Plain Packaging between IP, Trade, Investment and Health' (2013) 9 J Private Int'l L 309.

constitute are no less a threat than the sovereign prerogative than tax.³²¹ This need not necessarily lead to a complete absence of state control over tax dispute resolution - which is neither desirable nor feasible. At the same time, the current role of tax veto under IIAs suffers from various shortcomings of uncertainty and opaqueness. Also, proposals for improvement of tax arbitration are unlikely to yield desired results until the current opaque framework of dispute resolution process is reformed.³²² It is suggested that an evaluation of the role that states can play through joint interpretive agreements combined with certain changes to the dispute resolution mechanism can go a long way in improving the rule of law for taxpayers. This is discussed in the following Section.

IV. ROLE OF STATES - THE WAY FORWARD

A state is not only a potential respondent in investor-state disputes but as a treaty party also has an interest in the interpretation of the IIA.³²³ Once a treaty is concluded between two or more states, irrespective of the nature or subject matter of the treaty, states can influence the interpretation of the treaties. This can be either through their subsequent practice or a subsequent agreement. Both are potentially very useful tools in the hands of the states especially, to prevent treaty interpretations by a third party dispute settlement mechanism that does not reflect their intentions. They are, however, rarely used by the states and partially due to the same reason rarely relied on by the courts and arbitral tribunals. In the sphere of international tax where sovereignty considerations are omnipresent and states seek to control all the decisions - subsequent agreements can help to resolve the challenge of

³²¹ See William W. Park, *supra* note 221.

³²² The efficacy of international tax arbitration cannot be enhanced unless the international tax relations also lead to greater co-operation. Emphasising on mandatory arbitration without taking into account the broader international tax relations is counter-productive. See Barbara Koremenos, 'If Only Half of International Agreements have Dispute Resolution Provisions, Which Half Needs Explaining?', (2007) 36 J Legal Studies 189, at 208-209 (concluding an empirical study of international agreements by stating that - different cooperation problems imply different needs for dispute resolution provisions and that states include externally delegated dispute settlement mechanisms only when the cooperation problems have eased) ; Also see J.G. Merrills, *International Dispute Settlement* (Cambridge University Press 2005) 177 (stating that sometimes 'too much' is expected of judicial settlement and it is important not to become fixated with adjudication); Robert A. Green, 'Antilegalistic Approaches to Resolving Disputes between Governments: A Comparison of the International Tax and Trade Regimes' (1998) 23 Yale J Int'l L 78 (comparing dispute settlement of international tax and trade disputes and suggesting that it makes sense for intergovernmental tax disputes to remain less legalistic).

³²³ Anthea Roberts, *supra* note 220; Also see Shaheez Lalani, et al. (eds.), *The Role of the State in Investor-State Arbitration* (Brill/Nijhoff 2015).

providing for independent third party adjudication and addressing state concerns about preservation of sovereignty.

An ongoing project of the International Law Commission on ‘Subsequent Agreements and Subsequent Practice in Relation to Interpretation of Treaties’ has released a few initial reports.³²⁴ The preliminary conclusion of this Study Group is that while there are some examples of tribunals using subsequent agreements by parties to interpret an ambiguous provision of a treaty - such as the Elements of Crimes adopted by the ICC Assembly of States Parties or the joint interpretive statement issued by the NAFTA parties under the auspices of the Free Trade Commission - as a general matter such interpretive statements are relatively rare.³²⁵ The report states that its survey of the specialized regimes has led to the conclusion that ‘adjudicatory bodies have rarely relied on subsequent agreements in the sense of Article 31(3) (a) [of the] VCLT.’³²⁶ In the backdrop of this observation, in this Section I discuss the current and possible future role of subsequent agreements in ITL.

A. The Interpretation of Tax Treaties

A plain reading of Article 25 of the OECD Model suggests that it provides for three roles of competent authorities - to resolve claims of taxpayers unilaterally, to attempt to reach a joint agreement with its counterparts to resolve disputes and to resolve difficulties in the interpretation and application of the treaty. The first and second roles, as discussed above in Section II.C, overlap. Nonetheless, the joint interpretive functions as envisaged in the second and third roles need a more detailed analysis. Ordinarily tax treaties provide for two kinds of interpretive disputes that can be jointly resolved by the competent authorities - dispute resolution of the specific case brought to the notice of competent authorities by the taxpayer and second kind of disputes that involve resolving difficulties that arise from the interpretation and application of the tax treaty more generally. The role that the competent authorities play in both situations differs.

³²⁴ George Nolte, *Introductory Report for the Study Group on Treaties over Time, Jurisprudence of the International Court of Justice and Arbitral Tribunals of Ad Hoc Jurisdiction Relating to Subsequent Agreements and Subsequent Practice* (2010) (hereinafter ILC First Report); Georg Nolte, *Second Report for the ILC Study Group on Treaties over Time, Jurisprudence Under Special Regimes Relating to Subsequent Agreements and Subsequent Practice* (2011) (hereinafter ILC Second Report); Georg Nolte, *Third Report for the ILC Study Group on Treaties Over Time: Subsequent Agreements and Subsequent Practice of States Outside of Judicial or Quasi- Judicial Proceedings* (2012).³²⁵ ILC Second Report, *supra* note 324, at 111.

³²⁶ *Ibid*, at 51.

1. Interpretive Agreements on Specific Disputes

Tax treaties provide that the competent authorities can jointly agree whether or not the tax imposed on the taxpayer is in accordance with the tax treaty. The primary role of the competent authorities in these situations is to resolve the dispute and arrive at a solution that alleviates the tax liability of the taxpayer. The concern of the authorities is to apply the tax treaty to the specific dispute brought to their attention. While the process of arriving at a joint agreement can certainly be improved, it is equally vital that the agreement should be publicly available.³²⁷ Irrespective of the taxpayer's acceptance or rejection of the joint agreement, it should be made public.

If the taxpayer does not accept the agreement reached under the MAP and proceeds to initiate or resume proceedings before a domestic court - the court can refer to and take into account the joint agreement reached by the competent authorities under the MAP. However, the current unavailability of the joint agreement denies such an opportunity to the national courts. If the joint agreement is made publicly available, it is possible to increase the likelihood of domestic courts of the contracting states interpreting the tax treaty more harmoniously instead of giving different and divergent interpretations of the same treaty.³²⁸ The intention of the treaty parties can be more clearly spelled out in a joint agreement and it can aid the courts in interpreting the treaty. In my view, the joint agreement between competent authorities contemplated under tax treaties certainly qualifies as a subsequent agreement under Article 31(3)(a) of the VCLT. There is no bright dividing line between subsequent agreement and practice; but as long as the parties intend that their understanding forms a basis for treaty interpretation, it should be understood to constitute as a subsequent agreement.³²⁹ Thus, subsequent agreements can and should be used to interpret the tax treaties.³³⁰ The first step in that direction is to make the joint agreements public.

2. Interpretive Agreements on 'Interpretation and Application of the Convention'

The second kind of interpretive agreements tax treaties contemplate are of a more general nature. They do not concern a specific dispute or a taxpayer but provide for states to issue

³²⁷ Allison Christians, *supra* note 258.

³²⁸ See Michael Lang (ed.), *Tax Treaty Interpretation* (Kluwer Law International 2001) (a detailed compilation of the role of national courts in treaty interpretation in various jurisdictions).

³²⁹ See Anthea Roberts, *supra* note 220, at 199-200 (stating that subsequent agreements can range from a jointly signed document to a series of acts or communications from which an agreement can be inferred. And that more informal the basis of agreement the more it tends to overlap with subsequent practice).

³³⁰ See generally George Nolte (ed.), *Treaties and Subsequent Agreements* (Oxford University Press 2013).

joint interpretative statements that, for instance, may resolve doubts about the meaning of certain provisions. Even though the parties involved in issuing a general interpretation of the tax treaties are generally the same as those entrusted to resolve the specific disputes of the taxpayer, they act in a different capacity and the nature and function of the interpretative statements is different.³³¹ First, in resolving specific disputes the competent authorities act as tax experts; the focus is on resolving the particular dispute before them. However, in issuing the interpretive statements - they act as treaty parties and potential respondents in the disputes that may arise in future under the treaties. Second, while acting as tax experts, the focus of the competent authorities is usually narrower and limited to the facts involved in the dispute. In contrast, when acting as interpreting bodies the aim is to facilitate a more coherent legal framework. General interpretive statements are usually not addressed to one particular taxpayer; they may be intended to reduce frequency of certain kinds of disputes or clarify ambiguity in certain provisions of the tax treaties. General interpretive statements can be extremely useful to many taxpayers and can provide a more predictable legal framework of tax liabilities since they are not limited to a specific taxpayer.³³² The use of subsequent agreements may raise the possibility of states suffering from role confusion - role as treaty parties and role as an adjudicating body resolving disputes. However, in my opinion, the two functions are conceptually distinct and if the relevant state actors are discerning, confusion is unlikely.

The joint interpretive statements by competent authorities, contemplated under tax treaties that concern the 'interpretation and application of the convention' also amount to subsequent agreements under Article 31(3)(a) of the VCLT. These interpretive statements can also be relied on by the domestic courts of both the states that are frequently required to interpret the tax treaties. Unfortunately, competent authorities rarely exercise this power. The rare use of joint interpretive mechanism provided in the tax treaties does not adequately serve the interests of taxpayers. Further, it prevents any development of rules and evolution of the jurisprudence in ITL.

Interpretive statements in ITL also assume significance because tax treaties only contain a bare bone structure for demarcating the jurisdictions of the contracting states. The text of the tax treaties alone provides little guidance to taxpayers about the possible tax liabilities.

³³¹ OECD Manual, *supra* note 251.

³³² See generally Lara Friedlander, Scott Wilkie, 'The History of Tax Treaty Provisions - And Why it is Important to Know About It' (2006) 54 Canadian Tax J 907, at 910.

Similar provision of a tax treaty can be interpreted in divergent ways; for instance, interpretation of a particular provision can be influenced by various factors such as the interpretive practices of the national courts.³³³ In fact, the interpretation of tax treaties by national courts is a contributory factor in the development of ITL as a self-contained regime.³³⁴ The bare bone structure of tax treaties thus makes the case for a publicly available and a more frequently issued joint interpretive statement even stronger.

Currently, the common documents that are relied on by various national courts are the OECD Commentary and the UN Commentary.³³⁵ The reliance on commentaries and their relevance is contentious.³³⁶ Certain commentators are of the view that if a commentary has been updated since the conclusion of the tax treaty, the updated commentary is not relevant for tax disputes that arise under the treaty. This is because the updated commentary does not reflect the intention of the parties when they entered into the treaty.³³⁷ Others have suggested that an ambulatory approach to tax treaty interpretation (i.e. taking into account the updated commentary) should be adopted but only if the interpretation serves the object and purpose of the treaty.³³⁸ Both views are unconvincing. Completely ignoring the updates to the commentary may lead to ignoring any major changes that may be incorporated in the update in the intervening period. And, Juan Angel's suggestion to refer to updates only to serve the aims and objectives of the treaty gives a qualified role to the updates but does not adequately elaborate as to how to apply it. Michael Lang has articulated a more nuanced

³³³ See Gianluigi Bizioli, 'Tax Treaty Interpretation in Italy' in Michael Lang, *Tax Treaty Interpretation*, *supra* note 328, at 195-213 (discussing the Supreme Court of Italy's reluctance to employ the interpretative rules of the VCLT and the influence of 'domestic methods' to interpret tax treaties); Also see *Union of India v Azadi Bachao Andolan* (2004) 10 SCC 1 (Supreme Court of India insisting that 'rules of interpretation of in respect of international treaties are different to those applicable in respect of domestic law'); J Freeman, 'Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament' (2007) 123 LQR 53 (discussing that English courts adopt a strictly textual approach in interpreting both - domestic tax laws and tax treaties).

³³⁴ See Vik Kanwar, *supra* note 195; Also see *Union of India v Azadi Bachao Andolan*, *supra* note 333; *Hindalco Industries Ltd v Assistant Commissioner of Income Tax* (2005) 94 ITD 242 (Mumbai ITAT) ('The words employed in the tax treaties not being those of a regular Parliamentary draughtsman, the words need not be examined in precise grammatical sense or literal sense.').

³³⁵ OECD Commentary, *supra* note 168; Also see Sjoerd Douma, Frank Engelen (eds.), *The Legal Status of the OECD Commentaries* (IBFD 2008); In the case of certain US tax treaties, a 'Technical Explanation' is published which is comparable in nature to the OECD and UN Commentaries.

³³⁶ See Peter J. Wattel, Otto Marres, 'The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties' (2003) 43 European Taxation 222.

³³⁷ This is referred to as static interpretation of tax treaties. See Klaus Vogel, 'Double Tax Treaties and Their Interpretation' (1986) 4 Berkeley J Int'l L 1.

³³⁸ Juan Angel Becerra, *Interpretation and Application of Tax Treaties in North America* (IBFD 2007) 74-75 (he argues that the aims and objectives of the tax treaty are easy to identify since they are usually well-established during the negotiation and conclusion of the treaty).

view. He suggests that the updated commentary can be referred to but it is not binding on the courts.³³⁹ He further suggests that since the OECD Commentary is not binding on the treaty parties, it does not constitute subsequent agreements under Article 31(3)(a) of the VCLT.³⁴⁰ He argues that the changes in the OECD Commentary are relevant as subsequent practice under Article 31(3)(b) of the VCLT.³⁴¹ This is an important distinction.

The ILC First Report also distinguishes between subsequent agreement and subsequent practice.³⁴² The latter, it states, is ‘objective evidence of the understanding of the parties as to the meaning of the treaty’ while the former is ‘an authentic interpretation by the parties which must be read into the treaty for purposes of its interpretation.’³⁴³ Relying on ILC Study Groups’ Report and Michael Lang’s distinction, I submit that the OECD and UN Commentaries constitute subsequent practice while joint interpretive agreements discussed above are subsequent agreements. This distinction, thus, indicates that joint interpretative statements can play a complementary role to the OECD and UN Commentaries. When states agree, they can issue joint interpretative statements. For instance, the definition of Permanent Establishment or the tax liability of income from royalties. On matters that states do not agree or where rules are still evolving - states and national courts can rely on the relevant Commentaries of either the OECD or the UN. Thus, apart from the Commentaries, the joint interpretative statements can serve as an additional reference document for national courts and competent authorities to interpret the tax treaties.

Joint interpretive statements by states can be particularly useful if the tax treaty is between a developed and a developing state. Ordinarily, when a developed and a developing state enter into a tax treaty, the eventual treaty that emerges after negotiations generally incorporates provisions from both the models - the OECD Model and the UN Model.³⁴⁴ As discussed in Chapter 1, the OECD Model generally contains provisions which favour resident

³³⁹ Michael Lang, Florian Brugger, ‘The Role of the OECD Commentary in Tax Treaty Interpretation’ (2008)

³⁴⁰ Australian Tax Forum 95.

³⁴¹ *Ibid*, at 104.

³⁴² *Ibid*, at 103.

³⁴³ ILC First Report, *supra* note 324, at 5.

³⁴⁴ *Ibid*; Also see *Case Concerning Kasikili/Sedudu Island (Botswana v Namibia)* (1999) ICJ Rep 1087, at para 63 (where the court observed that evidentiary value is higher in the case of subsequent agreement than in the case of subsequent practice).

³⁴⁴ See generally Victor Thuronyi, ‘Tax Treaties and Developing Countries’ in Michael Lang, et al (eds.), *Tax Treaties: Building Bridges between Law and Economics* (IBFD 2010) 441.

states which in turn are primarily capital exporting states or resident states.³⁴⁵ The UN Model on the other hand contains provisions that are more inclined to the interests of the developing states - capital importing states or source states.³⁴⁶ In such situations, reliance on a single commentary - either of the OECD or the UN may not be particularly helpful. If the courts of one state rely on the OECD Commentary and the courts of the other contracting state rely on the UN Commentary - disputes on interpretation will be frequent. In such situations, joint interpretive statements can be a useful common document to assist in the interpretation of the tax treaty. Further, if in these situations there is contradiction between any Commentary and the joint interpretive statement - the latter should be given more weight. It is more likely to reflect the intention of the contracting parties.

In addition to the provision for joint interpretive statements, competent authorities have been given a mandate to even 'consult together for the elimination of double taxation in cases not provided for in the Convention.'³⁴⁷ This provision is generally intended to clarify matters that are not strictly speaking within the scope of the tax treaty but are closely related to the disputes that are within the scope of the tax treaties. Competent authorities can greatly improve the implementation of the tax treaties by more frequently identifying and pursuing opportunities to use this authority as well.³⁴⁸

Thus, in totality, joint interpretive statements can be a very important tool in the interpretation of tax treaties and need to be used more frequently by the states.³⁴⁹ They can play a very important and useful role and contribute to the development of a common and coherent jurisprudence in ITL. Further, it has been suggested that joint interpretive

³⁴⁵ See, for example, Art 5, OECD Model and the UN Model (the provision in the OECD Model, inter alia, provides that a building site, construction or installation project does not constitute a permanent establishment until it exceeds a 12-month period. Due to a 12-month threshold, it is difficult for a source state to exercise its jurisdiction to tax. On the other hand, the provision in the UN Model, inter alia, provides a 6-month period for a building site, construction or installation project to constitute a permanent establishment. Due to a lower time threshold in the UN Model, it is easier for a source state or a capital importing state to exercise its jurisdiction to tax).

³⁴⁶ *Ibid.*

³⁴⁷ Art 25(3), OECD Model; Also see OECD Manual, *supra* note 251, Best Practice [N°1 \(n 28\)](#) (Recommending that many issues of a general nature regarding the interpretation or application of a treaty could be successfully addressed by competent authorities' exercising their ability under the first sentence of Article 25(3) to reach a mutual agreement on those issues).

³⁴⁸ OECD Commentary, *supra* note 166.

³⁴⁹ However, George Nolte suggests that even when the parties to a treaty have the political will to enter into a subsequent agreement, they generally prefer to amend the treaty expressly. The latter approach is politically desirable for it prevents antagonising domestic actors normally involved in the treaty-making process. See George Nolte, *Treaties and Subsequent Agreements*, *supra* note 330, at 84.

statements can also be used a ‘safety valve’ to prevent jurisprudence from developing in unintended directions.³⁵⁰

B. International Tax Disputes - A Proposal for State-State Arbitration

The 1925 report of the League stated that it would be desirable in the future to consider the creation of an international organisation that ‘would undertake the duties of conciliation or voluntary and advisory arbitration between States in regard to the interpretation of the conventions concluded between them.’³⁵¹ The 1927 Model Convention of the League also mentioned that the Permanent Court of International Justice will be the last resort for states to resolve their disputes.³⁵² However, even today, there is no international body that adjudicates on international tax disputes and neither is such a proposal under serious consideration.³⁵³ However, an alternative to an international organisation is worth considering.

I propose that state-state arbitration - as an independent dispute resolution mechanism and unrelated to the MAP, can provide a better alternative to the existing dispute resolution mechanism under the tax treaties.³⁵⁴ State-state arbitration would be a better alternative for it would still allow the states to actively participate in dispute resolution, control various aspects of the adjudication process and it could be more transparent than the MAP and tax arbitration. By conceptualising state-state tax arbitration as an independent dispute resolution mechanism, the arbitral panel could be provided jurisdiction over the dispute in the first instance itself instead of requesting the arbitrators to address unresolved issues from the MAP. The jurisdiction of the tribunals can be decided beforehand under a common legal instrument. It would also allow formulation of rules that prevent conflicts of interest among the arbitrators and ensure the independence of arbitrators.

Further, state-state arbitration also has the potential to address some of the other criticisms of tax arbitration discussed above in Section II.D. State-state arbitration will be a form of

³⁵⁰ Christian J. Tams, et al. (eds.), *Research Handbook on the Law of Treaties* (Edward Elgar 2014) 406.

³⁵¹ 1925 report, *supra* note 49, at 30.

³⁵² Art 14, para 4, Draft Bilateral Convention for the Prevention of Double Taxation (1927); Also see Section II.B above.

³⁵³ See Edwin van der Bruggen, ‘Compulsory Jurisdiction of the International Court of Justice in Tax Cases: Do We Already Have an ‘International Tax Court?’ (2001) 29 *Intertax* 250.

³⁵⁴ See generally Anthea Roberts, ‘State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority’ (2014) 55 *Harvard Int’l L J* 1 (hereinafter Anthea Roberts, *State-to-State Arbitration*); Also see Michele Potestà, ‘Towards a Greater Role for State-to-State Arbitration in the Architecture of Investment Treaties?’ in Shaheez Lalani et al, *supra* note 323, at 249.

adjudication and not a non-binding consultative mechanism. In this respect, state-state arbitration has the potential to contribute to the evolution of jurisprudence in ITL. Subject to privacy of the taxpayer, awards can be made public instead of competent authorities arriving at solutions in secrecy. There is also a greater possibility to address triangular cases that arise in international tax - the third state can join the arbitral proceedings as an interested party. State-state arbitration could allow the respective states to argue their positions and their respective interpretations of the tax treaties and relevant provisions of the domestic tax laws thereby establishing a more robust system of jurisprudence.

Furthermore, there is a strong case for state-state arbitration if one looks at the nature of tax treaties. Tax treaties do not grant resident of either contracting states any substantive treaty rights. Tax treaties are best viewed as legal instruments that allocate jurisdiction of the contracting states and the resident is merely a beneficiary of the tax treaties; the benefit being the potential removal of the burden of international double taxation. The limited participation of the taxpayers in the dispute resolution of tax treaties is indicative that taxpayers have no enforceable rights under tax treaties. Enforceable remedies are available to a taxpayer only in the domestic courts. Anthea Roberts makes a persuasive case that IIAs should be reconceptualised as triangular treaties i.e. agreements between sovereign states that create enforceable rights for investors.³⁵⁵ It is doubtful if a similar case can be made in the context of tax treaties. Providing a taxpayer the right to directly bring a tax related claim against the contracting state is likely to change the nature of tax treaties; it would involve reconceptualising the nature of tax treaties that have remained largely unchanged since late 1920s. Providing enforceable rights to a taxpayer would be a more preferable option for it may significantly improve dispute resolution under tax treaties. However, it is unlikely that states would agree to provide such a right to the taxpayer. In such a scenario, state-state arbitration where a contracting state brings claims before an arbitral tribunal is a more plausible option and in my view, more likely to be acceptable to the states.

In IIL, the increasing number of investor-state disputes, the escalating costs of contesting the claims of the investors are some of the factors that have contributed to states seeking to play a more active role in international investment disputes. State-state arbitration is one of the

³⁵⁵ Anthea Roberts, 'Triangular Treaties: The Extent and Limits of Investment Treaty Rights' (2015) 56 *Harvard Int'l L J* 354.

possible means by which the states can play a greater role.³⁵⁶ Anthea Roberts has correctly argued that IIL contemplates the co-existence of both kinds of arbitration - investor-state arbitration and state-state arbitration.³⁵⁷ In the specific context of tax-related investment disputes, an argument for considering the potential role of state-state arbitration is worth exploring given the drawbacks and some of the limitations of tax veto.

Tax veto, as discussed above in Section III.A, has several shortcomings. States should reconsider if they desire to play a more active role in the adjudication of tax-related investment disputes. The tax veto, ordinarily, only allows the competent authorities of the contracting states to take a joint decision and disallow an investor's claim. Partly due to the provision of tax veto, a priority to state's role in tax-related investment disputes is evident; but in exercising their power of tax veto, states are under no obligation to provide reasons for the decision.³⁵⁸ This needs correction. Either the provision of tax veto should be reformulated to provide that the competent authorities need to pass a reasoned order; else, state-state arbitration should be given priority over investor-state arbitration in tax-related investment disputes. In the latter case, tax veto should be removed altogether. Certain tribunals have indicated that taxation constitutes a special category in international investment disputes.³⁵⁹ Giving priority of state-state arbitration over investor-state arbitration in tax matters would not be inconsistent with the views of some of the investor-state tribunals which have accorded comparatively greater deference to states in respect of taxation measures.³⁶⁰

In my view, state-state arbitration can overcome the present shortcomings of dispute resolution - both under the tax treaties and the IIAs. While a greater role for state-state arbitration under tax treaties is certainly advisable, it not possible to say the same with certainty in respect of tax-related investment disputes. But the current manner of dispute resolution in IIAs has certain drawbacks that can be corrected by a better appreciation of the roles that the states seek to play in tax-related investment disputes.

³⁵⁶ Even if international investment disputes are increasingly investor-state disputes, there is always an inter-state element involved for the investor is a national of one of the contracting states. See UNCTAD, *Dispute Settlement: State-State* U.N. Doc. UNCTAD/ITE/IIT/2003/1 (2003).

³⁵⁷ Anthea Roberts, *State-to-State Arbitration*, *supra* note 354; Also see Rudolf Dolzer, Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995) 119 ('Virtually all BIT's contains provisions calling for the settlement by arbitration of disputes between the contracting parties over the interpretation or application of the BIT. These may be characterized as inter-governmental disputes.').

³⁵⁸ See *Gottlieb Investors et al v Govt of Canada* discussed in Section III.A above.

³⁵⁹ See *EnCana* award, *supra* note 211, at para 177. For more details see Chapter 4 and 5 below.

³⁶⁰ *Ibid.*

V. CONCLUSION

Dispute resolution under tax treaties is not ideal due to the secrecy and uncertainty surrounding the entire process. The MAP is inefficient partially due to the involvement of states which are usually under no obligation to resolve a dispute within a specific period. With the introduction of tax arbitration, there is partial recognition of the need to increase the taxpayer's involvement in dispute resolution under tax treaties. However, little headway is likely to be made unless the opaque nature of dispute resolution is removed and a more meaningful participation for the taxpayer is provided. The nature of dispute resolution in tax treaties still resembles the original dispute resolution proposed by the League in its Model Convention of 1927. Due to the fact that state dominates and the taxpayer is marginalised, it is fair to say that dispute resolution in tax treaties has not evolved significantly as compared to other sub-disciplines of international law such as IIL.

In IIL, investor-state arbitration provides investors a direct remedy against the host state. However, in tax-related investment disputes states have a pre-emptive role. The provision of 'tax veto' can scuttle initiation of arbitration by an investor. Here again, there is not complete transparency and states have extensive power to scuttle investor-state arbitration in tax-related investment disputes and that too without providing any reasons. Thus, both under tax treaties and IIAs, there is a common challenge to improve international tax dispute resolution by balancing the interests of the three parties involved - the taxpayer/investor and the two contracting states.

To address the above mentioned challenge, I suggested that state-state arbitration should be introduced in tax treaties and its role in tax-related investment disputes should also be evaluated. I argue that state-state arbitration is a better dispute resolution mechanism than tax arbitration as proposed by the OECD and now also incorporated in some tax treaties. State-state arbitration, I suggest, will allow states to control various aspects of dispute resolution and at the same time allow for the evolution of a genuine IIL jurisprudence. It would be advantageous for the development of IIL as a sub-discipline of international law, provide more certainty to taxpayers and lead to a more coherent framework for resolution of disputes on international taxation. In IIL, states should consider if state-state arbitration should be given a priority over investor-state arbitration or else remove the various limitations of tax veto.

CHAPTER 3

JURISDICTION, ADMISSIBILITY, AND COUNTERCLAIMS IN TAX-RELATED INVESTMENT DISPUTES

I. INTRODUCTION

Jurisdiction refers to the scope of a tribunal's authority over the dispute while admissibility refers to the appropriateness of the claim at the time.³⁶¹ Inadmissibility results from defects in the claim itself. While the tribunal may be empowered to adjudicate, the claimant may not have followed the prescribed procedure - for instance, it may have failed to exhaust local remedies. Both jurisdiction and admissibility concern the preliminary stages of the proceedings and tribunals frequently adjudicate on these threshold issues separately before proceeding to examine the merits of the claim.

Despite numerous awards on jurisdiction, investor-state tribunals have not used the terms jurisdiction and admissibility consistently. At times, the same term - admissibility has been used in the same award by tribunals to mean different things.³⁶² Even where there has been an opportunity to address the issue of distinction between admissibility and jurisdiction, tribunals have not articulated the difference with sufficient clarity.³⁶³

This chapter looks at the concepts of jurisdiction and admissibility with specific reference to tax-related investment disputes - disputes which belong to a separate category. I shall elaborate in this Chapter that due to tax carve outs, taxation measures are neither completely excluded from the purview of IIAs nor are they subject to scrutiny across the board like labour regulations.³⁶⁴ This makes the issues of jurisdiction and admissibility in tax-related investments unique. This chapter also examines the concept of arbitrability and its limited relevance to tax-related investment disputes. While ordinarily matters relating to

³⁶¹ See Ian Laird, 'A Distinction Without a Difference? An Examination of the Concepts of Admissibility and Jurisdiction in *Salini v Jordan* and *Methanex v USA*' in Todd Weiler (ed.), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005) 201.

³⁶² Tribunals have used the term admissibility to refer to the weakness of the claim and also to suggest that the claim may be pre-mature. At times, the confusion has been further enhanced when tribunals have held that a claim is dismissed as inadmissible due to lack of jurisdiction. See, for example, *Valores* award, *supra* note 295.

³⁶³ See, for instance, *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v Islamic Republic of Pakistan* ICSID Case No. ARB/03/29 (Decision on Jurisdiction, 14 November 2005).

³⁶⁴ See Section III.B below.

status, capacity and testamentary dispositions cannot be submitted to arbitration, tax disputes are not necessarily inarbitrable. Additionally, counterclaims are discussed in the context of tax-related investment disputes. Counterclaims are interesting in tax-related investment disputes because states often tend to present a defence and sometimes put forth a counterclaim that investors have evaded taxes. This raises issues of jurisdiction of the tribunal to hear a counterclaim, the enforcement of domestic tax laws by an investor-state tribunal and the role of counterclaims in tax-related investment disputes in general. I suggest that tribunals should allow a greater role for counterclaims in tax-related investment disputes by liberally interpreting the conditions for jurisdictional conditions in counterclaims.³⁶⁵

The chapter is structured as follows: Section II examines the role of arbitrability in tax-related investment disputes. I suggest that arbitrability has limited role in informing the issues that arise before investor-state tribunals. Section III discusses the distinction between jurisdiction and admissibility and the importance of the distinction for tax-related investment disputes. The latter part of Section III examines the rationale and significance of tax carve outs before examining the implications of tax veto from the perspective of jurisdiction and admissibility. Section IV elaborates on counterclaims. It looks into the role of counterclaims in investor-state arbitration and the conditions for a tribunal to exercise jurisdiction over counterclaims. I suggest that states should rely on counterclaims more frequently in tax-related investment disputes. Section V concludes.

II. THE LIMITED ROLE OF ARBITRABILITY IN TAX-RELATED INVESTMENT DISPUTES

Is there a limitation on the subject matters that can be submitted to arbitration? In the context of international commercial arbitration, this question is generally answered with reference to the concept of arbitrability. Arbitrability limits the kinds of legal disputes that can be submitted to arbitration. Arbitrability is further sub-divided into two distinct concepts - subjective arbitrability and objective arbitrability.³⁶⁶ The former refers to the validity of the arbitration agreement or clause between the two parties. The latter refers to the legal disputes that are not inherently considered to be arbitrable - for instance, disputes concerning marital status or criminal offences. Submitting such disputes to arbitration is

³⁶⁵ See Section IV below.

³⁶⁶ See Mauro Rubino-Sammartano, *International Arbitration Law and Practice* (Kluwer Law International 2000) 171-193.

either not allowed under the domestic laws of the state or the enforcement of such arbitral awards is considered against the public policy of the state. In investor-state arbitration, arbitrability is, however, rarely used as a tool to examine the scope of permissible adjudication.³⁶⁷ The questions that I seek to answer are - does arbitrability constrain state's ability to submit tax-related investment disputes to investor-state tribunals? Can investor-state tribunals say that tax-related investment disputes are not arbitrable and thereby decline jurisdiction?

Bernard Hanotiau states that the resolution of the question of arbitrability may depend on the stage at which the issue of arbitrability is raised.³⁶⁸ In investor-state arbitration, the issue of arbitrability may be relevant either at the preliminary stage or at the enforcement stage. In the preliminary stage, the state may argue that the claim of the investor is incapable of being adjudicated by the arbitral tribunal. However, a survey of the awards on tax-related investment disputes reveals that the states have generally formulated the argument in jurisdictional terms.³⁶⁹ It is either argued that the dispute is outside the scope of the IIA and by extension beyond the consent of the parties; or it is argued that the relevant taxation dispute is subject to jurisdiction of the domestic courts.³⁷⁰ In investor-state arbitration, a state has rarely raised the issue of tax disputes not being arbitrable per se.

A possible argument that a state can raise is that under its domestic law, arbitration of taxation disputes is either not permissible or that arbitration is not a suitable avenue to adjudicate tax disputes. With respect to suitability of arbitration for tax disputes, a credible argument can be made that domestic courts armed with their well-developed jurisprudence are better suited to resolve tax disputes. For instance, domestic courts regularly examine the interpretation and application of tax treaties in combination with domestic taxation laws.³⁷¹ Nonetheless, the question of whether arbitration of tax disputes is allowed under a state's domestic law brings forth the issue of incompatibility of domestic law and international law. In this respect, it is important to highlight an established principle of international

³⁶⁷ See Lauren Brazier, 'The Arbitrability of Investor-State Taxation Disputes in International Commercial Arbitration' (2015) 32 J Int'l Arb 1.

³⁶⁸ Bernard Hanotiau, 'What Law Governs the Issue of Arbitrability' (1996) 12 Arb Int'l 391, at 391.

³⁶⁹ See, for instance, *Duke Energy International Peru Investments No. 1, Ltd v Republic of Peru* ICSID Case No. ARB/03/28 (Decision on Jurisdiction, 1 February 2006).

³⁷⁰ See *Burlington Resources Inc. v Republic of Ecuador* ICSID Case No. ARB/08/5 (Decision on Jurisdiction, 2 June 2010).

³⁷¹ See Chapter 1, Section V above (briefly discussing the role of domestic courts in developing ITL jurisprudence); Also see Chapter 2, Section IV above.

responsibility - that a state cannot evade its obligations under international law due to their alleged incompatibility with domestic law provisions.³⁷² Thus, the question of whether states prefer domestic courts and whether domestic law of the state permits arbitral tribunals to adjudicate on tax disputes needs to be decided by the states at the time of entering into treaties. Subsequently, the provisions of the treaty in force prevail over the domestic law.³⁷³ I argue that the suggestion that tax-related investment disputes are not arbitrable lacks any merit. Tribunals need to defer to the scope of consent and cannot override it. It is not open to an investor-state tribunal to say that it refuses to adjudicate on a tax-related investment dispute even though the parties have validly agreed to arbitrate the matter.³⁷⁴ Thus, so far we see that the concept of arbitrability has limited use in investor-state arbitration.

The enforcement stage is the second stage at which the arbitrability issue may arise. The effectiveness of international arbitration - commercial and investment, depends upon a widespread legal framework for enforcement. Enforcement of arbitral awards ensures that their legal effect is equivalent to binding judgment of a court. Investor-state arbitration awards are generally enforced under two multilateral conventions: either the International Centre for Settlement of Investment Disputes (ICSID) Convention or the New York Convention. Article V of the New York Convention, 1958 provides that the recognition and enforcement of an arbitral award may be refused if the competent authority in the state where recognition

³⁷² Art 27 of the Vienna Convention on the Law of Treaties, 1969 (VCLT, 1969) specifically provides that 'a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.'; Also see Ian Brownlie, *Principles of Public International Law* (Oxford University Press 2008) 34 ('state cannot plead provisions of its own law or deficiencies in that law to answer to a claim against it for alleged breach of its obligations under international law', citing Art 27, VCLT).

³⁷³ For other express formulations of this principle see *Greco-Bulgarian Communities, Advisory Opinion*, 1930P.C.I.J. (ser. B) No. 17, at para 81('it is a generally accepted principle of international law that in the relations between Powers who are contracting Parties to a treaty, the provisions of municipal law cannot prevail over those of the treaty'); *Case of the Free Zones of Upper Savoy and the District of Gex* (Second Phase), Order of 6 December 1930, P.C.I.J. (ser. A) No. 24, at 24 ('...it is certain that France cannot rely on her own legislation to limit the scope of her international obligations.');

Treatment of Polish Nationals and other Persons of Polish Origin or Speech in the Danzig Territory, Advisory Opinion of 4 February 1932, P.C.I.J. (ser. A/B) No. 44, at 24 ('...a State cannot adduce against another State its own Constitution with a view to evading obligations incumbent upon it under international law or treaties in force.').

³⁷⁴ See *Hulley Enterprises Ltd v The Russian Federation* PCA Case No. AA 226 (Interim Award on Jurisdiction and Admissibility, 30 November 2009) para 370 (where the tribunal rejected the claimants argument that tax disputes are inarbitrable under Russian law. The tribunal effectively observed that consent to the ECT (provisionally applicable to Russia) overrides domestic law of the state); Also see *Veteran Petroleum Ltd (Cyprus) v The Russian Federation* PCA Case No. AA 228 (Interim Award on Jurisdiction and Admissibility, 30 November 2009); *Yukos Universal Limited (Isle of Man) v The Russian Federation* PCA Case No. AA 227 (Interim Award on Jurisdiction and Admissibility, 30 November 2009); *Quasar De Valores SICA SA, Orgor De Valores SICA SA, GBI 9000 SICA SA and Alos 34 SL v The Russian Federation*, SCC No. 24/2007 (Award on Preliminary Objections, 20 March 2009); *RosInvest UK Ltd v The Russian Federation* (Award on Jurisdiction, 1 October 2007).

and enforcement is sought finds that: either the subject matter of the difference is not capable of settlement by arbitration under the law of that state; or the recognition or enforcement of the award would be contrary to the public policy of that state. With reference to the first ground - incapable of judicial settlement, I've argued above that the consent of states is paramount in investor-state arbitration. The ground of incapable of judicial settlement is unlikely to be a hurdle in enforcement of tax-related investment awards. With respect to public policy, certain observations are necessary.

National public policy generally performs the role of 'eliminating' certain arbitration agreements that are contrary to the core values or interests of the state. However, the role of national public policy is shrinking in arbitration. Disputes involving securities law, competition law and even intellectual property are being referred to arbitration.³⁷⁵ National public policies on arbitrability are thus becoming increasingly liberal. It has been argued that recent domestic laws rarely regulate questions of arbitrability, nor do they set forth general rules of procedure applicable to arbitration of future disputes.³⁷⁶ Also, if one may extrapolate the attitude of the states from various IIAs - most states show a qualified acceptance to arbitrability of tax-related investment disputes.³⁷⁷ Thus, even if one adopts 'international public policy' as the frame of reference, the trend seems to be towards acceptance of a limited but definite authority of investor-state arbitral tribunals in tax disputes. The idea that certain kinds of tax disputes and certain aspects of tax disputes are arbitrable is finding its root in international public policy.³⁷⁸ Some authors have suggested that there is no rule of international public policy opposing the arbitrability of tax disputes per se.³⁷⁹ This view is contestable and contingent on the definition of the term international public policy.³⁸⁰

³⁷⁵ See, for instance, William Grantham, 'Arbitrability of International Intellectual Property Disputes' (1996) 14 Berkeley J Int'l L 173; Also see *Philip Morris Brands SARL, Philip Morris Products S.A. and Abal Hermanos S.A. v Oriental Republic of Uruguay* ICSID Case No. ARB/10/7 (Decision on Jurisdiction, 2 July 2013).

³⁷⁶ See Loukas A. Mistelis, 'Arbitrability - International and Comparative Perspectives: Is Arbitrability a National or an International Law Issue' in Loukas A. Mistelis, Stavros L. Brekoulakis (eds.), *Arbitrability: International and Comparative Perspectives* (Kluwer Law International 2009) paras 1-35.

³⁷⁷ See Section III below.

³⁷⁸ This is not only applicable to tax-related investment disputes but also tax disputes arising under tax treaties where states have begun to accept arbitration as a mode of dispute resolution. For more details see Chapter 2 above.

³⁷⁹ See Emmanuel Gaillard, 'Tax Disputes Between States and Foreign Investors' (1997) 217 NYLJ 25; Also see Martin Hunter, Gui Conde E Silva, 'Transnational Public Policy and its Application in Investment Arbitrations' (2003) 4 J World Invst 367.

³⁸⁰ See *World Duty Free Company Limited v Republic of Kenya* ICSID Case No ARB/00/7 (Award, 25 September 2006) paras 138-139 (Stating that international public policy is 'in fact no more than domestic public policy applied to foreign awards ...'. The tribunal then stated that the term 'international public policy' is sometimes used with

Investor-state arbitral awards can alternatively also be enforced under the ICSID Convention. Article 54 of the ICSID Convention states that: ‘each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.’ Enforcement under ICSID Convention is not qualified by the two conditions provided in the New York Convention. However, Article 52 does provide that a party may request the annulment of the award if the tribunal has ‘manifestly exceeded its powers.’ The ICSID Convention contemplates annulment as the final challenge to the award of the investor-state tribunal. Once arguments about a tribunal exceeding its jurisdiction fail at the annulment as well - the award has to be enforced. There is no room for arguing that the award is not enforceable due to arbitrability or due to reasons related to public policy. Thus, arbitrability has no role to play at the enforcement stage as well if the award is sought to be enforced under the ICSID Convention.

To conclude this Section, arbitrability may play a useful role in international commercial arbitration. However, in investor-state arbitration it does not inform the issues of jurisdiction or admissibility - especially, in tax-related investment disputes. Investor-state tribunals derive their authority and jurisdiction from the scope of the consent in the underlying treaty. In such a scenario, the incapability of certain disputes being arbitrable recedes into the background. In fact, the concept of arbitrability has no significance and fails to provide the required insight to address arguments about jurisdictional or admissibility that arise in tax-related investment disputes. Tax-related investment disputes have now become an important part of investor-state arbitration. Domestic courts do not have exclusive jurisdiction over all kinds of tax disputes. Insofar as the taxation policies of states involve a breach of international obligations, there is a clear mandate and role for investor-state tribunals to perform. In such cases - arbitrability or public policy exception have no role to play. The only relevant questions are if the tribunal has jurisdiction to entertain the claims and whether the claims are admissible.

another meaning, ‘signifying an international consensus as to universal standards and accepted forms of conduct that must be applied in all fora.’).

III. JURISDICTION AND ADMISSIBILITY

A. The Distinction between Jurisdiction and Admissibility

The terms admissibility and jurisdiction are often used interchangeably with arbitrability, especially in the US. The US courts tend to use the term arbitrability, admissibility and jurisdiction to mean the same thing.³⁸¹ This, at times, causes further confusion on the meaning of the three terms. It is not the object of this chapter to elucidate the meanings ascribed to these terms in different jurisdictions.³⁸² It suffices to say here that the term arbitrability is used in the same sense as in Section II above i.e. to reflect the meaning ascribed to it in international commercial arbitration.³⁸³ The distinction between admissibility and jurisdiction is discussed below.

In accordance with the principle of *Kompetenz-Kompetenz*, an arbitral tribunal has the power to determine its own jurisdiction. It can also simultaneously determine the question of admissibility. The questions of jurisdiction and admissibility are generally dealt by the tribunal in a preliminary stage before proceeding with the merits of the case.³⁸⁴

Jurisdiction, simply put, involves the capacity of the tribunal to adjudicate the dispute brought before it.³⁸⁵ Jurisdiction has four dimensions: *ratione materiae* (jurisdiction over subject matter); *ratione personae* (jurisdiction over persons); *ratione temporis* (jurisdiction over time); *ratione loci* (jurisdiction over location).³⁸⁶ Further, the requirements of jurisdiction are fixed and immutable at the date of seisin and cannot be circumvented by

³⁸¹ See W.W. Park, 'The Arbitrability Dicta in First Options v Kaplan: What Sort of Kompetenz-Kompetenz Has Crossed the Atlantic?' (1996) 12 Arb Int'l 137; Thomas E. Carbonneau, Andrew W. Sheldrick, 'Tax Liability and Inarbitrability in International Commercial Arbitration' (1992) 23 J Tran'l L& Poly 23; Solomon Eber, Blerina Xheraj, 'Who Decides Arbitrability Where a Precondition to Arbitration Has Not Been Satisfied?: A Comment on the U.S. Supreme Court's Decision to Hear the Appeal in BG Group v Argentina' (2014) 31 J Int'l Arb 101.

³⁸² For a detailed discussion on various aspects of arbitration see Jackson H. Ralston, *International Arbitration from Athens to Locarno* (Stanford University Press 1929).

³⁸³ See Section II above.

³⁸⁴ See Art 79, ICJ Rules ('Any objection by the respondent to the jurisdiction of the Court or to the admissibility of the application, or other objection the decision upon which is requested before any further proceedings on the merits, shall be made in writing as soon as possible, and not later than three months after the delivery of the Memorial.');

Rule 21(4), UNCITRAL Arbitration Rules ('In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question.').

³⁸⁵ Zachary Douglas, *supra* note 166, at 146-47.

³⁸⁶ For a detailed discussion on the concepts of jurisdiction and admissibility see Michael Waibel, 'Investment Arbitration: Jurisdiction and Admissibility' in Marc Bungenberg, et al (eds.), *International Investment Law A Handbook* (Hart Publishing 2015) 1212; Gerold Zeiler, 'Jurisdiction, Competence, and the Admissibility of Claims in ICSID Arbitration Proceedings' in Christina Binder, et al (eds.), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press 2009) 79; *Duke Energy award*, *supra* note 369, at 19-48.

supervening facts.³⁸⁷ By contrast, a challenge to admissibility is an attack on the particular claim brought forward by the investor.³⁸⁸ The boundary between the concepts of jurisdiction and admissibility is fluid.³⁸⁹ In fact, there is a viewpoint which doubts that jurisdiction and admissibility are separate concepts.³⁹⁰ However, in my view, a distinction can be made and in fact such distinction is useful in tax-related investment disputes.

The award in *SGS v Philippines* is useful to understand the distinction between jurisdiction and admissibility.³⁹¹ The dispute between the two parties involved an investment contract which contained a stipulation that disputes arising out of it should be referred to a Philippine court. SGS, nonetheless sought an ICSID arbitration claiming failure of payment. The tribunal had to determine whether the broadly worded treaty encompassed contract claims and if the answer was in the affirmative, whether it should exercise jurisdiction notwithstanding the presence of choice of a forum clause. With respect to the former, the tribunal noted that the Switzerland-Philippines BIT gave it jurisdiction over essentially contractual claims against the respondent. As regards the latter, it observed that SGS's claim was premature and must await a determination of the amount payable in accordance with contractually agreed process. The tribunal thus stayed the proceedings to await the judgment of the Philippine court.³⁹² The tribunal in effect held that it had the jurisdiction to adjudicate but the claim was inadmissible due to a defect in the claim that could be cured. The tribunal treated the failure to first approach the Philippine court as a matter of admissibility without expressly saying so.

Zachary Douglas states that the principles to distinguish jurisdiction and admissibility are twofold: first, if the sustenance of the preliminary objection leads to the conclusion that it is inappropriate for the tribunal to exercise its adjudicative power *in any circumstances*, then the issue is properly characterised as one of jurisdiction; second, if sustaining the preliminary objection would lead to the conclusion that it is inappropriate for the tribunal to rule on a specific claim or counterclaim then the issue is properly characterised as one of

³⁸⁷ Zachary Douglas, *supra* note 166.

³⁸⁸ *Ibid*, at 148.

³⁸⁹ See generally *South West Africa Cases (First Phase)* (1962) ICJ Rep 319; Also see Jan Paulsson, 'Jurisdiction and Admissibility' in Gerald Aksen, Robert Briner (eds.), *Global Reflections on International Law, Commerce and Dispute Resolution* (International Chamber of Commerce 2005) 601 (stating that a lack of clear distinction between the two concepts resembles a twilight zone.).

³⁹⁰ See *Methanex Corporation v United States of America* (1st Partial Award, 7 August 2002) 36-71.

³⁹¹ ICSID Case No. ARB/02/6 (Decision on Jurisdiction, 29 January 2004).

³⁹² *Ibid*; Also see *Case Concerning the Administration of the Prince Von Pless* 1933 PCIJ (Ser. A/B) No. 52 (Interim Measures of Protection, 11 May 1933) (where the international proceedings were stayed to await the determination of certain tax issues by the Polish courts).

admissibility.³⁹³ If the tribunal considers that its decision under the treaty would be premature, it can be classified as an issue of admissibility. A jurisdictional issue is subject to appeal for it relates to the adjudicative power of the tribunal itself while on the issue of admissibility the tribunal's decision is final.³⁹⁴ This is a convincing way to distinguish jurisdiction and admissibility. I shall rely on the above stated distinction to further examine the importance of jurisdiction and admissibility in tax-related investment disputes.

B. The Rationale and Significance of Tax Carve Outs

In this sub-section, I examine tax carve-outs in detail. Tax carve outs contribute to the distinctive nature of tax-related investment disputes by limiting the applicability of IIA to a state's taxation measures. The extent of jurisdiction of investor-state tribunals is determined by the wording of tax carve outs that in turn differs in each IIA. I begin by highlighting the different kinds of tax carve outs in a tabular form. The aim of this table is to show that tax carve outs are of different kinds and also that they have evolved over years. Thereafter, I examine the rationale for tax carve outs such as the need to avoid conflict with tax treaties. I specifically address the reasons for carving out the national treatment, Most Favored Nation (MFN) obligation and the fair and equitable treatment standard (FET standard). In the last sub-section, I highlight the significance of tax carve outs by discussing relevant arbitral awards.

³⁹³ Zachary Douglas, *supra* note 166, at 148; *Waste Management Inc. v United Mexican States* ICSID Case No. ARB(AF)/98/2 (Dissenting Opinion of Keith Highet on Jurisdiction, 8 May 2002) para 58 ('Jurisdiction is the power of the tribunal to hear the case; admissibility is whether the case itself is defective - whether it is appropriate for the tribunal to hear it.); *Ioan Micula, Viorel Micula, SC European Food SA, SC Starmill SRL and SC Multipack SRL v Romania*, ICSID Case No ARB/05/20 (Decision on Jurisdiction and Admissibility, 24 September 2008) para 64 ('[W]hen an objection relates to a requirement contained in the text on which consent is based, it remains a jurisdictional objection. If such a requirement is not satisfied, the Tribunal may not examine the case at all for lack of jurisdiction. By contrast, an objection relating to admissibility will not necessarily bar the Tribunal from examining the case if the reasons for the inadmissibility of the claim are capable of being removed and are indeed removed at a subsequent stage.').

³⁹⁴ See Jan Paulsson, *supra* note 389.

TABLE 2: TAX CARVE OUTS IN IIAs³⁹⁵

IIA	APPLICABILITY TO TAXATION MEASURE			
	Expropriation	Fair and Equitable Treatment	National Treatment	Most Favored Nation Treatment
ASEAN Agreement (1987)				
US Model BIT (1983); US Model (2004)	x			
Kenya-Netherlands BIT (1970)	x	x	x	x
Australia-China BIT (1988)	x	x	x	x
NAFTA (1994); ECT (1991)	x	x		
US-Albania BIT (1995)	x	x		

³⁹⁵ This Table is representative and not exhaustive. The aim is to show the various kinds of tax carve outs that are included in IIAs.

A S E A N Comprehensive Investment Agreement (2009)	×			
CETA (2016)	×			
Nigeria-Singapore BIT (2016); Japan- Iran BIT (2016)				

1. Rationale of Tax Carve Outs

Tax carve outs are provisions in IIAs that partially exclude the applicability of substantive obligations to taxation measures. Tax carve outs did not appear in IIAs from the very beginning and have evolved over time. The first BIT between Germany and Pakistan did not contain any exception for taxation.³⁹⁶ The absence of any tax carve outs in IIAs continued in the 1960s.³⁹⁷ The substantive obligation of national treatment and the MFN obligation continued to apply to a state's taxation measures even in the IIAs that were concluded in the 1970s and the 1980s.³⁹⁸ For instance, the Belgium-Luxembourg Economic Union-China BIT (1984) did not exclude taxation from the above mentioned substantive obligations. This position continued in a number of IIAs until the early 1990s. The prominent outlier in the initial phase was the US. The 1983 US Model BIT was the first to include a tax carve out and provided that the IIA shall apply to taxation matters only with respect to expropriation, transferability of payments related to investment and the observance and enforcement of an investment agreement.³⁹⁹

The rationale for the presence of tax carve outs in IIAs is linked to the existence of thousands of tax treaties. Kenneth Vandeveld has argued that due to the existence of bilateral tax treaties between US and BIT partners, the BIT drafters excluded tax matters from the BIT

³⁹⁶ See Germany-Pakistan BIT (1959).

³⁹⁷ See, for instance, Germany-Korea BIT (1964).

³⁹⁸ See, for instance, Kenya-Netherlands BIT (1970); Malaysia-Netherlands BIT (1971); Australia-China BIT (1988). ³⁹⁹ Art XI, US Model BIT (1983) (This is the first BIT that had an extensive tax carve out, though the wording of the tax carve out has evolved over the past few decades).

provisions.⁴⁰⁰ He contends that the US BIT negotiators claimed that provisions relating to national treatment in BITs conflicted with tax treaties and hence taxation measures were carved out of BITs.⁴⁰¹ At the same time, the goal of US BIT was to prevent taxation measures from infringing investor's rights and thus substantive protections against expropriation and limits on transfers continued to be applicable to taxation measures.⁴⁰² Currently, the exclusion of national treatment does not have the desired effect due to the development of non-discrimination aspect as part of the FET standard.

National treatment precludes states from adopting discriminatory measures and almost all tax treaties oblige state not to discriminate.⁴⁰³ Thus, by excluding the applicability of the IIA's national treatment to taxation measures, an overlap or a conflict with tax treaties was sought to be avoided. Though, in retrospect, the possibility of a conflict may have been overstated.⁴⁰⁴ But, only some IIAs exempt taxation measures from the FET standard and non-discrimination now constitutes an important element of the FET standard.⁴⁰⁵ Thus, as long as states are obliged to provide FET with respect to taxation measures, an exception for taxation measures with respect to national treatment does not work.

Hypothetically, if national treatment was applied to taxation measures - what was the kind of conflict that the treaty negotiators were anticipating? Tax treaties aim to prevent double taxation while IIAs safeguard investors and their investments. There seems to be little overlap in the objectives of tax treaties and IIAs. There is only a limited jurisprudence on non-discrimination in tax-related investment disputes;⁴⁰⁶ but to the extent that tribunals have engaged with the non-discrimination standard in IIAs there is little to suggest any conflict with tax treaties.⁴⁰⁷ While the treaty negotiators may have reasons to expect conflict, there is little evidence of it in the arbitral awards.

On the other hand, there exists a strong rationale for exempting tax measures from the MFN clause. The pre-dominance of bilateral tax relationships has been discussed in Chapter 1

⁴⁰⁰ Kenneth Vandeveld, *U.S. International Investment Agreements* (Oxford University Press 2009) 442-455 (he makes this argument while referring to the 1983 US Model).

⁴⁰¹ *Ibid*, at 442.

⁴⁰² *Ibid*, at 443.

⁴⁰³ See, for instance, Art 25, UK-France tax treaty (2010).

⁴⁰⁴ One of the reasons is that non-discrimination is comparatively a narrower concept under ITL as compared to non-discrimination standard in IIL and is applied in a different context. See Chapter 6 below for details.

⁴⁰⁵ See, for instance, Art X, US-Ecuador BIT (1993); For details see Chapter 5 below.

⁴⁰⁶ See Chapter 6 below for a detailed discussion.

⁴⁰⁷ *Ibid*.

above. For instance, states may negotiate to incorporate a certain rate of withholding tax in a tax treaty with one state and different rate with another state. By applying the MFN obligation, the withholding rates will move to the lowest level. The exclusion of tax measures from the MFN excludes this outcome. Similarly, states may prefer to extend tax-related incentives to only investors from a few specific states. This may not be possible if MFN obligations in IIAs apply to taxation measures of a state.⁴⁰⁸ Thus, the exclusion of taxation from the MFN obligation is defensible. It has also been suggested that measures such as anti-avoidance rules are not compatible with the MFN obligations.⁴⁰⁹ In the General Agreement on Trade and Services (GATS), taxation measures, unless they are arbitrary or discriminatory, are also carved out from MFN obligation.⁴¹⁰ The rationale for tax carve outs for MFN obligation, in both IIAs and GATS, is to prevent conflict or overlap with tax treaties and preserve state discretion in taxation matters. Thus, the tax carve outs are justifiable in so far as MFN obligation is concerned.

The premise that taxation matters are best addressed under tax treaties and thus should be excluded from IIAs is correct but it does not explain the inconsistent application to the national treatment, FET standard and the MFN obligation. Tax treaties allocate revenue jurisdiction among two or more states. IIAs aim to protect foreign investors from excesses of the host state. The aim of latter is to protect revenue generating activities against excessive state interference while the former provide a framework for dividing the revenue.⁴¹¹ Thus, while the functions of IIAs and tax treaties are complementary, they do not necessarily overlap in a significant manner. Also, while the argument that tax treaties are better suited to address taxation-related disputes is correct, it obviates the fact that tax-related disputes have varied facets and tax treaties may not be best suited to resolve all kinds of disputes. For instance, tax-related investment disputes are best addressed under IIAs. In my view, the different kinds of tax disputes that arise have not been fully appreciated before including tax carve outs in IIAs.

⁴⁰⁸ See Art 5, UK-UAE BIT (1992) (excluding customs unions and tax treaties from the MFN obligation).

⁴⁰⁹ Servaas van Thiel, 'General Report' in Michael Lang, et al (eds.), *WTO and Direct Taxation* (Kluwer Law International 2005) 13, at 35-40.

⁴¹⁰ See Art 14, GATS (1995).

⁴¹¹ UNCTAD, *Taxation* (2000) UNCTAD/ITE/IIT/16; Also see Arthur J. Cockfield, 'Tax Integration under NAFTA: Resolving the Conflict between Economic and Sovereignty Interests' (1998) 34 *Stanford J Int'l L* 39.

Further, the tax carve outs are drafted in unnecessarily complicated language.⁴¹² William W. Park has compared the tax carve out clauses to the Russian nested doll - matryoshka, where '[O]ne carved figure opens to reveal another, which in turn unlocks to yield yet more diminutive figurines.'⁴¹³ The most prominent examples are the NAFTA and the Energy Charter Treaty (ECT).⁴¹⁴ The latter especially contains one of the most complicated tax carve outs in IIAs.⁴¹⁵ Other states have copied the tax carve outs in NAFTA and ECT for their IIAs.⁴¹⁶

Various states have adopted tax carve outs at different times and for different reasons. Among the states that were neither part of the NAFTA or the ECT, the approach to tax carve outs has varied. The ASEAN Agreement concluded in 1987 provides that the 'Provision of this Agreement shall not apply to matters of taxation in the territory of the Contracting Parties. Such matters shall be governed by Avoidance of Double Taxation between Contracting Parties and the domestic laws of each Contracting Party'.⁴¹⁷ The exclusion of taxation is unqualified, it even extends to expropriation.⁴¹⁸ However, in IIAs signed by states like India in the mid-1990s, tax carve outs were absent.⁴¹⁹ In fact, states like India have decided to include detailed tax carve outs in their IIAs only recently after receiving a notice for tax-related investment arbitration.⁴²⁰ The reasons for including tax carve outs may vary for different

⁴¹² The complex wording of some tax carve outs sometimes contributes to jurisdictional ambiguity. See Chapter 6 below for a discussion on the exercise of jurisdiction by tribunals in the specific context of non-discrimination obligation.

⁴¹³ William W. Park, 'Arbitrability and Tax' in L. Mistelis, S. Brekoulakis (eds.), *Arbitrability: International and Comparative Perspectives* (Kluwer Law International 2009) 179, at 189.

⁴¹⁴ See, Art 2103(6), NAFTA; Art 21, ECT.

⁴¹⁵ See the discussion on *Yukos* awards in Chapter 3 below; Also see BITs such as Art 3, China-Germany BIT (2003).

⁴¹⁶ See, for instance, US-Albania BIT (1995); Barbados-Canada BIT (1995); Armenia-Canada BIT (1997); Also see Canada Model BIT (2004); US Model BIT (2004).

⁴¹⁷ Art V, The 1987 ASEAN Agreement for the Promotion and Protection of Investments; Also see Art 3, 2009 ASEAN Comprehensive Investment Agreement (which has included a qualified carve out and applies to expropriation and transfers).

⁴¹⁸ Also see Art 10, Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (1961) (it provided that an uncompensated taking of an alien property which resulted from which resulted from the execution of tax laws, incidental to the normal operation of the laws of the state shall not be considered wrongful).

⁴¹⁹ See, for instance, UK-India BIT (1994); Germany-India BIT (1995).

⁴²⁰ See Art 2.6 India Model BIT (2015); Vodafone has issued a notice of arbitration to India for implementing a retrospective tax amendment that annuls Indian Supreme Court's judgment in favour of Vodafone. The notice was issued under the India-Netherlands BIT (1995) where the tax carve out is limited only to national treatment and MFN treatment. See James Crabtree, 'Vodafone turns to arbitrators in seven-year Indian tax dispute', 7 May 2014, Financial Times, available at <https://www.ft.com/content/21f91f9c-d5fa-11e3-a017-00144feabdc0>; Also see Lauge N. Skovgaard Poulsen, *Bounded Rationality and Economic Diplomacy The Politics of Investment Treaties in Developing Countries* (Cambridge University Press 2015) (arguing that the developing states overestimated the economic benefits of the IIAs and ignored their risks when entering into IIAs).

states such as preventing conflicts with tax treaties or shrinking of domestic tax policy space, but tax carve outs have certainly become ubiquitous in IIAs over the last two decades.

2. Significance of Tax Carve Outs

In tax-related investment disputes, most preliminary objections of jurisdiction relate to the tax carve out provisions.⁴²¹ Tax carve outs, as discussed above, essentially provide that the provisions of the IIA are not applicable to taxation measures except in certain circumstances. The contingent application of IIAs to taxation measures requires careful consideration by the tribunals to determine if they can exercise jurisdiction in the particular case. Tax carve outs are worded differently and consequently the extent to which taxation measures are excluded varies in each IIA. The text of the IIA and characterisation of the dispute are central factors for determining whether the tribunal is competent to adjudicate the dispute.⁴²² *Occidental* and the *EnCana* awards are two leading examples of how differently worded treaties led to different consequences.

In *Occidental* an important element of the dispute was whether Occidental was entitled to VAT refunds under a participation contract with Ecuador.⁴²³ Initially, Ecuador had refunded the VAT payments but later it changed its position. Occidental challenged the refusal of the VAT refunds. Ecuador challenged the jurisdiction of the tribunal by primarily relying on the tax carve out in the US-Ecuador BIT. The tribunal examined the carve out provision - Article X of the BIT to address the objection.⁴²⁴ The tribunal observed that the reference in Article X to ‘strive to accord fairness and equity’ in respect of tax policies is legally significant. The BIT, according to the tribunal, imposed on the host state an obligation of fair and equitable treatment no different from one in Article II of the BIT (which provided for fair and equitable treatment in respect of non-taxation measures). The nevertheless proviso in paragraph 2 did

⁴²¹ See, for instance, *Burlington* award, *supra* note 370; *Duke* award, *supra* note 364.

⁴²² See *Link Trading v Moldova* UNCITRAL (Award on Jurisdiction, 1976) 8-9.

⁴²³ See *Occidental* award, *supra* note 211, at paras 25-36.

⁴²⁴ Article X of the BIT provided as follows:

1. 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.
2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to *matters of taxation* only with respect to the following:
 - (a) expropriation, pursuant to Article III; or
 - (b) Transfers, pursuant to Article IV; or
 - (c) The observance *and enforcement of an investment Agreement* or authorization as referred to in Article VI (1)(a) or (b), to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time. (emphasis added).

not mean that in respect of tax policies the state could pursue unfair or inequitable treatment. It only meant ‘that such obligation [was] concerned with the three categories of tax matters therein listed.’⁴²⁵

The tribunal then considered the three categories mentioned in Article X (2). The question of transfers did not arise in the case. It then considered the question of expropriation. The tribunal stated that normally claim of expropriation should be considered at the merits stage, but ‘it is so evident that there is no expropriation in this case that the Tribunal will deal with this claim as a question of admissibility.’⁴²⁶ The tribunal then elaborated that it was not persuaded by the claimant’s arguments on expropriation and concluded that ‘the claim concerning expropriation is inadmissible.’⁴²⁷ The declaration of the claim of expropriation as inadmissible was not meant to signify that the claim was pre-mature but that it was a weak claim. Thus, while the tribunal correctly dismissed the claim on expropriation the use of the term admissibility in the award was, in my opinion, was not appropriate.

The next question before the tribunal was whether the dispute related to the observance and enforcement of the terms of an investment agreement concerning matters of taxation. The tribunal rejected the objection of Ecuador that the claims were contractual in nature. The tribunal observed that, ‘The characterization of the dispute by the Claimant probably would suffice alone for the Tribunal to reach a determination on jurisdiction.’⁴²⁸ The claim of VAT refunds by Occidental was based on the participation contract between Occidental and Ecuador which the tribunal concluded was as an investment agreement. The tribunal said that even though the claimant did not invoke its contractual rights but rather pursued its treaty rights, the dispute found its origins in the contract in so far the dispute on VAT reimbursement was concerned.⁴²⁹ The tribunal found that since the dispute concerned the observance and enforcement of the contract the tax dispute fell squarely within the exceptions of Article X and hence within its jurisdiction.⁴³⁰

Crucial to the tribunal’s finding of jurisdiction was that tribunal accepted Occidental’s characterisation of claims as treaty claims. Occidental had not formulated its claim for the VAT refunds solely under the participation contract. However, the tribunal noted that it was

⁴²⁵ *Occidental award, supra note 211, at para 70.*

⁴²⁶ *Ibid, at para 80.*

⁴²⁷ *Ibid, at para 92.*

⁴²⁸ *Ibid, at para 47.*

⁴²⁹ *Ibid, at para 72.*

⁴³⁰ *Ibid.*

entitled to the VAT payments under the general tax law of Ecuador.⁴³¹ The conclusion of the tribunal where it relied on the general tax law, was unusual since Occidental had made claims relying on breach of treaty obligations by Ecuador.⁴³²

The dispute in *EnCana*, similar to the one in *Occidental*, concerned the refusal of VAT refunds by the state that the claimant had earlier claimed successfully.⁴³³ In response to the jurisdictional challenge, the tribunal examined the tax carve out provision.⁴³⁴ However, since the wording of the Canada-Ecuador BIT in *EnCana* differed from the US-Ecuador BIT in the *Occidental* arbitration, the tribunal correctly arrived at a different conclusion in *EnCana*.⁴³⁵

The vital question for jurisdictional purposes was the meaning of the term ‘taxation measures’. The tribunal noted that though the term ‘taxation measure’ was not defined in the BIT, it ‘should be given its normal meaning in the context of the Treaty.’⁴³⁶ The tribunal observed that ‘taxation’ need not necessarily be limited to direct taxation. It also includes indirect taxes such as VAT refunds. In noting the meaning of ‘measure’, it remarked that there is no need to limit it to merely the provisions of the law which impose a tax. It observed, ‘all those aspects of the tax regime which go to determine how much tax is payable or refundable are part of the notion of “taxation measures”’. Thus tax deductions, allowances or rebates are caught by the term.’⁴³⁷ Thus, the tribunal concluded, the law imposing an

⁴³¹ *Ibid*, at para 143.

⁴³² For a more detailed critique of other aspects of the *Occidental* award see Zachary Douglas, *supra* note 166, at 37; Also see James Crawford, ‘Treaty and Contract in Investment Arbitration’ (2008) 24 *Arb Int’l* 351.

⁴³³ See *EnCana* award, *supra* note 211, at paras 20-106.

⁴³⁴ Article XII of the Canada-Ecuador BIT provided that:

1. Except as set out in this Article, nothing in this Agreement shall apply to *taxation measures*.
2. Nothing in this Agreement shall affect the rights and obligations of the Contracting Parties under any tax convention. In the event of any inconsistency between the provisions of this Agreement and any such convention, the provisions of that convention shall apply to the extent of the inconsistency.
3. Subject to paragraph (2), a claim by an investor that a tax measure of a Contracting Party is in breach of an agreement between the central government authorities of a Contracting Party and the investor concerning an investment shall be considered a claim for breach of this Agreement unless the taxation authorities of the Contracting Parties, no later than six months after being notified of the claim by the investor, jointly determine that the measure does not contravene such agreement.
4. Article VIII may be applied to a taxation measure unless the taxation authorities of the Contracting Parties, no later than six months after being notified by an investor that he disputes a taxation measure jointly determine that the measure is not an expropriation.
5. If the taxation authorities of the Contracting Parties fail to reach the joint determinations specified under paragraphs (3) and (4) within six months after being notified the investor may submit its claim for resolution under Article XIII. (emphasis added).

⁴³⁵ *Ibid*; *supra* note 211.

⁴³⁶ *Ibid*, at para 142.

⁴³⁷ *Ibid*.

obligation to account for VAT received, the law entitling the supplier to offset VAT paid to those from whom it has purchased goods and services, as well as law regulating the availability of refunds of VAT were ‘taxation measures’.⁴³⁸ For these reasons, the tribunal held that EnCana’s claim so far as it related to the entitlement of VAT refunds was partially excluded from the scope of the BIT and observed that its jurisdiction was limited only to EnCana’s expropriation claim . Interestingly, the tribunal not only noted the difference in the text of the relevant BITs in *Occidental* and *EnCana* but also the manner in which the claims had been characterised - the latter, in tribunal’s opinion also influenced the conclusions on jurisdiction.⁴³⁹ In *Occidental*, the dispute though related to a contract was characterised as a treaty dispute while in *EnCana* a similar claim was essentially advanced as a contractual claim itself - this partially contributed to different outcomes in both cases.

The tribunal in the *El Paso* award, however, adopted an unusual approach. The tribunal addressed El Paso’s allegation that Argentina’s imposition of a withholding tax on energy companies discriminated against the energy sector and in particular El Paso. The tribunal analysed the arguments of El Paso and Argentina for six pages and concluded that:

Last but not least, the Tribunal recalls that the application of standards in the BIT other than that of protection from expropriation is excluded for tax matters. The question that was discussed in the preceding paragraphs is therefore somewhat academic, although, if it had had to decide the issue, the Tribunal would have considered it important to state that, for the reasons presented, it held that there had been neither de jure nor de facto discrimination against El Paso during the Argentine crisis.⁴⁴⁰ (emphasis added)

In my opinion, the tribunal should have been more categorical about its scope of jurisdiction and more precise in identifying the scope of the tax carve out clause. If in tribunal’s opinion, the non-discrimination obligation was not applicable to taxation measures and hence not within its jurisdiction, it should have refrained from examining the claimant’s arguments. A mere ‘academic’ opinion in an arbitral award was not necessary.

⁴³⁸ *Ibid.*

⁴³⁹ In *EnCana* award, the tribunal in its award pointed out that there were significant differences in the BIT applicable in the present case and the BIT that was applicable in *Occidental*. Even though both contained tax-carve out clauses, they were worded differently which in turn affected the scope of jurisdiction of the tribunals. See *EnCana* award, *supra* note 211, footnote at para 167.

⁴⁴⁰ *El Paso Energy International Company v The Argentine Republic* ICSID Case No. ARB/03/15 (Award, 31 October 2011) para 316; Also see Chapter 6 below for a discussion on jurisdictional ambiguity surrounding the non- discrimination obligation.

The above mentioned awards (especially *EnCana*) show that the meaning of the term ‘tax’ or ‘taxation measures’ can have a significant impact in a tribunal asserting or declining jurisdiction.⁴⁴¹ These terms are not usually defined in IIAs. Even double taxation treaties do not usually define the term tax in an informative manner.⁴⁴² Investment agreements involving natural resources use terms such as levies, royalties, licence fees or taxes, and whether a tribunal has jurisdiction may hinge on the meaning of the term ‘tax’.⁴⁴³ In *Link Trading v Moldova*, the claimant argued that it enjoyed the right to custom duty stability for a period of ten years on its investment. It further claimed that by changing the customs rule the respondent state had violated the claimant’s right. The tribunal was required to interpret the term taxation in order to establish its jurisdiction. The tribunal gave a liberal meaning to the term taxation and observed that the term taxation as used in the Moldova-US BIT was ‘broad enough to cover customs duties and other forms of raising revenue that are within the State’s power.’⁴⁴⁴

This meaning of the term ‘tax’ was also examined by the tribunal in *Burlington*.⁴⁴⁵ The dispute in *Burlington* concerned Ecuador’s legislation (Law 42) which increased the government’s share in production sharing contracts from around 22% to 50% (later increased to 99%). This was to avowedly increase the state’s share in extra-ordinary profits i.e. profits from oil prices which were in excess of the price of oil when the production sharing contracts were executed. The parties disagreed whether the increase in oil prices was unforeseen or foreseeable at the time of execution of the contract. Eventually the claimant invoked the US-Ecuador BIT and the tribunal at the jurisdiction stage examined Article X.⁴⁴⁶ After ruling that it had jurisdiction over *Burlington*’s expropriation claim, the tribunal examined jurisdiction objections concerning the non-expropriation claims. It sought to answer the question that whether the non-expropriation claims involve ‘matters of taxation’ under Article X of the BIT.

⁴⁴¹ At times, however, the tribunal may derive its jurisdiction from a MFN clause. See *RosInvest Co* award, *supra* note 374, at paras 124-139.

⁴⁴² Income tax treaties generally define the term ‘tax’ in reference to the domestic tax laws of the contracting states. See Art 3, India-Mauritius tax treaty (1983) where the term ‘tax’ is defined to mean Indian tax or Malta tax

i.e. the income tax in India and the income tax in Malta respectively.

⁴⁴³ See Art 16, Canada Model BIT (2004) which provides that if in connection with a claim by an investor, an issue arises whether the measure of a contracting party is a taxation measure, the party may refer it to the taxation authorities of the parties. The decision of the taxation authorities shall bind the tribunal. In case the taxation authorities do not decide the issue within 6 months, the arbitral tribunal shall decide in place of the taxation authorities.

⁴⁴⁴ *Link Trading* award, *supra* note 422.

⁴⁴⁵ *Burlington* award, *supra* note 370, at paras 159-177.

⁴⁴⁶ *Ibid*, at para 160.

In order to answer that question, the tribunal first needed to answer the question ‘whether the impugned law - ‘Law 42’ is a tax for the purposes of Article X of BIT.’⁴⁴⁷ It rejected claimant’s contention that ‘Law 42’ can be a tax for the purposes of Article X only if it qualified as a tax under Ecuadorian law. The tribunal observed that Article X is part of a treaty and the question - ‘whether Law 42 is a tax?’, is governed by international law and not Ecuadorian law.⁴⁴⁸ Relying on the *EnCana* award, the tribunal observed that Law 42 is "tax" under Article X of the Treaty if the following four requirements are met: (i) there is a law; (ii) that imposes a liability on classes of persons; (iii) to pay money to the state; (iv) for public purposes. Under this definition, the tribunal held that Law 42 was a tax.⁴⁴⁹ The tribunal concluded that since Burlington's Law 42 was a tax, the non-expropriation claims raised "matters of taxation" within the meaning of Article X and hence the tribunal did not have jurisdiction over the same.⁴⁵⁰

While the tribunal was correct in relying on the robust reasoning of the *EnCana* award, its distinction between international law and domestic law was not entirely accurate. The term ‘tax’ cannot be defined solely by recourse to international law - in fact, the widespread practice in ITL suggests completely otherwise. For instance, the UK-India tax treaty provides that ‘the term "tax" means United Kingdom tax or Indian tax’.⁴⁵¹ In almost every tax treaty the term tax is equated to its meaning under the relevant domestic tax law. For an investor-state tribunal to treat international law and domestic law as completely separate while defining the term tax does not reflect an accurate understanding of ITL.

Contrary to the *Burlington* award, the tribunal in *Occidental(II)* observed that the same ‘Law 42’ is ‘neither a royalty, a tax, a levy or any other measure of taxation.’⁴⁵² The tribunal added that Law 42 was merely a unilateral decision of the Ecuadorian Congress to ‘allocate to the Ecuadorian State’ a defined percentage of the revenues earned by contractor companies such

⁴⁴⁷ *Ibid*, at para 161.

⁴⁴⁸ *Ibid*, at para 162.

⁴⁴⁹ *Ibid*, at para 165.

⁴⁵⁰ *Ibid*, at para 168; Also see *Perenco Ecuador v Republic of Ecuador* ICSID Case No. ARB/08/6 (Decision on Jurisdiction, 30 June 2011) (where the same Law 42 was in question, but the tribunal in contrast to the *Burlington* award noted that it had jurisdiction over non-expropriation claims. This is because Perenco filed its claim under the France-Ecuador BIT whose tax carve out had limited scope as compared to a more expansive tax carve out in the US-Ecuador BIT under which Burlington filed its claim).

⁴⁵¹ Art 3(1)(c), UK-India tax treaty (1993).

⁴⁵² *Occidental Petroleum Corporation Occidental Exploration and Production Company v The Republic of Ecuador*, (Award, 5 October 2012) para 509; Also see *Dissenting Opinion Brigitte Stern*, at para 12 (stating that Law 42 is a ‘tax’) (hereinafter *Occidental(II)*).

as Occidental under the participation contract they had signed with Ecuador.⁴⁵³ The tribunal unconvincingly attempted to distinguish between tax, royalty and levy. In my view, the approach of the tribunal in *Burlington* was comparatively more thorough and ‘Law 42’ enacted by Ecuador to tax windfall profits should have been characterised as a tax by the tribunal in *Occidental(II)*.⁴⁵⁴

In a similar vein, the tribunal in the *Murphy* award made an unconvincing observation that Ecuador’s ‘Law 42’ was not a tax or a matter of taxation under international law, but a unilateral change of its contract with the claimant.⁴⁵⁵ The tribunal concluded that under international law, ‘Law 42’ did not constitute a tax. However, the tribunal did not authoritatively elaborate as to how tax is defined under international law.⁴⁵⁶

The tribunals in the *Yukos* awards tried to earmark a tribunal’s jurisdiction by distinguishing mala fide and bona fide taxation measures. For instance, in the *Hulley* award, the tribunal justifying its jurisdiction under the ECT observed that:

in any event, the carve-out of Article 21(1) can apply only to *bona fide* taxation actions, *i.e.*, actions that are motivated by the purpose of raising general revenue for the State. By contrast, actions that are taken only under the guise of taxation, but in reality aim to achieve an entirely unrelated purpose (such as the destruction of a company or the elimination of a political opponent) cannot qualify for exemption from the protection standards of the ECT under the tax carve-out in Article 21(1).⁴⁵⁷

The premise of the tribunal - that only mala fide taxation measures can cause expropriation, is questionable. Bona fide tax measures can be expropriatory if they substantially deprive an investor of its investment. The tribunal, however, in its award on jurisdiction and

⁴⁵³ *Ibid*, at para 510.

⁴⁵⁴ Incidentally, the tribunal in *Occidental (II)* observed that irrespective of whether ‘Law 42’ is characterised as a taxation measure or not, the tribunal would have jurisdiction over the claim. This makes the tribunal’s observations on the meaning of tax, levy and royalty superfluous and unnecessary. *Ibid*, at paras 497-499.

⁴⁵⁵ *Murphy Exploration and Production Company v The Republic of Ecuador* (UNCITRAL, Partial Award, 6 May 2016). para 192.

⁴⁵⁶ The tribunal (in an ostensible disagreement with the *EnCana* award) merely observed that Law 42 imposed economic burdens on a class of persons to pay money to the state ostensibly for public purposes without there being a direct benefit to the taxpayer. But, not every mandatory payment that meets these three criteria is a tax. The tribunal did not give any specific reasons for this conclusion. *Ibid*, at paras 188-192.

⁴⁵⁷ *Hulley* award, *supra* note 299.

admissibility,⁴⁵⁸ correctly clarifies that it is not an appellate court and it shall not adjudicate on the correctness or otherwise of the decisions of the domestic courts of Russia.

Almost every arbitral tribunal carefully scrutinises tax carve outs and the nature of the claim to determine whether the taxation measure in question is within the scope of the IIA. This is particularly important because investor-state tribunals are not appellate courts in tax matters. The tribunals need to carefully segregate the tax-related investment dispute from other issues or disputes that may be closely related but nonetheless are beyond their jurisdiction.⁴⁵⁹ The taxation measure in question needs to have a nexus with the investment for the tribunal to validly assume jurisdiction.⁴⁶⁰ The respondent raised this argument in the *Duke Energy* award.⁴⁶¹ The dispute concerned the tax assessment of the claimant by the tax authorities of Peru and the eventual determination of the tax liability. The dispute concerning the assessment and tax liability had been adjudicated by Peruvian tax courts. One of the respondent's objections to the jurisdiction of the tribunal was that Peruvian tax courts had fully resolved the dispute. Peru contended that even if the tribunal found that the claims were admissible, it should decline to sit as an appellate body for the Peruvian Tax Court. The tribunal stated that it cannot accept the respondent's argument because the issue before it was 'not a dispute about taxes but, rather, an investment dispute arising out of the imposition of taxes.'⁴⁶²

Further, the tribunal emphasised that the issues before it could not have been within the purview of the Peruvian tax court. The dispute before the tribunal involved determining the impact on investment as opposed to the general obligation under tax laws. Also, the tribunal noted, it was not required to determine whether the decision of the tax court was right or wrong as a matter of Peruvian tax law but whether the interpretation by the court was consistent with the claimant's rights secured under the legal stability agreement. Since the tribunal would not adjudicate on the correctness or otherwise of the decisions of the tax courts, it was not an appellate court. The tribunal, thus, concluded that since the dispute

⁴⁵⁸ *Ibid*, at 202-216.

⁴⁵⁹ See *EnCana* award, *supra* note 211, at para 142.

⁴⁶⁰ See *El Paso Energy International Co. v The Argentine Republic* ICSID Case No. ARB/3/15 (Decision on Jurisdiction, 27 April 2006) paras 101-116 (where the tribunal stressed that it had jurisdiction over the tax matters in so far as they were related to the investor concessions).

⁴⁶¹ *Duke Energy* award, *supra* note 369.

⁴⁶² *Ibid*, at para 159.

concerned the investment, it was within its jurisdiction.⁴⁶³ This line of reasoning adopted in the *Duke Energy* award echoed the *EnCana* award where the tribunal had observed that:

provided a matter is sufficiently clearly connected to a taxation law or regulation (or to a procedure, requirement or practice of the taxation authorities in apparent reliance on such a law or regulation), its legality is a matter for the courts of the host State.⁴⁶⁴

Thus, the discussion in this sub-section shows that tribunals have relied on the wording of the tax carve out clause and the meaning of the term tax to determine the scope of their jurisdiction. While the differently worded tax carve out clauses necessarily means that the jurisdiction of the tribunal would need to be determined on a case-by-case basis; the term 'tax' has invited different interpretations by tribunals. The tribunal in the *EnCana* award articulated a convincing definition, but the tribunals such as in the *Murphy* award have expressed disagreement with it. Further, it must be noted that apart from the *Occidental* award, most tribunals have correctly treated objections relating to tax carve out provisions as one of jurisdiction and not of admissibility. The issue of admissibility in tax-related investment disputes is also relevant when one considers the implications of provisions relating to tax veto in IIAs.

C. Implications of the Tax Veto

Apart from tax carve outs, the provision of tax veto is another unique aspect of tax-related investment disputes. Tax veto, as discussed in Chapter 2, provides that under the relevant IIA, the contracting states have the first right to determine if the relevant taxation measures do not amount to expropriation. The provision of tax veto is only for tax-related investment disputes and for no other kind of investment dispute. The implications that flow from tax veto are, however, unclear.

From the viewpoint of admissibility of a claim, the provision of tax veto leaves several issues undressed. For instance, in the *Yukos Universal* award, the tribunal has interpreted that

⁴⁶³ *Supra* note 469; Also see *Bogdanov & Bogdanova v Moldova* SCC Arbitration V (091/2012) (Award, 16 April 2013) paras 173-174 (The arbitral tribunal held that if the investor had sought relief in a local court, the basis of those claims were different. The fundamental basis of the dispute before the arbitral tribunal is whether or not the losses suffered by the claimants are attributable to the breaches of the BIT. This cause of action could not be and in fact never was reviewed by Moldovan courts. The tribunal, thus, dismissed objections to its jurisdiction by the respondent state).

⁴⁶⁴ *EnCana* award, *supra* note 211, at para 142.

under Article 21 of the ECT the reference to the competent tax authorities is contemplated as merely a step towards arbitration.⁴⁶⁵ The tribunal, in my view, has incorrectly categorised the requirement of reference to the competent authorities in a tax-related investment dispute with the requirement of the 6-month waiting period provided in various IIAs.⁴⁶⁶ The tribunal in *EnCana* observed that an ‘investor’s referral to the taxation authorities may be made out of an abundance of caution.’⁴⁶⁷ I would like to submit that in both the awards, the tribunals did not fully appreciate that the provision of tax veto is different from the 6-month waiting or negotiating period provided for in certain IIAs.⁴⁶⁸

In *Sergei Paushok*, the tribunal stated that the failure to abide by the negotiating period would not go to the jurisdiction and the tribunal would consider the failure to abide by the negotiation requirement under damages and not as part of the jurisdictional hearing.⁴⁶⁹ The negotiating period in this case did not refer to the treaty provision that incorporated tax veto and hence the observation of the tribunal was correct. However, in case the provision of tax veto is involved, the distinction between jurisdiction and admissibility is essential and can usefully inform tax-related investment disputes.

In the event that the dispute is referred to the competent authorities and they fail to arrive at a joint determination within the specified time period, the dispute can thereafter be referred to the arbitral tribunal. In such a scenario, the tribunal will normally be confronted with an objection from the respondent state that taxation measures do not fall within the

⁴⁶⁵ *Yukos Universal Award*, *supra* note 160, at paras 1417-1429; *Plama award*, *supra* note 158; Also see Chapter 2, Section III.A above.

⁴⁶⁶ See *Murphy Exploration and Production Company International v Republic of Ecuador* ICSID Case No. ARB/08/4 (Decision on Jurisdiction, 15 December 2010) (where the tribunal declined to hear the claim since the mandatory requirement of observing the negotiating period had not been fulfilled. But, the tribunal did not confuse the negotiating period with the provision of tax veto).

⁴⁶⁷ See *EnCana v Ecuador* (Partial Award on Jurisdiction, 27 February 2004) para 33 (the tribunal also mistakenly observed that the referral of the matter to the taxation authorities did not affect its jurisdiction one way or another).

⁴⁶⁸ See, for instance, Art 6, US-Ecuador BIT (1993) (provides that the disputants should initially seek to resolve the dispute by consultation and negotiation).

⁴⁶⁹ *Sergei Paushok CJSC Golden East Company CJSC Vostokneftegaz Company v Government of Mongolia* (Award on Jurisdiction and Liability, 28 April 2011) para 220; Also see *RosInvest award*, *supra* note 374, at para 140-152 (the respondent state pointed to the failure to exhaust local remedies by the claimant. It argued that the failure to exhaust local remedies be treated either as an objection based on jurisdiction or admissibility. The claimant responded that the respondent in its arguments had implicitly argued that the rule of exhaustion of local remedies can dispensed with. The concept of waiver, the claimant argued, is the distinguishing element between objections to admissibility and jurisdiction. The tribunal agreed with the claimant and observed that the ‘very fact that the local remedies rule may be waived, as is undoubtedly the case, demonstrates that one is not dealing with a jurisdictional issue.’); Also see *SGS v Philippines award*, *supra* note 391, at para 184.

scope of the relevant IIA. This objection may be classified as a matter of jurisdiction and the parties will have the opportunity to contest the tribunal's decision.⁴⁷⁰ By contrast, if the parties are under an obligation to first refer the dispute to competent authorities but fail to do so - it should be classified as an issue of admissibility. If the claimant bypasses the requirement of informing the tax authorities or subsequent to informing them fails to comply with the stipulated waiting period; in such a case filing the claim before the tribunal will be premature and hence inadmissible.⁴⁷¹ Once the prescribed time period has elapsed and no joint determination is issued by the authorities, it is open for the tribunal to adjudicate on the claim provided it establishes its jurisdiction. Hence, the classification of a matter as one of admissibility or jurisdiction is vital when the provision of tax veto is involved in tax-related investment disputes. This distinction is of course applicable to the IIAs where the provision to refer to tax veto is mandatory; if it is only enabling or discretionary, then the above distinction may not apply.⁴⁷²

IV. A GREATER ROLE FOR COUNTERCLAIMS IN TAX-RELATED INVESTMENT DISPUTES

A counterclaim is distinct from a defence on merits of the principal claim;⁴⁷³ it is autonomous but related to the principal claim.⁴⁷⁴ Advancing defence on merits allows the respondent to merely avoid losing while a successful counterclaim allows the respondent to seek redress for its own grievance.⁴⁷⁵ Counterclaims assume an additional significance in investor-state arbitration where states are usually the respondent as IIAs ordinarily only contain obligations for the host state and permit investors to initiate arbitration claiming damages for breach of the obligations. Counterclaims allow states to present their claims against the investor.

⁴⁷⁰ *Republic of Ecuador v Occidental Exploration & Production Co* (No. 2) [2006] 1 Lloyd's Rep 777 (Ecuador applied under section 67 of the English Arbitration Act to challenge the arbitral award rendered in favour of Occidental under the Ecuador-US BIT. Ecuador challenged the award on the ground that the tribunal had exceeded its jurisdiction by ruling on a taxation matter.).

⁴⁷¹ Certain IIAs expressly mention that in case the investor does not refer the dispute to the competent authorities, the adjudicating body 'shall' make a referral to the relevant tax authorities. See Art 21(5)(b)(i), ECT.

⁴⁷² See Art X 06, para 7, CETA, *supra* note 301.

⁴⁷³ See generally Michael Waibel, *supra* note 386.

⁴⁷⁴ See *Klöckner Industrie-Anlagen GmbH and others v United Republic of Cameroon and Société Camerounaise des Engrais* ICSID Case No. ARB/81/2 (Award, 12 October 1983) (the tribunal observed that the subject-matter of both the claim and the counterclaim should be 'indivisible' and 'interdependent').

⁴⁷⁵ See Andrea K. Bjorklund, 'The Role of Counterclaims in Rebalancing Investment Law' (2013) 17 *Lewis & Clark L Rev* 461.

Various arbitration rules envisage counterclaims. Article 46 of the ICSID Convention states that:

Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre.⁴⁷⁶

The ICJ Rules also provide that the Court may entertain a counter-claim only if it comes within the jurisdiction of the court and is directly connected with the subject-matter of the claim of the other party.⁴⁷⁷

In investor-state arbitration, counterclaims, if successfully advanced, can correct the asymmetry in favour of investors. Counterclaims not only allow the states to bring the conduct of the investor to the notice of the tribunal but they also advance state's own claims against the investor.⁴⁷⁸ Despite the advantages of counterclaims, states have not resorted to counterclaims in investor-state arbitration frequently or successfully.⁴⁷⁹

In this Section, I discuss the relevance of counterclaims in tax-related investment disputes with the help of a few arbitral awards. However, to advance counterclaims certain conditions need to be met. As mentioned above, the ICJ Rules and the ICSID Convention both contain two similar conditions: the adjudicating body should have jurisdiction to hear the counterclaims and the counterclaims should be directly connected to the subject-matter of the dispute. I argue that a more liberal interpretation of the latter condition can help in promoting a greater role of counterclaims in tax-related investment disputes. It would, to some extent, correct the asymmetry of investor-state arbitration currently in favour of investors.

⁴⁷⁶ Also see Art 40, ICSID Arbitration Rules (1967); Art 21(3), UNCITRAL Arbitration Rules (2010); Art 5, Rules of the Arbitration Institute of the SCC (2010); Art 5, ICC Arbitration Rules (2012).

⁴⁷⁷ Art 80, para 1, ICJ Rules (1978).

⁴⁷⁸ T. Weiler, 'Balancing Human Rights and Investor Protection: A New Approach for a Different Legal Order' (2004) 27 B.C. Int'l & Comp L Rev 429, at 449 (arguing that counterclaims may be permitted for human rights violations by the investor).

⁴⁷⁹ Andrea Bjorklund suggests that the tenacity with which investors resist counterclaims suggests that they would rather defend themselves in municipal courts than in international arbitration or it may simply be a litigation or arbitration strategy. See Andrea K. Bjorklund, *supra* note 475, at 464; For a detailed discussion on counterclaims before the ICJ see Sean D. Murphy, 'Counter-Claims at the International Court of Justice' in Andreas Zimmermann, et al. (eds.), *The Statute of International Court of Justice: A Commentary* (Oxford University Press 2012) 1016.

A. Jurisdiction

The jurisdiction to hear counterclaims is essentially related to the scope of consent of the parties to the dispute. Zachary Douglas argues that the scope of consent by the investor in accepting the offer to arbitrate is not limited to the principal claim. The investor accepts the offer in its entirety and not a part of it.⁴⁸⁰ This, in my opinion, is the correct position. A modification of the offer to arbitrate is not an acceptance of the offer but a counter-offer. Similarly, accepting only a part of the offer to arbitrate is akin to segregating the offer into different parts. Such an option is only open to the investor if the state formulated its offer to arbitrate in a similar fashion. In the *Roussalis* award, the tribunal stated that it is not disputed that the respondent, Romania, expressed its consent to arbitration in the BIT and that the claimant accepted Romania's offer to arbitrate. However, respondent contended that such consent included consent to arbitrate counterclaims. The tribunal observed that the scope of the consent can only be determined by reference to the dispute resolution clause contained in the BIT. The investor's consent to the BIT's arbitration clause can only exist in relation to counterclaims if such counterclaims come within the consent of the host state as expressed in the BIT.⁴⁸¹ To extend the observations of the tribunal in *Roussalis* further - the wording of the IIA should determine if the tribunal is empowered to adjudicate on the counterclaims. The acceptance by the investor should not be construed as only limited to the claims submitted by it and the acceptance should be interpreted by referring to the text of the relevant IIA.⁴⁸²

In *Roussalis* the tribunal rejected the counterclaim of the state by stating that the references made in the text of Article 9(1) of the BIT to 'disputes ... concerning an obligation of the latter' undoubtedly limit the jurisdiction of the tribunal on claims brought by investors about obligations of the host state.⁴⁸³ Accordingly, the BIT does not provide for counterclaims to be introduced by the host state in relation to obligations of the investor. The meaning of the 'dispute' was restricted to the issue of compliance by the state with the BIT.⁴⁸⁴

However, Professor Reisman issued a dissenting opinion in which he disagreed with the majority's decision to reject jurisdiction and stated:

⁴⁸⁰ Zachary Douglas, *supra* note 166, at para 491.

⁴⁸¹ *Spyridon Roussalis v Romania* ICSID Case No ARB/06/1 (Award, 7 December 2011) para 866.

⁴⁸² See *Oil Platforms (Islamic Republic of Iran v United States of America)* Counter-Claim Order (1998) ICJ Rep 218, at 219.

⁴⁸³ *Roussalis* award, *supra* note 481, at para 869.

⁴⁸⁴ *Ibid.*

... in my view, when the State Parties to a BIT contingently consent, *inter alia*, to ICSID jurisdiction, the consent component of Article 46 of the Washington Convention is ipso facto imported into any ICSID arbitration which an investor then elects to pursue. It is important to bear in mind that such counterclaim jurisdiction is not only concession to a State Party: Article 46 works to the benefit of both respondent state *and* investor. In rejecting ICSID jurisdiction over counterclaims, a neutral tribunal - which was, in fact, selected by the claimant - perforce directs the respondent State to pursue its claims in its own courts where the very investor who had sought a forum outside the state apparatus is now constrained to become the defendant.⁴⁸⁵

While Professor Reisman is accurate in stating the aims that could be achieved by allowing the counterclaims, in my view, he places greater emphasis on the objectives of judicial economy and diminishes the importance of the scope of consent of the parties. As I stated in Section II above, the tribunals need to defer to the consent of the parties. The wording of the relevant IIA reveals the scope of consent of the parties and should be the controlling factor in allowing/disallowing a counterclaim. The objective of judicial economy is certainly worth pursuing but it cannot override the consent of the parties to the dispute.⁴⁸⁶ While I agree with the underlying intent of Professor Reisman's opinion - a need for liberal stance on counterclaims, I disagree with the manner in which he approaches the issue.⁴⁸⁷ A liberal interpretation of the second requirement of counterclaims - close connection with the subject-matter of dispute, is in my opinion, preferable.

B. Directly Related to the Subject-Matter of the Dispute

The second requirement of counterclaims is that they should be connected to the subject-matter of the dispute. This condition serves the objective of judicial economy. The inclusion of counterclaims in proceedings can prevent multiple legal proceedings.⁴⁸⁸ Counterclaims

⁴⁸⁵ Declaration by W. Michael Reisman, 28 November 2011.

⁴⁸⁶ See *Klöckner* award, *supra* note 474 (where the tribunal observed that efficiency and economy in international dispute resolution could not outweigh considerations of a strictly legal nature and that the scope of a tribunal's jurisdiction is determined by the parties' consent.).

⁴⁸⁷ For a critique of Professor Reisman's opinion see Dafina Atanasova, et al, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31 J Int'l Arb 357.

⁴⁸⁸ In *Saluka Investments B.V. v The Czech Republic* (Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004) para 24 (the respondent argued that the exercise of jurisdiction by the tribunal over the respondent's counterclaim would advance the goals of economy and efficiency in international dispute resolution, since otherwise the respondent would have to pursue its claim elsewhere).

should not be irrelevant claims that unnecessarily delay the arbitral proceedings. The ICJ in the *Armed Activities Case* observed that ‘as a general rule, the existence of a direct connection between the counter-claim and the principal claim must be assessed both in fact and in law.’⁴⁸⁹ The requirement of connection with law assumes significance in investor-state arbitration because IIAs do not generally contain obligations for investors. The respondent state, will thus base its claims in a law other than the IIA. It has been observed that it is of capital importance to determine the governing law applicable in order to consider the source of jurisdiction of the counter-claim.⁴⁹⁰ Where the IIA specifies that the applicable law is the IIA itself, counterclaims usually fall outside the tribunal’s jurisdiction.⁴⁹¹ For example, in *AMTO v Ukraine*, the tribunal observed that the applicable law is the ECT and the rules and principles of international law. The tribunal observed that the respondent did not present any counterclaim in the applicable law and dismissed the counterclaim.⁴⁹²

States have advanced counterclaims in a few tax-related investment disputes. When it comes to counterclaims in tax-related investment disputes, two aspects are important at the outset: first, counterclaims by states ordinarily arise from domestic tax laws as both IIAs and tax treaties do not usually impose any obligations on the investors; second, states can argue in counterclaims that investors should follow general principles of law, as recognised in ITL, even if they are not specifically incorporated in the provisions of the IIAs.⁴⁹³ But states have not relied on this argument. Nonetheless, as I proceed to discuss in the following paragraphs - the tribunals have not adequately appreciated the first aspect while the states have not relied on general principles of law in advancing counterclaims.⁴⁹⁴

In *Sergei Paushok*, the state’s counterclaims inter alia asserted that the claimants owed taxes and that a company owned by the claimants evaded a worker fee. The counterclaims were

⁴⁸⁹ *Armed Activities Case (DRC/Uganda)*, Counter Claims Order, (2001) ICJ Rep 660, at para 44. For a different view see Pierre Lalive, Laura Halonen, ‘On the Availability of Counterclaims in Investment Treaty Arbitration’ (2011) *Czech Yrbk Int’l L* 141, at 145 para 7.13 (stating that ‘it should be enough that there is a factual nexus with the claims themselves’).

⁴⁹⁰ *SGS v Islamic Republic of Pakistan* ICSID Case No. ARB/01/13 (Procedural Order No 2, 16 October 2002).

⁴⁹¹ *Roussalis* award, *supra* note 481, at para 871.

⁴⁹² *Limited Liability Company AMTO v Ukraine*, SCC Arbitration No. 080/2005 (Final Award, 26 March 2008) para 118.

⁴⁹³ It is an open question, however, if and to what extent would such an argument be successful; Also see José Antonio Rivas, ‘ICSID Treaty Counterclaims: Case Law and Treaty Evolution’ in Jean E. Kalicki, Anna Joubin-Bret (eds.), *Reshaping the Investor-State Dispute Settlement System Journeys for the 21st Century* (Brill/Nijhoff 2015) 779, at 781 (makes the point that investor should follow general principles of law, but more generally and not in the specific context of ITL); For a discussion on general principles of law in ITL see Chapter 1 above.

⁴⁹⁴ At the same time, the scope of counterclaims would also be determined by the applicable law mentioned in the IIA.

rejected by the tribunal for three reasons: first, they were directed against a third party which was not party to the dispute; second, they did not have a close connection with the primary claim; third, the counterclaims did not arise out of the investment contract between the host state and the foreign investor but arose out of Mongolian public law including the tax law of Mongolia. The tribunal elaborated on the last reason and observed that Mongolia, through counterclaims, was seeking to ‘extend the extraterritorial application and enforcement of its public laws, and in particular its tax laws, to individuals and entities not subject to and not having accepted to submit to Mongolian public law or its courts.’⁴⁹⁵ The tribunal added that extending its jurisdiction over the counterclaims advanced by the respondent would amount to ‘acquiescing to a possible exorbitant extension of Mongolia’s legislative jurisdiction without any legal basis under international law to do so, since the generally accepted principle is the non-extraterritorial enforceability of national public laws and, specifically, of national tax laws.’⁴⁹⁶ In the context of the dispute the tribunal was correct since the counterclaims, inter alia, demanded that the tribunal declare that a corporation owed taxes to Mongolia but the said corporation was not a party to the dispute. However, the observations of the tribunal are not necessarily applicable in a case where the counterclaim of unpaid taxes is directed towards the claimant. Where the claimant is an investor in the territory of the host state, the issue of extraterritorial enforcement of taxation laws does not ordinarily arise. The tribunal, however, may be faced with the question of whether it has jurisdiction over the parent company incorporated in a different jurisdiction.⁴⁹⁷

The other issue before the tribunal in such a case will be if it has the power to adjudicate on tax liability of the investor and whether it encroaches on the domain of the domestic courts of the host state. For example, in *Amco v Indonesia No. 2*,⁴⁹⁸ Indonesia raised a counterclaim for tax fraud on the part of the claimants and sought restitution of sums representing tax allegedly evaded by the claimants. The tribunal rejected the claim by stating that it lacked jurisdiction over the counterclaim. The tribunal observed that the obligation not to engage in

⁴⁹⁵ *Sergei Paushok* award, *supra* note 469, at para 695.

⁴⁹⁶ *Ibid.*

⁴⁹⁷ Also see *Saluka Investments* award, *supra* note 488, at para 44 (where the claimant contended that tribunal had no jurisdiction over the entity against which counterclaim was asserted because that entity had not consented to be a party to arbitration. The tribunal proceeded on the assumption that ‘the relationship between [affiliated parties] is sufficiently close to enable the Tribunal’s jurisdiction in proceedings instituted by [the local subsidiary] to extend its claims against [the parent company].’).

⁴⁹⁸ (Preliminary Objections) 1 ICSID Rep 543.

tax fraud was a general obligation of Indonesian law and did not directly arise out of the investment.⁴⁹⁹ This is similar to the observations of the tribunal in *Sergei Paushok* award which also rejected counterclaims for the reason that the counterclaims were based in the domestic law of the host state. This aspect of counterclaims, as stated above, needs a more careful approach in investor-state arbitration.

In my view, the fact that a counterclaim arises from a different legal instrument is separate from the requirement that it should be connected to the subject-matter of the dispute. As long as applicable law did not restrict the tribunal, connection with subject-matter is enough. Additionally, while Mongolia could have claimed the investor should follow the general principles of law in ITL and should not indulge in tax evasion. But, this argument was not raised before the tribunal. It remains to be seen how tribunals would address this argument - if and when it is raised by the states.

States have also tried to present tax evasion by claimant as a defence. In *Sergei Paushok*, the respondent state also relied on the pre-arbitration conduct of the claimant. The respondent alleged that the claimant was involved in 'systematic tax evasion by way of inter-company loans and service agreements.'⁵⁰⁰ This conduct of the claimant, the respondent argued, made its claim inadmissible. The tribunal correctly rejected this argument and stated that such conduct does not itself deprive the tribunal of its jurisdiction or make the claims inadmissible. The tribunal added that the conduct of the claimant may influence its conclusion but it is an issue that is related to the merits of the case and is not an issue of jurisdiction or admissibility. The question of tax evasion by the claimant and abuse of tax treaties was raised by the respondent state more forcefully in the *Yukos* awards.

In *Yukos Universal*, the tribunal, conceded to the argument of the respondent that an investor who had through violation of the laws of the host state brought itself within the scope of the ECT should not be allowed to benefit from it. However, the tribunal went ahead to make a distinction between the making of an investment and its performance. The tribunal observed:

[T]here is no compelling reason to deny altogether the right to invoke the ECT to any investor who has breached the law of the host State in the course of its investment. If the investor acts illegally, the host state can request it to

⁴⁹⁹ In *Saluka Investments* award, one of the counterclaims was denied on the ground that it was related to non-compliance with the general law of the Czech Republic and was not sufficiently closely connected with the subject-matter of the original claim so as to fall within the tribunal's jurisdiction under the IIA. See *supra* note 488.

⁵⁰⁰ *Ibid*, at para 222.

correct its behaviour and impose upon it sanctions available under domestic law, as the Russian Federation indeed purports to have done by reassessing taxes and imposing fines. However, if the investor believes these sanctions to be unjustified (as Claimants do in the present case), it must have the possibility of challenging their validity in accordance with the applicable investment treaty. It would undermine the purpose and object of the ECT to deny the investor the right to make its case before an arbitral tribunal based on the same alleged violations the existence of which the investor seeks to dispute on the merits.⁵⁰¹

In *Yukos Universal*, the respondent state raised the issue of tax evasion by the investor as a defence and not as a counterclaim. The intent of the respondent state was to underline that due to the conduct of the investor (namely tax evasion) during the course of investment, it should not be allowed access to investor-state arbitration. Like the tribunal in *Sergei Paushok*, the tribunal in *Yukos Universal* correctly observed that the illegality conducted by an investor during the course of investment does not affect a tribunal's jurisdiction but may influence its conclusion on merits and the eventual damages that may be awarded. In my opinion, the arguments relating to tax evasion by an investor are better made as a counterclaim and not as a defence. Tribunals should, however, liberally allow counter claims.

A signalling function to encourage more counterclaims is to liberally interpret the connection with the subject matter. In the context of counterclaims in tax-related investment disputes, the meaning of connection to subject-matter needs to be assessed more elaborately. The term 'directly related to subject matter' is expressly referred to in the ICSID Convention. Unless the relevant IIA mentions the applicable law and thereby restricts jurisdiction of the arbitral tribunal, counterclaims should be allowed as long as they are 'part of the same factual complex'.⁵⁰²

A hurdle to this suggested liberal approach is the use of the terms principal claims and subject-matter of dispute interchangeably. In my view, viewing principal claims and subject-matter of the dispute as synonymous is not accurate. The former is likely to be narrower than the latter and thus if a connection with the principal claims is insisted then the respondent state is less likely to succeed in its counterclaims.

⁵⁰¹ *Yukos Universal* award, *supra* note 160, at para 1355.

⁵⁰² *Oil Platforms Case*, *supra* note 482, at para 38.

If tribunals insist on connection with a principal claim it will add another hurdle in tax-related investment disputes where the tribunals have not been inclined to accept counterclaims that rely on the domestic tax law of the host state. By adopting a distinction between principal claims and the subject-matter, counterclaims are more likely to provide a credible balance between the investor and the state in investor-state arbitration. It is submitted, that the normative function of enhancing procedural and judicial economy is captured by the requirement of connectivity with the subject-matter of dispute and not principal claims of the investor. This permissive approach can be followed by other tribunals similar to the relatively liberal approach adopted in *Benvenuti v Congo*.⁵⁰³

Benvenuti and Bonfant entered into an agreement with the government of Congo to set up an establishment for the manufacture of plastic bottles and also a mineral water bottling plant. A company was incorporated where Congo held 60% of the shares. It was promised that the company will not be subject to any foreign competition and shall operate under a single tax regime. Later, the government interfered with the conduct of business and unilaterally fixed selling prices of bottles. Mr. Bonfant taking into account the changed circumstances concluded that the company had essentially become a state company but without any formal act of expropriation. Fearing for his personal safety he left Congo along with most of his Italian staff and the army later took over the head office of the company. Bonfant initiated arbitration and claimed damages under Article 12 of the agreement which provided recourse to ICSID. The government advanced counterclaims claiming damages for non-payment of duties and charges, over invoicing of raw materials and moral damages.

With regard to its jurisdiction to hear counterclaims the tribunal simply observed that the ‘counterclaim relates directly to the subject-matter of the dispute, that the jurisdiction of the Tribunal has not been disputed and that it falls within the jurisdiction of the Centre.’⁵⁰⁴ The tribunal, in a wide interpretation of its jurisdiction also claimed jurisdiction over the ‘moral damages’ claimed by Congo.⁵⁰⁵ The claim for moral damages was eventually rejected on merits. As compared to the more recent decisions of the arbitral tribunals on

⁵⁰³ *Benvenuti ET Bonfant v People’s Republic of the Congo* (1982) 4 ILM 740.

⁵⁰⁴ *Ibid*, at para 4.104.

⁵⁰⁵ *Ibid*, at para 4.120.

counterclaims, the tribunal adopted a more permissive approach towards the counterclaims.

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Perenco award is another example of a tribunal's liberal view of jurisdiction in accepting counterclaims.⁵⁰⁷ In the *Perenco* award, the respondent state filed a counterclaim for environmental damages claiming that the claimant had failed to maintain the oil blocks and the infrastructure in a working condition. It was argued that the damage caused to the oil blocks violated Ecuador's environmental law. The tribunal exercised jurisdiction over the counterclaims and found that the claimant had violated various provisions of the environmental law.⁵⁰⁸ From a jurisdictional perspective, this award is distinct from the above discussed awards for the tribunal exercised its jurisdiction under a contract and not a treaty.⁵⁰⁹ Nonetheless, it was a liberal interpretation of jurisdiction to entertain an environmental counterclaim in what was essentially a tax-related investment dispute.⁵¹⁰

The liberal interpretation of jurisdiction in relation to counterclaims in *Benvenuti* and *Perenco* is, in my view, a desirable approach. It should be followed by tribunals as it allows a certain balancing act between states and investors and brings conduct of certain investors like tax evasion to the notice of the tribunals.

V. CONCLUSION

Jurisdiction and admissibility acquire special importance in tax-related investment disputes due to tax carve outs and the tax veto. The former are worded differently which necessitates a careful scrutiny of the relevant tax carve out before the arbitral tribunal exercises jurisdiction. Similarly, some IIAs contain tax vetoes that require that investors first refer arbitration to the host state's competent authorities; failure to do so likely leads to inadmissibility. However, there is some inconsistency in the way tribunals have used the term

⁵⁰⁶ Also see *AL-Warraq v Indonesia* (UNCITRAL, Final Award, 15 December 2014) paras 660-667 (the tribunal accepted the respondent's counterclaim by relying on the broadly worded dispute resolution provision of the relevant IIA); See generally Sean D. Murphy, 'Amplifying the World Court's Jurisdiction through Counter-claims and Third Party Intervention' (2000) 33 *Geo Wash Univ Int'l L Rev* 5.

⁵⁰⁷ *Perenco v Ecuador* ICSID Case No. ARB/08/6 (Interim Decision on the Environmental Claim, 11 August 2015).

⁵⁰⁸ *Ibid*, at para 611.

⁵⁰⁹ Though at no place in the award one finds tribunal examining if the contract terms allowed it to exercise jurisdiction over the counterclaims. This is possibly because the claimant did not contest the jurisdiction of tribunal to entertain counterclaims. *Ibid*, at paras 34-35.

⁵¹⁰ See Chapter 6 below for a discussion on the evolving relationship between environment and tax.

admissibility. I suggest that a defect in the claim should be treated as a matter of admissibility. Jurisdiction, on the other hand, should be understood in reference to the competence of the tribunal to hear the claim. This distinction, I suggest, should be employed by tribunals at the preliminary stage of the arbitral proceedings. By contrast, arbitrability is of limited relevance in investor-state arbitration and offers little insight on whether an arbitral tribunal should accept an investor's claims that challenge a state's taxation measures.

Additionally, I suggest that counterclaims can play a greater role in tax-related investment disputes. In tax-related investment disputes, counterclaims primarily arise because the host state argues that the investor evaded its tax obligations. I argue that such counterclaims can be encouraged by liberally interpreting the jurisdictional requirements that are prescribed for counterclaims. I specifically suggest that the requirement of 'directly related to the subject-matter' be interpreted liberally by arbitral tribunals. Since counterclaims in tax-related investment disputes are normally based in a legal instrument other than the IIA; I suggest that this factor should not always lead to rejection of counterclaims, unless the applicable law compels the opposite conclusion. At the same time, states should consider relying on general principles of law in ITL to advance their counterclaims.

While investment tribunals are unlikely to adjudicate on tax liabilities that arise under domestic tax, tribunals can take the conduct of the investor including with respect to tax, into account. For instance, in the *Yukos* awards, investor's the conduct on tax influenced the compensation that the tribunal awarded. Similar approach by other tribunals could help bring about the much required balance in investor-state arbitration that is currently perceived to be favourable to investors.

CHAPTER 4

TAXATION MEASURES AS EXPROPRIATION

I. INTRODUCTION

Investors frequently allege that the state's taxation measures constitute expropriation.⁵¹¹ Taxation measures include retrospective taxation, windfall profits taxes imposed due to sudden and exponential increase in the profits of the investor or a state withdrawing tax incentives which were earlier extended to an investor.⁵¹² Irrespective of the nature of tax measure in question, tribunals are extremely careful before concluding that taxation measures are expropriatory. The threshold of 'expropriation by taxation' has been set high and tribunals have acknowledged, expressly and impliedly, that taxation constitutes a special category in so far as expropriation is concerned.

The high threshold is apparent when one looks at the approach of the tribunals in the *Burlington* and the *Yukos* awards. In the former it was the physical dispossession of the investor that was decisive in tribunal arriving at a finding of direct expropriation and not a tax rate of 99%. In the latter, again, it was auctioning of the assets of the claimant that was the primary reason for tribunal's conclusion that the state's actions constituted expropriation. The misuse of official tax administration and retrospective imposition of tax laws were only secondary factors. Similarly, in addressing arguments on indirect expropriation while most tribunals have relied on the 'substantial deprivation' test, one sees that tribunals hesitate to term a state's taxation measures as expropriatory unless the tax measures result in transfer of property or investor's dispossession.

This chapter analyses the awards of the tribunals in tax-related investment disputes with a view to distil the canon of 'expropriation by taxation'. This chapter makes two arguments. First, while tribunals have rightly acknowledged that taxation forms a special category in investor-state arbitrations, the rationale for treating taxation as a distinct category has not been explained satisfactorily. It is unclear if recognition of taxation as a special category flows from the high threshold set by the tribunals for 'expropriation by taxation' or the other way around. There are occasions when tribunals have unconvincingly justified the special

⁵¹¹ See, for instance, *Señor Tza Yap Shum v The Republic of Peru* ICSID Case No. ARB/07/6 (Decision on Jurisdiction and Competence, 19 June 2009); *Antoine Goetz and others v Republic of Burundi* Case No. ARB/95/3 (Award, 10 February 1999).

⁵¹² See Table 3 below.

status of taxation by obliquely referring to the ‘sovereignty argument’.⁵¹³ I instead suggest that the nature of taxation which per se involves an involuntary transfer of money is the primary factor that distinguishes tax from other state measures and is an important reason for treating tax-related investment disputes as a separate category of disputes.⁵¹⁴ Second, this chapter argues that (some) tribunals are correct in referring to international tax avoidance strategies of MNEs but relying on customary norms in international taxation may be a misguided approach.⁵¹⁵ I rely on my argument in Chapter 1 to reiterate that there no customary norms in ITL. I suggest that the tribunals should view the principles in tax treaties as general principles of law in ITL.⁵¹⁶ In my view, if arbitral tribunals take into account the general principles of law in ITL it could lead to a more nuanced approach, at least in so far as engagement with ITL is concerned.

To examine the above mentioned aspects, this chapter proceeds as follows: in Section II, I engage with J.E. Penner’s argument that taxation and expropriation are distinct concepts.⁵¹⁷ I agree with his argument but suggest that a few exceptions could be added to the distinction.⁵¹⁸ Thereafter, in Section III, I look at the concept of direct expropriation as applied in tax-related investment disputes and the singular importance of physical dispossession. In Section IV, I examine the concept of indirect expropriation. The substantial deprivation test applied by the tribunals is examined along with taxation of windfall profits. I argue that states have significant policy space to enact tax measures despite their obligations in IIAs. In Section V, I look at tax stabilisation clauses, their evolution and suggest that the contemporary tax stabilisation clauses ordinarily reduce the policy space of states to adopt tax measures. Section VI examines the persuasive value of different reasons given by tribunals to endorse taxation as a special category of investment disputes. Section VII discusses the limited engagement of investor-state tribunals with ITL in tax-related investment disputes. Section VIII concludes.

⁵¹³ *Sergei Paushok* award, *supra* note 469; Also see Diane M. Ring, ‘What’s at Stake in the Sovereignty Debate?: International Tax and the Nation-State’ (2008) 49 *Virginia J Int’l L* 155; Ronen Palan, ‘Tax Havens and the Commercialisation of State Sovereignty’ (2002) 56 *Int’l Org* 151.

⁵¹⁴ See *EnCana Award*, *supra* note 211; Also see Section VI below.

⁵¹⁵ See *Yukos Universal* award, *supra* note 160, at 102-170; Also see *Sergei Paushok* award, *supra* note 469, at paras 225-225, 316.

⁵¹⁶ See Section VII below; Also see Chapter 5 below.

⁵¹⁷ J.E. Penner, ‘Misled by Property’ (2005) XVIII *Canadian J L & Juris* 75.

⁵¹⁸ Immediately before Section II, Table 3 lists the various taxation measures challenged in tax-related investment disputes. A more detailed taxonomy of the arbitral awards in tax-related investment disputes is attached as Annexure - 1 to this thesis. This detailed taxonomy contains the summary of the award and the observations of the tribunal on tax-related investment disputes as a separate category in investor-state arbitration.

TABLE 3: TAX MEASURES CHALLENGED IN INVESTOR-STATE ARBITRATION

AWARD	TAX MEASURE CHALLENGED
<i>Antoine Goetz v Republic of Burundi (1999)</i>	Withdrawal of free zone certificate conferring tax and custom exemptions
<i>Archer Daniels v Mexico (2007); Corn Products v Mexico (2008); Cargill v Mexico (2009)</i>	Imposition of 20% excise tax by Mexico on soft drinks that used a sweetener other than cane sugar
<i>Bogdan v Republic of Moldova (2010)</i>	Environmental Charge
<i>Duke Energy v Peru (2008)</i>	Violation of tax stability agreement
<i>El Paso v Argentina (2011)</i>	Imposition of withholding tax
<i>Link Trading v Moldova (2002)</i>	Change in custom duties

<i>Mamidoil v Albania (2015)</i>	Import taxes on petroleum products
<i>Marvin Feldman v Mexico (2002)</i>	Denial of tax rebates to cigarette exporters
<i>Micula v Romania (2013)</i>	Withdrawal of tax incentives
<i>Occidental v Ecuador (2004); EnCana v Ecuador (2006)</i>	Retrospective denial of VAT refunds
<i>Oostergetel v The Slovak Republic (2012)</i>	Bankruptcy proceedings initiated against the claimant by tax authorities for non-payment of taxes
<i>Señor Tza Yap Shum v Peru (2011)</i>	Imposition of back taxes and fines after a tax audit
<i>Sergei Paushok v Mongolia (2011); Burlington v Ecuador (2012); Occidental v Ecuador (Occidental(II)) ((2012); Perenco v Ecuador (2014); Murphy v Ecuador (2016)</i>	Windfall Profits Tax
<i>Yukos awards (2010-2014)</i>	Discriminatory and retrospective tax assessment; seizure and auctioning of assets due to non-payment of taxes

II. TAXATION AND EXPROPRIATION - DISTINCT CONCEPTS

J.E. Penner in his article 'Misled by Property' argues that treating taxation and expropriation both as 'taking of property' is illicit.⁵¹⁹ I identify three main arguments made by Penner to distinguish taxation and expropriation: first, expropriation is a claim to a particular item of property while taxation is a claim for value; second, expropriation can only take place in respect of property one has, which is not true of taxation and also expropriation decisions are typically made without consideration for the particular owner; third, decisions to tax are, by and large, 'individual taxpayer independent' - unlike expropriation, taxes never identify a particular individual as the person on whom to levy a tax.⁵²⁰ I submit that the distinction, though well-argued by Penner, may not be applicable to all cases and in all circumstances.

To begin with, Penner makes a clear distinction between the property and the value of the property. He states that expropriation is a 'claim to a particular item of property' because that property itself is what the expropriating authority wants.⁵²¹ The question of value, Penner argues, only comes after expropriation and good liberal states typically compensate expropriated owners by estimate of market value.⁵²² This is not always the case. For instance, if due to sudden rise in gold prices, a gold mine generates extraordinary profits for a foreign investor, the state may make claim to the windfall profits by imposing additional taxes.⁵²³ In this case, the claim by the state is for value and not necessarily the underlying property. If the additional taxes imposed are too burdensome, an investor-state tribunal can certainly term the taxes as expropriatory. Penner's argument may hold if the state reacts by nationalising the gold mine. In such a scenario, it can be possibly argued that the state's claim is to a specific item of property. But, in such a case the distinction will need to be framed as 'claim to a particular item of property at a particular time.' This is because the state's interest in the property may diminish considerably if the profits margins drop drastically or to a more 'normal' level. To put it differently, a strict distinction between the property and the value of the property may not be applicable in all cases and at all times.

The second argument that Penner makes is that expropriation can only take place in respect of property one already has while one can be liable for taxes even without owning a property or even if one has insufficient assets to meet the claim. This is a valid point, but, Penner then

⁵¹⁹ See Penner, *supra* note 517, at 75.

⁵²⁰ *Ibid*, at 80-81.

⁵²¹ *Ibid*.

⁵²² *Ibid*.

⁵²³ See Section IV below for discussion on windfall profits tax.

elaborates that expropriation decisions are related to a specific item of property and are ‘made without consideration for the particular owner.’⁵²⁴ With respect to the latter limb of the argument, the dispute between Russia and Yukos offers a credible counter-point.⁵²⁵ The dispute between Yukos and Russia essentially involved Russian President, Vladimir Putin and a Russian businessman Mikhail Khodorkovsky - the main shareholder of Yukos and its Chief Executive Officer. During the arbitral proceedings between Yukos and Russia it was alleged that the forced sale of Yukos, its bankruptcy and removal from companies register was due to the rivalry between Mr. Putin and Mr. Khodorkovsky. The claimants asserted that the increasing influence wielded by Mr. Khodorkovsky due the success of Yukos, his financial support of opposition parties was politically threatening to Mr. Putin. This, it was argued, was the main reason behind targeting Yukos through hefty tax assessments, fines, and arrests of Yukos officers among other measures. The tribunal endorsed several of the above mentioned arguments and stated that the bankruptcy of Yukos had accomplished the removal of Mr. Khodorkovsky from the political scene.⁵²⁶ While the Yukos dispute may be extraordinary and rare in its scale and abuse of authority, but it dilutes Penner’s suggestion that expropriatory acts are always aimed at the property. In my view, the owner of the property also, at times, influences the expropriation decisions.

The third argument that Penner makes is that decisions to tax are not taken to target specific individuals, instead taxes are imposed on various sorts of transactions such as sales, receipt of income, import of goods, etc.⁵²⁷ Here again, Penner draws a neat distinction between persons and the commercial transactions. I would argue that the distinction cannot always be drawn so clearly. It is possible for a state to target a particular investor or class of investors by disguising it as tax on the industry. This is possible if a certain sector such as the natural resources sector is dominated by a sizeable number of investors who either share same political views, ethnicity or are otherwise unfavourably viewed by the state.⁵²⁸ In such instances, the distinction between the economic activity and the persons involved in the activities collapses.

⁵²⁴ *Ibid.*

⁵²⁵ See Section III below for a detailed discussion on the *Yukos* awards.

⁵²⁶ See, for instance, *Hulley* award, *supra* note 299, at paras 795-804 (the tribunal accepted that claimant’s arguments that Russia had conducted a campaign of harassment and intimidation against Yukos partly due to political rivalry between Mr. Putin and Mr. Khodorkovsky).

⁵²⁷ Penner, *supra* note 517, at 81.

⁵²⁸ See Amy Chua, ‘Markets, Democracy and Ethnicity: Toward a New Paradigm for Law and Development’ (1998) 108 *Yale L J* 1; For a more detailed account see Amy Chua, *World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability* (Anchor 2003).

Penner makes a strong and valid case for distinguishing taxation from expropriation. My limited aim in this Section has been to suggest that the distinction may not be applicable in all cases and may need to acknowledge a few exceptions. Further, from the perspective of IIL, it needs to be stated that investor-state tribunals have treated taxation and expropriation as distinct concepts. Not all instance of taxation have been termed as expropriation. However, it is difficult to say if the criteria adopted by tribunals to distinguish taxation and expropriation are satisfactory. The recurrent question before investor-state tribunals is - At what point, does taxation cease to be a lawful exercise of state authority and becomes expropriation? To answer this question would require a coherent and well-reasoned approach to tax-related investment disputes. Sections III and IV below, examine the manner in which various tribunals have addressed the allegations of expropriation by taxation.

III. PHYSICAL DISPOSSESSION AS SOLE DETERMINANT OF DIRECT EXPROPRIATION

Direct expropriation usually involves a transfer of title in the property.⁵²⁹ Instances of direct expropriation are generally easy to identify as they involve physical dispossession. In certain situations, seizure of properties can occur on grounds of tax evasion and/or non-payment of the taxes assessed.⁵³⁰ In situations of continued non-payment of taxes or tax evasion, the domestic tax laws of almost every state provide for a procedure of seizure and attachment of the property of the taxpayer.⁵³¹ Such seizure is generally given effect to after a court order authorising the same.⁵³² However, the legal procedure for attachment and subsequent auction of the properties of the tax assessee may be abused. It is possible that the procedure for attachment may be in accordance with the letter of the law but the entire procedure may be

⁵²⁹ *Nykomb Synergetics Technology Holding AB v The Republic of Latvia* (SCC Award, 16 December 2003) para 4.3.1 (The tribunal held that even if the investment became worthless, the decisive factor for drawing the borderline for expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measure entailed).

⁵³⁰ See Section 132, Indian Income Tax (1961).

⁵³¹ See *Amco* award, *supra* note 498.

⁵³² See *Jan Oostergetel Theodora Laurentius v The Slovak Republic* (UNCITRAL, Final Award, 23 April 2012) (where the claimant alleged that the bankruptcy proceedings initiated against it by the tax authority of the respondent state to claim tax dues, constituted expropriation. The tribunal rejected the claim because the submissions by the claimant did not contain any specific and clear allegations of expropriation. The tribunal added that there was a lot of vagueness in the claims relating to expropriation) paras 309-321.

a facade to confiscate the property of the claimant.⁵³³ In such cases, the entire procedure may be termed as expropriation.⁵³⁴

The misuse of the taxation powers of the state with an intent to expropriate were central to the *Yukos* awards. There are five reported awards that have resulted from the same fact situation.⁵³⁵ The claims were brought by different shareholders of Yukos under different IIAs.⁵³⁶ The arguments of the claimants before all the five tribunals (in so far as they related to expropriation) were essentially that: Firstly, it was alleged that Russia had brought massive tax claims against Yukos which had no basis in law and that such tax assessment was not a bona fide interpretation of the Russian tax law. Secondly, it was claimed that Russia after making tax demands prevented Yukos from paying its tax liabilities so that the non-payment of the tax claims could be used as a pretext to seize the assets of Yukos and auction them off. It was alleged that the actions of Russia constituted either a direct or an indirect expropriation.

In the *Hulley* award, the claimants argued that the respondent completely and totally deprived them of their investments in Yukos which were motivated by a political and economic agenda and not any legitimate tax collection purpose. In this regard, the tribunal observed that ‘the primary objective of the Russian Federation was not to collect taxes but rather to bankrupt Yukos and appropriate its valuable assets.’⁵³⁷ The tribunal also observed that there were no grounds for holding Yukos liable for the payment of more than 13 billion dollars in VAT. However, despite these categorical observations about the misuse of state power by Russia and its mala fide interpretation of tax law, the tribunal did not term these actions of Russian tax authorities as expropriatory. It relied on the events that occurred subsequent to the tax assessment in order to arrive at a finding of expropriation. The tribunal relied on the illegal auction of Yukos’ assets to conclude that the actions of Russia amounted to illegal expropriation.

⁵³³ *RosInvest* award, *supra* note 299, at para 628 (‘it is generally accepted that the mere fact that measures by a host state are taken in the form of application and enforcement of its tax law, does not prevent a tribunal from examining whether this conduct of the host state must be considered, under the applicable BIT or other international treaties on investment protection, as an abuse of tax law to in fact enact an expropriation.’).

⁵³⁴ GC Christie, ‘What Constitutes A Taking of Property under International Law?’ (1962) 38 *British Yb’k Int’l L* 307, at 320 (‘Certain types of State interference which, from the outset, will be considered expropriation even though not labelled as such. Among these are the appointment of a receiver to liquidate the business or other property.’). ⁵³⁵ See *Yukos* awards, *supra* note 299.

⁵³⁶ For instance, the claim in the *Valores* award was in reference to the Spain-USSR BIT (1991) while the *Hulley*

award was in reference to the ECT (1991).

⁵³⁷ *Hulley* award, *supra* note 299, at para 320.

The tribunal in its finding on expropriation observed that - Yukos was vulnerable on some aspects of its tax optimization scheme as some of its operations were sham-like and designed to take advantages low-tax jurisdictions. Yukos, the tribunal observed, could have faced some legitimate tax claims had Russia limited itself to bona fide taxation measures. Instead, the Russian state apparatus decided to take advantage of that vulnerability by launching a full assault on Yukos and its beneficial owners in order to bankrupt Yukos and appropriate its assets while, at the same time, removing Mr. Khodorkovsky from the political arena.⁵³⁸ While the conclusion of the tribunal can hardly be disputed, it is of interest to note that the tribunal avoided calling the arbitrary and retrospective tax assessment as expropriatory in itself. The tribunal's deference to Russia's tax measures is obvious in the award. The tribunal was cautious before it finally concluded that it was the cumulative actions of Russia that amounted to expropriation i.e. the tax assessments and the auction process. This approach finds its echo in all the other *Yukos* awards.

In *Valores*, the tribunal observed that the Russian tax authorities invalidated the tax arrangements of Yukos in a cavalier manner and the retrospective tax assessments of Yukos were not bona fide.⁵³⁹ The tribunal further observed that the conduct of Russia raised significant doubts as to whether it acted in good faith in its attempts to resolve its tax dispute with Yukos, and whether its actions were really part of an ordinary process of assessing and collecting taxes. However, after such categorical statements, the tribunal finally observed that the rejection by Russia of the offers of Yukos to pay the taxes so assessed was 'disturbing to say the least.'⁵⁴⁰ It was only after the tribunal had taken into account that the auction process - which resulted in sale of the assets of Yukos and lacked legal credibility, it finally concluded that the Respondent's measures, seen in 'their cumulative effect towards Yukos' were an unlawful expropriation under the treaty.⁵⁴¹

The tribunal's approach in *Hulley* and *Valores* awards, with minor variations, is evident in the *Yukos Universal*, *Veteran* and the *RosInvest* awards too. For instance, in *Yukos Universal*, the tribunal concluded, very early in its assessment that 'the primary objective of the Russian Federation was not to collect taxes but rather to bankrupt Yukos and appropriate its valuable assets.'⁵⁴² The tribunal added, the sentencing of Messrs. Khodorkovsky and Lebedev on the

⁵³⁸ *Hulley* award, *supra* note 299, at para 1404.

⁵³⁹ See *Valores* award, *supra* note 299, at paras 53-74.

⁵⁴⁰ *Ibid*, at para 103.

⁵⁴¹ *Ibid*, at para 185.

⁵⁴² *Yukos Universal* Award, *supra* note 160, at para 756.

creative legal theory of their theft of Yukos' oil production, indicated that Russian courts bent to the will of Russian executive authorities to bankrupt Yukos, assigned its assets to a state controlled company, and incarcerated a man on the verge of becoming a political competitor.⁵⁴³ However, it was only after the tribunal had elaborated on the sham like nature of bankruptcy proceedings against Yukos, it eventually observed that - 'the Tribunal does not accept that the effective expropriation of Yukos was "carried out under due process of law"' and concluded that Russia had breached Article 13 of the ECT by an unlawful expropriation.⁵⁴⁴ The observations of the tribunal in the *Veteran* award were an almost verbatim copy of its observations in the *Yukos Universal* award because both the claims were made under the same legal instrument - the ECT and in respect of the same facts.⁵⁴⁵

In *RosInvest*, the tribunal made several observations about the abuse of discretion by tax authorities and their lack of bona fide intentions. With respect to the latter, the tribunal observed that certain actions of the tax officials did not comply with the letter of the domestic tax law and constituted an abuse of the tax collection process. However, it always stopped short of terming any single act as expropriation. Eventually, the tribunal concluded that the application of Russian tax law, the tax assessment, and the auctions led the tribunal to conclude that 'Respondent's actions towards Yukos cannot be justified by its authority to apply and enforce its tax laws.'⁵⁴⁶ However, this conclusion is arrived at only after the tribunal has, at considerable length discussed the arguments of both sides. The need to discuss each aspect was justified as 'relevant for the consideration of the cumulative effect of the totality of Respondent's conduct.'⁵⁴⁷ It is hard to imagine a comparable state action - in the field of environmental law or public health where the tribunal may have shown this amount of restraint before finally concluding that the laws of the state were in violation of its obligations under the IIA. This deferential approach of tribunals is reflected in each of the *Yukos* awards as discussed above.

The approach of the tribunals in the *Yukos* awards is perhaps the best example of the deference accorded by tribunals before terming a taxation measure as expropriatory. The expropriation of the assets of Yukos is one of the most glaring examples of direct

⁵⁴³ *Ibid*, at para 1583.

⁵⁴⁴ *Ibid*, at para 1584.

⁵⁴⁵ See *Veteran award*, *supra* note 299, at paras 756 and paras 1582-1585.

⁵⁴⁶ *RosInvest Co award*, *supra* note 299, at para 580.

⁵⁴⁷ *Ibid*, at para

expropriation by a host state.⁵⁴⁸ It was an obvious misuse of state power to dismantle an economically profitable company because of political considerations. Each of the several acts of the Russian tax authorities - tax assessment of Yukos, the retrospective application of the tax laws through questionable interpretations, the subsequent auctions and bankruptcy proceedings against Yukos were excessive exercise of state powers. However, none of the tribunals termed any of these actions as expropriation in itself. The conclusion by tribunals that the actions of Russia constituted expropriation were always made by taking into 'account all the circumstances of the case' or were 'based on extensive record on the proceeding.' Russia's actions in totality were termed as expropriatory and not each individual action - though there were sufficient grounds for the same.

While little fault can be found in tribunals taking into account all the circumstances and facts of the case; in tax-related investment disputes such an approach results in setting the threshold of expropriation by taxation too high. Further, one may find little fault in setting a high threshold of expropriation by taxation, if accompanied by cogent reasons. In none of the *Yukos* awards, the tribunals mention persuasive reasons for deference to taxation measures.⁵⁴⁹ There are possible legal reasons for according high deference to taxation measures of a state. The nature of tax itself which involves compulsory transfer of money is one reason. Wide discretion of states to enact tax laws, even retrospectively is another. A few tribunals have also relied on tax carve outs to justify deference to taxation measures.⁵⁵⁰ But the *Yukos* awards do not rely on any of the above mentioned reasons to convincingly justify a high threshold for expropriation by taxation. The *Yukos* awards are not an outlier, another example of showing a great deference for expropriation by taxation is the *Burlington* award.

In *Burlington*, the dispute revolved around the enactment of a windfall tax law (known as 'Law 42') by Ecuador through which it sought to levy additional taxes on the windfall profits that the investor had received due to escalation of oil prices in the world market. The tax rate was 50% to begin with and was eventually increased to 99% in order to prevent the investor from pocketing windfall profits. The investor's opposition to the tax laws culminated in the announcement that it would, within three days, suspend its oil exploration activities in

⁵⁴⁸ See Paul B. Stephan III, 'Taxation and Expropriation - The Destruction of the Yukos Oil Empire' (2012), Virginia Public Law and Legal Theory Research Paper No 2012, at 48, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2138241

⁵⁴⁹ The tribunal made a few assertions about sovereignty of states, but, in my view, they are not persuasive. See Section VI below for details.

⁵⁵⁰ See Section VI below.

the oil blocks under its control. Ecuador, the respondent state, responded by taking physical control of those oil exploration areas after three days. Burlington eventually challenged the enactment of the tax laws and the physical takeover by Ecuador.

The tribunal in its detailed analysis found that the enactment of the tax law was well within the rights of the state and that the initial tax rate of 50% and even the subsequent tax rate of 99% did not amount to expropriation. The tribunal was not convinced that imposing the most stringent possible tax rates on a particular income stream constituted expropriation. While the facts of the case - particularly the receipt of windfall profits, may arguably justify the imposition of a tax rate of 99%; the tribunal showed a very high amount of deference to the discretion of a state to enact a tax law. The tribunal concluded that it is not persuaded that tax rate at 99% 'substantially deprived Burlington of the value of its investment. While Law 42 at 99% diminished Burlington's profits considerably.'⁵⁵¹ The tribunal noted that Burlington's allegations that its investment was rendered worthless and unviable have not been substantiated.⁵⁵² This conclusion in the *Burlington* award certainly does not mean that in the event of an investor receiving windfall profits every host state can legally impose a tax rate of 99% - but it is certainly an extraordinary conclusion by the tribunal.

The *Burlington* tribunal based its finding of illegal expropriation by relying solely on the physical takeover by the respondent state. The tribunal observed that Ecuador took physical possession of the oil blocks under the control of Burlington only three days after Burlington had announced that it would suspend its oil exploration activities. However, the tribunal stated that Ecuador under its domestic law (the Hydrocarbon Law) could declare the expiration of its contract with Burlington only when an unlawful suspension lasted for 30 days or more. Ecuador did not meet this requirement of waiting for the required period and took over the properties on the very day the suspension was supposed to begin. Hence, the tribunal concluded 'that Ecuador's entry and taking of possession of the Blocks was not justified under the police powers doctrine'.⁵⁵³

There is at least one common element in all the *Yukos* awards and the *Burlington* award - tribunals have only equated taxation measures of a state to expropriation when the actions of the state manifested themselves in the most obvious and undeniable instances of direct expropriation. This is usually a physical takeover or a transfer of property of the investor.

⁵⁵¹ See, for instance, *Burlington v Ecuador* (Decision on Liability, 14 December 2012) para 456.

⁵⁵² *Ibid.*

⁵⁵³ *Ibid.*, at para 529.

Thus, the tax assessment of Yukos by the Russian authorities and their highly questionable interpretations of tax laws were not termed expropriation. It was only the combination of tax assessments and the illegal auction that was termed as expropriation. Similarly, in *Burlington*, even a tax rate of 99% was not considered to be expropriatory until the host state physically took over the oil production blocks of the investor. Factors such as tax rates or abusive tax administration have played a secondary and, in fact, a minimal role; tribunals have almost exclusively relied on the fact of physical dispossession before arriving at a finding of direct expropriation thereby underlining a tribunals' extensive deference to taxation measures at least in so far as direct expropriation is concerned.

IV. INDIRECT EXPROPRIATION

Indirect expropriation has no single definition and the variety of means by which it can be accomplished is a huge if not the only hurdle in encapsulating it in a single definition.⁵⁵⁴ For instance, it has been stated that the absence of an expropriatory decree, but the presence of an expropriatory consequence, defines an indirect expropriation.⁵⁵⁵ There are many other views on what constitutes indirect expropriation.⁵⁵⁶ This Section does not intend to provide an exhaustive survey of the concept of indirect expropriation in IIL. The aim is to examine some of the arbitral awards in order to shed light on the concept of indirect expropriation with a focus on tax-related investment disputes. An analysis of the awards suggests that states have a significant policy space to enact their tax laws and impose tax liabilities.⁵⁵⁷ This position is in contrast to non-tax related investment disputes, in respect of which it is usually argued that the effect of IIAs and awards is to significantly reduce a state's policy space.⁵⁵⁸

⁵⁵⁴ See UNCTAD, *Expropriation* (2012) UNCTAD/DIAE/IA/2011/7.

⁵⁵⁵ W. Michael Reisman, Robert D. Sloane, 'Indirect Expropriation and its Valuation in the BIT Generation' (2004) 75 *British Yb'k of Int'l L* 115, at 130.

⁵⁵⁶ See UNCTAD, *supra* note 554, at 57-111; see also Rudolf Dolzer, 'Indirect Expropriations: New Developments?' (2002) 11 *NYU Env't'l L J* 64; Rudolf Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 *American J Int'l L* 553.

⁵⁵⁷ See A.E. Gildemeister, 'Burlington Resources, Inc. v Republic of Ecuador: How Much is Too Much: When is Taxation Tantamount to Expropriation' (2014) 29 *ICSID-Rev FILJ* 315.

⁵⁵⁸ See, for example, Jan Kleinheisterkamp, 'Financial Responsibility in European Investment Policy' (2014) 63 *ICLQ* 449; Suzanne A. Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) *J Int'l Eco L* 1037.

A. Substantial Deprivation/Effects Test

A survey of the arbitral awards reveals that several tribunals have adopted the 'effects test' or the 'substantial deprivation test' in order to determine if the taxation measures of the state amount to unlawful expropriation or not. However, at the same time, tribunals have been wary of concluding that the imposition of taxes was expropriatory unless it is indisputably obvious that there is violation of the relevant IIA. Tribunals have, to borrow a phrase from criminal law almost stretched it to the point where there is 'no reasonable doubt' that the states exceeded its regulatory powers of taxation and breached its obligations in international law.

In *Burlington*, the tribunal observed that the effect of the taxation measure is the touchstone to determine the permissibility of the taxation measure.⁵⁵⁹ It noted, however, that additional questions would also need to be answered - role of the state's intent, the discriminatory character of the tax and the weight of contractual stabilization clauses.⁵⁶⁰ A state measure designed to deprive the investor of its property or to cause it to "abandon or sell it at a distressed price" would support a finding of expropriation; it would reveal state's intent. Additionally, the tribunal observed that under general international law a tax is illegal not only if it is confiscatory but also discriminatory. However, the tribunal observed that state's intent and a discriminatory tax play secondary role to the effects test. For instance, to reach the level of expropriation, the discriminatory tax must cause substantial deprivation i.e. a discriminatory tax cannot per se amount to an expropriation. The secondary role accorded to discriminatory taxes is perhaps because discriminatory taxation is relatively easier to prove.⁵⁶¹ For instance, the tribunal in *Feldman* noted that in most regimes, the tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favoured while others are less disadvantaged.⁵⁶² The fact that discriminatory taxation is

⁵⁵⁹ In its analysis of the effects of tax, the tribunal observed that when a measure affects the environment or conditions under which the investor carries on its business, it is the loss of the economic value or economic viability that is decisive in assessing whether there is a substantial deprivation. The loss of viability does not necessarily imply a loss of management or control. What matters is the capacity to earn a commercial return. See *Burlington* award, *supra* note 551.

⁵⁶⁰ See Thomas Wälde, Abba Kolo, 'Confiscatory Taxation under Customary International Law and Modern Investment Treaties' (1999) 4 CEPMLP Journal, at <http://www.dundee.ac.uk/cepmlp/journal/html/vol4/article4-17.html> (arguing that it is easier to establish a breach of an IIL by mainly relying on discrimination and breach of contractual commitment).

⁵⁶¹ *Ibid*; Also see Chapter 6 below.

⁵⁶² *Marvin Feldman v Mexico* ICSID Case No. ARB(AF)/99/1 (Award, 16 December 2002) para 113.

commonplace is perhaps another reason why tribunals do not accord them primary importance in determining if the tax is expropriatory.

In the *Occidental* award, the tribunal relied on the substantial deprivation test and observed that the criterion of ‘substantial deprivation’ test had not been met in the case and dismissed the investor’s claim that the denial of VAT refunds by Ecuador amounted to indirect expropriation.⁵⁶³ In a similar vein, the tribunal in *EnCana* concluded that there was no expropriation in the case by observing that:

[T]here is nothing in the record which suggests that the change in VAT laws or their interpretation brought the companies to a standstill or rendered the value to be derived from their activities so marginal or unprofitable as effectively to deprive them of their character as investments.⁵⁶⁴

However, unlike the *Occidental* award, the tribunal in *EnCana* did not expressly endorse the substantial deprivation test.⁵⁶⁵

The NAFTA tribunals, like most non-NAFTA tribunals, have also been hesitant to adjudicate taxation measures as expropriation unless accompanied by a physical takeover and have relied on the effects test to determine if taxation measures of the state amount to indirect expropriation. This is reflected in the three NAFTA awards that emerged from the imposition of a 20 percent excise tax by Mexico on soft drinks and syrups and the same tax on services used to transfer and distribute soft drinks and syrups.⁵⁶⁶ This tax applied only to those soft drinks and syrups that used a sweetener other than cane sugar, such as high fructose corn syrup (HFCS). Soft drinks and syrups sweetened exclusively with cane sugar were tax

⁵⁶³ *Occidental* award, *supra* note 211, at 28-31. The tribunal though inexplicably relied on the findings of the tribunal in *Metalclad*. The *Metalclad* tribunal was constituted under NAFTA, had nothing to do with taxation and made wide formulations on expropriation and had little relevance to the *Occidental* award which was to be adjudicated in reference to the US-Ecuador BIT.

⁵⁶⁴ *EnCana* award, *supra* note 211, at para 173.

⁵⁶⁵ Also see *El Paso* award, *supra* note 440, at para 295 (where the claimants complained that there was ‘no change in law’ by the respondent state to alleviate the economic problems arising from the adverse economic situation due to the collapse of Argentina’s economy. The tribunal observed that a state does not have its duty to adapt its tax regime to the best interests of investors. Further, ‘an unfavourable calculation of taxes cannot be equated with expropriation...’).

⁵⁶⁶ The three awards are: *Archer Daniels Midland Company v United Mexican States* ICSID Case No. ARB(AF)/04/05 (Award, 21 November 2007); *Cargill, Incorporated v United Mexican States* ICSID Case No. ARB(AF)/05/2 (Award, 18 September 2009); *Corn Products International, Inc. v United Mexican States* ICSID Case No. ARB(AF)/04/1 (Decision on Responsibility, 15 January 2008).

exempt.⁵⁶⁷ The tax was in effect for 5 years - 1 January 2002 to 1 January 2007. The imposition of the tax led to three claims under the NAFTA and the claimants sought damages and related relief alleging that the imposition of the tax had a direct impact on the claimants' investment in HFCS production and distribution facilities and caused them substantial loss or damage in violation of Chapter Eleven of the NAFTA. One of the arguments was that the levy of tax was an indirect expropriation.

The tribunal in *Corn Products* award observed that the claimant's production facilities had suffered a 'substantial blow' and affected their market share for a period of two years. But, the claimant retained full control of its investment at all times and was able to report to its shareholders that the tax would not make a long term difference to its business. The tribunal, did not use the precise words, but effectively endorsed the 'continued profitability' of the venture as a benchmark to determine if the investment had been expropriated. It also underlined the continued control over the production facilities by the investor - a fact which if absent, in my opinion, would have certainly altered the findings of the tribunal. The tribunal added that in view of the facts of the case there was no 'substantially complete deprivation' of the use and enjoyment of the investment.⁵⁶⁸ The tribunal further emphasised that in the 'absence of a physical taking or transfer of ownership' the degree of interference should be as to 'sterilise its business'.⁵⁶⁹

In the *Cargill* award, the tribunal, in a familiar trend, emphasised that the expropriation of the property required a radical deprivation of the claimants' economic use. The tribunal concluded that the imposition of the tax did not amount to expropriation by essentially relying on the fact that the claimant was still in physical possession of its business facilities, no 'total cessation of business' had occurred and that the claimant could use its assets for other products.⁵⁷⁰ The tribunal in the *Archer Daniels* award followed similar reasoning by relying on the 'effects test.'⁵⁷¹ It observed that judicial practice indicates that the severity of the economic impact is the decisive criterion in deciding whether an indirect expropriation or

⁵⁶⁷ This increase in the excise tax was allegedly aimed at protecting the domestic sugarcane industry of Mexico which was under intense pressure from the corn syrup industry which was primarily based in the United States.

⁵⁶⁸ *Corn Products* award, *supra* note 566, at para 92.

⁵⁶⁹ *Ibid*, at para 91; This approach was in line with the observations of the tribunal in the *Feldman* award where the tribunal concluded that considering all the relevant factors of the case there is no expropriation since the investor was at all times in complete control of his investment. See *Feldman* award, *supra* note 562.

⁵⁷⁰ *Cargill, Inc* award, *supra* note 566, at para 363.

⁵⁷¹ *Archer Daniels* award, *supra* note 566, at para 240.

a measure tantamount to expropriation has taken place.⁵⁷² In the present case, the tribunal observed, the criterion have not been met and hence the levy of the tax did not constitute an indirect expropriation.

Each of the three tribunals effectively relied on the substantial deprivation test applied by non-NAFTA tribunals. All the three tribunals also referred to the fact that the investor had not been deprived of the physical possession of the enterprise, a factor that played an important if not an influential role in the conclusion of the tribunals. As we saw in Section III, the continued physical possession by an investor of the enterprise constitutes a vital element in tax-related investment disputes, at least in addressing arguments on direct expropriation. Physical possession also plays an important if not equally important role in findings on indirect expropriation.

The only outlier seems to be the *Tza Yap Shum* award where the tribunal arrived at a finding of indirect expropriation even when the claimant was not dispossessed of its investment. The claimant's company was a Peruvian company that manufactured, distributed and exported fish-based food products to Asian markets. The Peruvian tax authority commenced an audit of the company and alleged that the claimant had underreported sales volumes and imposed taxes and fines of around 10 million Peruvian Nuevos Soles. According to Peruvian tax authorities, these were 'exceptional circumstances' and thus in order to secure the tax payments it ordered the banks to withhold the funds of the claimant.⁵⁷³ The claimant alleged that the actions of the Peruvian tax authority constituted indirect expropriation. The respondent in turn argued that the claimant's business operations had not come at a standstill, it had not gone bankrupt and was still continuing its exports.

The tribunal looked at the effect and the severity of measures to conclude that the measures of the respondent state constituted expropriation.⁵⁷⁴ With regard to the former, the tribunal observed that by freezing the claimant's bank accounts the respondent had cut off the conduit through which the claimant could secure letters of credit or pay its debt. The measures the tribunal observed had a severe effect on the claimant's business and created a

⁵⁷² The tribunal relied on various awards such as: *Norwegian Shipowners' Claims (Norway v United States)* 1 Rep Int'l Arb Awards 307; *Certain German Interests in Upper Polish Silesia Case (1926)* PCIJ Ser. A No.7.

⁵⁷³ Under Peruvian law, 'exceptional circumstances' were defined as situations where the tax debtor was unco-operative or the tax authorities believed that the efforts to secure tax payments would otherwise be unsuccessful. See *Tza Yap Shum* award, *supra* note 511, at paras 199-202.

⁵⁷⁴ *Ibid*, at para 159.

‘direct, close or permanent’ effect.⁵⁷⁵ The tribunal thus concluded that measures of the respondent constituted indirect expropriation without compensation.⁵⁷⁶

B. Wide Leeway in Taxing Windfall Profits

An investor earning excessive profits has been acknowledged as a valid and rational reason for a state to change its taxation policies.⁵⁷⁷ But an attempt to tax windfall gains may result in the taxation measure being termed as confiscatory and can also be challenged for breaching the tax stabilisation clause. In such a situation, one factor that tribunals have looked at is the continued profitability of the economic activity that the investor is engaged in. If the investor is able to generate profits even after the imposition of the windfall taxes - the tribunals have been reluctant to term the tax as expropriatory.

In the *Sergei Paushok* award, one of the claims related to Mongolia’s enactment of the windfall profit tax law.⁵⁷⁸ The tax law was enacted in response to the dramatic increase in the price of gold on the world market - the price had almost doubled in 2006 from the price that existed in 1997. Claimant argued that the windfall profit tax put it in a position where it would have to sell its gold at a loss and hence the tax was extraordinary, punitive in amount, arbitrary and discriminatory. The negative effects of the tax and the connected events led to the claim and formed the crux of the dispute between the investor and Mongolia. The tribunal, in its conclusion on allegations of expropriation noted that the windfall profit tax ‘by itself cannot be considered an expropriatory measure.’⁵⁷⁹ The various reasons for tribunals’ conclusion cannot be neatly compartmentalised and it is difficult to state with certainty which reason was the most influential.

Tribunal’s first reason was that subsequent to the levy of the tax, the claimants neither lost ownership nor control over the operations. As described in Section III above, unless a physical

⁵⁷⁵ The respondent’s argument that the claimant was continuing its export business even after the measures was dismissed by the tribunal. The tribunal observed that the claimant was only exporting from its existing inventory. *Ibid*, at paras 160-170.

⁵⁷⁶ *Ibid*, at para 170; For a detailed discussion on the award see Shen Wei, ‘Conceptuality or Textuality? Understanding the Notion of Expropriation in the Context of Tza Yap Shum v. The Republic of Peru’ (2014) 7 J East Asia & Int’l L 39.

⁵⁷⁷ See *AES Summit Generation Limited and AES-Tisza Erőmű Kft. v Republic of Hungary* ICSID Case No. ARB/07/22 (Award, 23 September 2010) para 10.3.34 (where Hungary introduced regulated electricity pricing in order to address excessive profits in the sector and the tribunal upheld it to be a ‘perfectly valid and rational policy objective for a government to address luxury profits’ and that ‘excessive profits may well give rise to legitimate reasons for governments to regulate or re-regulate’).

⁵⁷⁸ *Sergei Paushok* award, *supra* note 469.

⁵⁷⁹ *Ibid*, at para 331.

dispossession of the investor takes place, tribunals have been very reluctant to term any taxation measure as expropriatory. The tribunal then relied on a comparison of the claimant with other mine operators. The tribunal observed that while the claimants did not have the protection of a stability agreement, 'but other mines not benefitting from a stability agreement still managed to continue their operations in spite of the application of the WPT [windfall profit tax].'⁵⁸⁰ The tribunal acknowledged that the burden of the tax was 'heavy' on the claimant - but was it not convinced that the tax equated to 'substantial deprivation'.⁵⁸¹ The last reason that the tribunal relied on was the extent of the loss the claimant suffered. The tribunal relied on the 'long history of strong annual profits' of the claimant, the presumption that the claimants would have ended the year of 2007 with a 'loss of slightly less than 1 million US dollars' and stated that 'a loss of that size for one year is not a matter leading to the destruction of an ongoing enterprise'.⁵⁸² In the latter two reasons, the thrust of the tribunal was on the profit making ability of the claimant despite the levy of the windfall profit tax - this can be cumulatively referred to as the 'continued profitability' test. In essence, the tribunal concluded that - as long as the investor is able to keep its enterprise afloat, either by taking steps to reduce the impact of the tax or because of past profits, the taxation measure shall not be considered expropriatory.⁵⁸³

In the *Burlington* award, as described in Section III above, the tribunal had to adjudicate on Ecuador's 'Law 42' under which the windfall profit tax was imposed. The law, to begin with, levied a tax rate of 50% and then subsequently increased it to 99%. The tribunal relied on the 'effects test' in order to determine if the taxes were expropriatory or not. The *Burlington* tribunal like the *Sergei Paushok* tribunal, also relied on the 'continued profitability' test in order to determine if the taxes were a bona fide exercise of the regulatory power of the state or an unlawful expropriation.

To begin with, when examining the law that imposed a tax rate of 50%, the tribunal observed that despite the enactment of Law 42, the claimant was planning to make additional investments of 100 million US dollars and bidders were willing to acquire its interests in the oil blocks. Also, the fact that the financial statements of Burlington 'do not show a loss but a

⁵⁸⁰ *Ibid*, at para 332.

⁵⁸¹ See Section III.A above.

⁵⁸² *Sergei Paushok* award, *supra* note 469, at para 334.

⁵⁸³ Also see *Continental Award* where the tribunal observed that a finding of expropriation demands a certain level of sacrifice of private property - and minor losses suffered by the claimant do not meet this criteria. See *Continental Casualty Company v The Argentine Republic* ICSID Case No. ARB/03/9 (Final Award, 5 September 2008), at para 284.

“positive figure”, showed that the Law 42 at 50% did not substantially deprive Burlington of the value of its investment and therefore was not tantamount to expropriation.⁵⁸⁴ In a similar vein, while examining the validity of Law 42 at 99%, the tribunal observed that while the law did diminish Burlington’s profits considerably, Burlington’s investment was not rendered worthless and unviable for the ‘investment preserved its capacity to generate a commercial return.’⁵⁸⁵ The tribunal, apart from its reliance on the ‘substantial deprivation’ test or the ‘effects test’, considered the ability of the investor to generate profits or earn a commercial return as an important factor in determining that the windfall profits tax in itself did not amount to unlawful expropriation. This approach was similar to the approach adopted by the *Sergei Paushok* tribunal.⁵⁸⁶

The findings of the tribunals in the *Sergei Paushok* and *Burlington* awards suggests that there is no upper limit of tax rates beyond which tax becomes expropriatory. Tax rates are only one factor - the ability of an investor to generate profits even after imposition of high tax rates, past profits, continued physical possession - all cumulatively guide tribunal’s conclusion. Which factor is the most influential is usually determined by the facts of the case, the nature of taxation measure in question and the nature of arguments presented before the tribunal. Though like in the case of direct expropriation, tribunals accord deference to tax measures even in relation to indirect expropriation. The *Perenco* award is one such instance where the high deference is visible.

In the *Perenco* award, where again Ecuador’s Law 42 that imposed a windfall profit tax was in question, even physical takeover was not termed expropriation; the influencing factor was the respondent state thereafter terminating the claimants’ contract.⁵⁸⁷ The tribunal in *Perenco* observed that when the claimants announced their decision to suspend operations in the oil blocks, Ecuador could with good and valid reasons intervene to operate the blocks and

⁵⁸⁴ *Burlington* award, *supra* note 551, at para 431.

⁵⁸⁵ *Ibid*, at para 456; Also see *Dissenting Opinion Francisco Orrego Vicuña*, at para 27 (stating that a 50% tax was substantial and unheard of, while a 99% tax was confiscatory).

⁵⁸⁶ The ability of the enterprise to make profits has also been stressed by other tribunals, though not in relation to the windfall profits taxes. In *EnCana* award, the tribunal observed that ‘although the EnCana subsidiaries suffered financially from the denial of VAT and the recovery of VAT refunds wrongly made, they were nonetheless able to continue to function profitably and to engage in the normal range of activities, extracting and exporting oil (the price of which increased during the period under consideration). There is nothing in the record which suggests that the change in VAT laws or their interpretation brought the companies to a standstill or rendered the value to be derived from their activities so marginal or unprofitable as effectively to deprive them of their character as investments.’ See *EnCana* award, *supra* note 211, at para 174.

⁵⁸⁷ *Perenco Ecuador Ltd v The Republic of Ecuador* ICSID Case No. ARB/08/6 (Decision on Remaining Issues of Jurisdiction and on Liability, 12 September 2014).

maintain their productivity. The tribunal added that since the claimants had voluntarily suspended their right of management and control of the oil blocks temporarily, Ecuador could lawfully intervene to operate the oil blocks.⁵⁸⁸ The tribunal's finding on expropriation was based on the respondent's decision to initiate *caducidad* proceedings with an aim to end the claimant's contract. The decision to end the contract was termed expropriation because: first, Ecuador had indicated its intention to not terminate the claimant's contract in the preliminary proceedings of arbitration, but changed its position thereafter; second, the tribunal observed that Ecuador's discretion to end the contract should have been postponed till the end of arbitration; third, since Ecuador had taken over the oil blocks, it was 'unnecessary' to end the contract.⁵⁸⁹

C. Concluding Remarks

In view of the discussion in Sections III and IV above, a few concluding remarks are necessary. To begin with, it is fair to say that the deference accorded by tribunals to a state's taxation measures suggests that states have a significant policy space to enact their tax measures without violating their obligations under IIAs. Second, tribunals have accepted that investors making excessive profits is a legitimate policy objective and a state can change its tax laws to impose additional tax liability on the huge profits being earned by the investor. However, the tribunals have focused more on the effects of the tax measures as seen in the *Burlington*, *Yukos*, and *Perenco* awards, and less on the proportionality of the taxation measures. Finally, one also sees a lack of any meaningful reference to and engagement with ITL in the arbitral awards and whether the principles of law in ITL meaningfully constrain a state's ability to enact its tax laws.⁵⁹⁰

V. TAX STABILISATION CLAUSES

Another unique facet of tax-related investment disputes is connected to tax stabilisation clauses. Such clauses are part of legal stability agreements and frequently signed between the investor and a host state. A tax imposed in violation of a stabilisation clause would amount to breach of contract and can be the subject of challenge. At the same time, a mere breach of contract does not amount to expropriation and in order to constitute expropriation

⁵⁸⁸ *Ibid*, at para 705.

⁵⁸⁹ *Ibid*, at paras 706-711.

⁵⁹⁰ For a detailed discussion on this aspect see Section VII below.

it must amount to a substantial deprivation of investment.⁵⁹¹ Tax stabilisation clauses have changed a lot during the past few decades - their nomenclature, life-spans and even their nature. From the initial 'freezing contracts' they have evolved into 'contracts that stipulate re-negotiation in case of adverse changes in the legal regime' of the host state. The essential difference between the two is that - while the former provided that the laws applicable at the time of entering into contract shall apply to the investor over the entire duration of the project, the latter provide that if the amendment to the laws has an adverse economic effect on the investor - the state and the investor can re-negotiate to amend the contract.

A. First Generation Stabilisation Clauses

The two most prominent awards that emerged from what may be termed as 'first generation clauses' were the *Aminoil* award and the *Revere Copper* award.⁵⁹² In *Aminoil*, the dispute centred around the concession agreement that had a duration of 60 years. Under the agreement, Aminoil was given the rights for exploration and exploitation of petroleum and natural gas and in return it was obligated to pay two shillings and six pence for every barrel of oil. In the subsequent years, not only did Kuwait became an independent state but the price of oil in the world market also increased substantially. The concession agreement was amended a couple of times when the oil prices increased substantially - the avowed objective of amendment was to prevent the oil company from receiving undue benefits due to windfall profits. However, subsequent attempts to renegotiate the contract failed and the state took over the production of oil. The actions of the state were challenged as amounting to breach of the agreement, but the tribunal dismissed the claim. The tribunal observed that Aminoil had tacitly accepted the initial changes in the contract and it neither entered objections nor reservations when the first changes were made. This brought about a 'metamorphosis in the whole character of the Concession.'⁵⁹³ The tribunal stressed that '[I]t is not a case of a change involving a departure from a contract, but of a change in the nature of the contract itself, brought by time, and the acquiescence or conduct of Parties.'⁵⁹⁴ The conclusion of the tribunal was warranted in view of the long period contemplated in the contract and the fact that the contract was entered into when Kuwait was not an independent state.

⁵⁹¹ See generally Thomas Wälde, George Ndi, 'Stabilizing International Investment Commitments: International Law Versus Contract Interpretation' (1996) 31 Texas Int'l L J 215.

⁵⁹² *Aminoil v Kuwait* (1982) 21 ILM 976; *Revere Copper and Brass Inc v Overseas Private Investment Corporation (OPIC)* (1978) 56 ILR 258.

⁵⁹³ *Aminoil* award, *supra* note 592, at para 97.

⁵⁹⁴ *Ibid*, at para 101.

In *Revere Copper*, the dispute arose from a concession agreement between Jamaica and a subsidiary of Revere Copper Company - RJA. The duration of the agreement was 25 years and it provided that the taxes on the company would remain the same for the duration of the contract. However, the government later claimed more royalties by arguing that the circumstances had changed. But the company closed its operations due to the difficulty in continuing its operations. The tribunal noted that the sole question before it was whether the actions of the government prevented RJA from exercising effective control over the use or disposition of a substantial portion of its property or from operating its property.⁵⁹⁵ The tribunal concluded that:

In our view the effects of the Jamaican government's actions in repudiating its long term commitments to RJA have substantially the same impact on effective control over use and operation as if the properties were themselves conceded by a concession contract that was repudiated.⁵⁹⁶

The tribunal added that here 'effective control not only of the contract but of the entire operation has been lost, due directly to the action of the government.'⁵⁹⁷ The observations of the tribunal have been rightly criticised for formulating too wide a rule and for supporting a proposition that the stabilisation clause immunises the investor from any changes in the regulatory regimes of the host state.⁵⁹⁸ Rosalyn Higgins commented on the award and stated that it 'comes very close to saying that all international contracts for the exploitation of resources are inherently immutable.'⁵⁹⁹

The above mentioned criticisms are valid but need to be read in the context of the nature of first generation stabilisation clauses. Freezing laws for (unrealistically) long time periods was a typical feature of the first generation stabilisation clauses. Any minor changes in law, which were invariable during a long period of time, led to disputes. The frequency of disputes was further intensified if there was an unexpected change in circumstances such as windfall profits or a general change in market conditions. The stabilisation clauses have changed in nature and so have the disputes that revolve around them.

⁵⁹⁵ *Revere Copper* award, *supra* note 592, at 55.

⁵⁹⁶ *Ibid*, at 57.

⁵⁹⁷ *Ibid*, at 59.

⁵⁹⁸ M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press 2010) 392.

⁵⁹⁹ Rosalyn Higgins, 'The Taking of Property by the State' (1982) 176 *Hague Recueil* 259, at 335.

B. Second Generation Stabilisation Clauses

One of the recent disputes that involved ‘second generation tax stabilisation clauses’ was the *Duke Energy* award. One of the issues that the tribunal was confronted with was - what constitutes tax stabilisation under legal stability agreements? The tribunal observed that laws often invite different interpretations and in order to preserve the proper balance between the parties, it must be shown that - absent a demonstrable change of law or a change to a stable prior interpretation or application, the application of the law was patently unreasonable or arbitrary.⁶⁰⁰

The tribunal held that tax stabilisation guarantees that: (a) laws and regulations that form part of the tax regime at the time the agreement is executed will not be amended or modified to the detriment of the investor; (b) a stable interpretation or application that is in place at the time of the agreement will not be changed to the detriment of the investor; (c) even in the absence of (a) and (b), stabilised laws will not be interpreted or applied in a patently unreasonable or arbitrary manner.⁶⁰¹ Further, the tribunal clarified that:

tax stabilization does not mean that the laws shall only be interpreted or applied based on the meaning that most favours the beneficiary, or the meaning that its legal advisors suggest would be the most appropriate. Tax stabilization does not provide a guarantee against the risk that the Government or the courts will interpret the law in a manner that is unfavourable to the investor, or that differs from the opinion of the investor’s legal advisors. An interpretation adverse to the investor cannot *per se* be considered a modification or violation of legal stability unless it is so unreasonable that, in practice, it violates the very stability that was guaranteed.⁶⁰² (emphasis added)

The tribunal has very carefully demarcated the scope of protection provided by the tax stabilisation clauses. It clearly did not approve of the wide formulation in the *Revere Copper* award. At the same time, it stated that any unreasonable action by the host state shall be considered as breach of the tax stabilisation clause. However, it is not clear how this threshold of ‘unreasonableness’ in contractual disputes is different from the test of ‘substantial deprivation’ applied in instances of treaty violations. Is it merely a distinction

⁶⁰⁰ *Duke Energy International Peru Investments No. 1, Ltd v Republic of Peru* ICSID Case No. ARB/03/28 (Award, 18 August 2008) para 226.

⁶⁰¹ *Ibid*, at para 227.

⁶⁰² *Ibid*, at para 228; Also see *Total* award, *supra* note 18.

without a difference? It is unclear. However, second generation tax stabilisation clauses do provide one essential element to the investor that is not otherwise available - an opportunity to re-negotiate the terms of the agreement in case of adverse changes to the tax law. This issue was examined in the *Burlington* award.

In *Burlington*, one of the issues before the tribunal related to the tax clauses contained in the contracts between the investor and the host state. The two tax clauses that were in dispute essentially provided that: in the event of a modification to the tax system or the creation or elimination of new taxes not foreseen in the contract, if such taxes have an impact on the economics of the contract, a correction factor will be included in the production sharing of oil (between the investor and the state) in order to absorb the impact of the increase or decrease in the tax.⁶⁰³ *Burlington* argued that the clauses were tax stabilisation clauses while Ecuador argued that they were merely renegotiation clauses.⁶⁰⁴ The position of Ecuador was that the application of correction factor was not mandatory. The tribunal concluded that the language of the 'tax modification clause' was mandatory and the mere fact that the clause required that the parties must jointly calculate the readjustment does not make the application of the correction factor optional. The requirement of jointly calculating the correction factor was 'to prevent a situation where a party unilaterally imposes its computation of the share of oil production.'⁶⁰⁵

The *Burlington* tribunal coined the term 'tax modification clause' to describe second generation stabilisation clauses. The clauses in dispute in *Duke Energy* and *Burlington* are prominent examples of the manner in which tax stabilisation clauses have evolved over the past few decades. They differ in several ways from the clauses that were challenged in the *Aminoil* and in the *Revere Copper* awards: first, they do not ordinarily prescribe that the tax laws shall stay 'unaltered' or 'frozen' for a period of decades; second, the change in tax law has to be unreasonable in order to constitute a breach of contract; third, they contain a provision that in case of any change in the tax laws that impact the economics of the contract the parties shall jointly negotiate and absorb the impact of the change in the tax laws.

Additionally, one of the most interesting aspects of the tax modification clauses, especially in the *Burlington* award, was that they provide that the parties shall negotiate to absorb the

⁶⁰³ See *Burlington* award, *supra* note 370, at paras 21-22.

⁶⁰⁴ *Ibid*, at paras 140-150.

⁶⁰⁵ *Ibid*, at para 323.

‘impact of the increase or decrease in the tax.’⁶⁰⁶ This ensures that the stabilisation clauses are not just beneficial to the investors but that the host state can also benefit if it reduces the tax burden of the investor. The evolution of the tax stabilisation clauses shows that they have matured from being merely tools to protect investors from adverse actions of the host state to being a mutually beneficial tool. The jurisprudence has evolved accordingly. From postulating a wide rule in the *Revere Copper* award to delineating the scope of protection provided by a tax stabilisation clause in the *Duke Energy* award.

At the same time, the above discussed awards do not provide a clear indication of the extent to which a tax stabilisation clause protects an investor. As I mentioned above, it is unclear how the standard of unreasonableness in the context of tax stabilisation clauses is different from the substantial deprivation test. In my view, a tax stabilisation clause is likely to provide greater protection to an investor in case of any volatility in the prices. For example, the tribunals in *Yukos* awards described the tax assessments by Russia as arbitrary; the tax assessments would have been termed as violation of tax stabilisation clause if one applies the standards laid down in the *Duke Energy* award. Further, in the *Sergei Paushok* award, one of the facts that the tribunal relied on was that the investor did not sign a stability agreement unlike other investors in the same sector and thus the argument of expropriation by tax was not accepted.⁶⁰⁷ But more clarity from tribunals is certainly needed.

VI. REASONS FOR THE UNIQUENESS OF TAX-RELATED INVESTMENT DISPUTES

Amongst different reasons for treating taxation as a unique category in investor-state arbitration, the nature of tax - a measure which makes a claim on the monies of the investor and necessarily reduces the investor’s profit and revenue - is the foremost reason. The compulsory payment of a part of income is what demarcates taxation from any other regulatory measure. Tax carve outs and the provision of tax veto also contribute in earmarking tax-related investment disputes as a separate category;⁶⁰⁸ even though the latter two are unlikely to influence the merits of an arbitral award.

⁶⁰⁶ *Ibid*, at para 21.

⁶⁰⁷ This of course was one of the reasons for the tribunal concluding that the windfall profit tax was not expropriatory. The tribunal relied on other reasons as well for its conclusions. See Chapter 5 below for more details on this aspect.

⁶⁰⁸ See Chapters 2 and 3 above.

As discussed in the Sections III and IV, tribunals have endorsed the notion that states have wide latitude in the enactment and enforcement of taxation laws.⁶⁰⁹ However, tribunals do not have a unanimous opinion on this aspect. Also, there is no clarity if the special nature of tax is due to the relatively higher threshold set for a taxation measure to be expropriatory or is it reverse - taxation, per se, constitutes a special category in investment disputes and thus tribunals have set exacting standards for expropriation claims to succeed. Tribunals have referred to a diverse set of reasons to justify the treatment of taxation as a separate category. In the paragraphs that follow I examine the tribunals which have endorsed taxation as a separate category of disputes - and the reasons advanced for the same.

In *Feldman*, the tribunal endorsed the US position that 'tax law and policy changes are intended to be given relatively broad leeway under NAFTA, even if their effect is to make impractical for certain business activities to continue.'⁶¹⁰ The tribunal indicated the need to provide greater leeway to states in taxation matters at several places in the award. At one place in the award the tribunal stated that it is undeniable that the claimant has been treated unreasonably and had great difficulties in dealing with the officials, but unfortunately, 'tax authorities in most countries do not always act in a consistent and predictable way.'⁶¹¹ Additionally, the tribunal placed the onus on the claimant to consult a legal counsel 'given that he was dealing with tax laws and tax authorities, which are subject to extensive formalities in Mexico and in most other countries of the world.'⁶¹² The tribunal did not, however, expressly address or endorse the view that taxation forms a special category of expropriation.

The most express endorsement of taxation as a special category was in *EnCana*. In *EnCana*, the tribunal before dismissing the claim of indirect expropriation by the claimants, remarked that in the absence of a specific commitment from the host state, the foreign investor neither has the right nor any legitimate expectation that the tax regime will not change to its disadvantage during the period of the investment.⁶¹³ Concluding on the indirect expropriation claims, the tribunal observed:

⁶⁰⁹ See A.R. Albrecht, 'Taxation of Aliens under International Law' (1952) 29 British Yb'k of Int'l L 145; A.R. Albrecht, 'The Enforcement of Taxation under International Law' (1953) 30 British Yb'k of Int'l L 454.

⁶¹⁰ *Feldman* award, *supra* note 562, at para 116.

⁶¹¹ *Ibid.*

⁶¹² *Ibid.*, at para 114.

⁶¹³ Relying on *Revere Copper* award, *supra* note 592.

From the perspective of expropriation, taxation is in a special category. In principle a tax law creates a new legal liability on a class of persons to pay money to the State in respect of some defined class of transactions, the money to be used for public purposes. In itself such a law is not taking of property; if it were, a universal State prerogative would be denied by a guarantee against expropriation, which cannot be the case. Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised.⁶¹⁴ (emphasis added)

The tribunal also referred to the reason for treating taxation as a special category, albeit briefly. The tribunal emphasised on nature of taxation and observed that ‘all taxation reduces the economic benefits an enterprise would otherwise derive from its investment’ and thus only in an extreme case shall a generally applicable tax be judged as equivalent in effect to an expropriation.⁶¹⁵

In *El Paso*, the tribunal relied on the tax carve out to justify special nature of taxation. It observed:

Every year, governments around the world propose the adoption of tax measures which constitute either new initiatives or amendments to the existing fiscal legislation. There is a presumption of validity in favour of legislative measures adopted by a State, and it is up to those who challenge such measures to demonstrate their invalidity. This idea has been embodied in Article XII of the BIT, the effect of which is to only limit slightly the State’s power to levy taxes.⁶¹⁶ (emphasis added)

The tribunal further added that the tax carve out grants an important margin of freedom to the host State in relation to its fiscal policy towards foreign investors and only creates a ‘best-effort obligation’ for the state.⁶¹⁷

In my view, the tribunal in the *El Paso* award could have also referred to the existence of tax treaties. As described in Chapter 3, tax treaties are the proximate cause for inclusion of tax carve outs in IIAs. Tax carve outs, in turn, not only limit the jurisdiction of investor-state tribunals they also grant states a wide margin to enact and implement tax measures. The *El*

⁶¹⁴ *EnCana* award, *supra* note 211, at para 177.

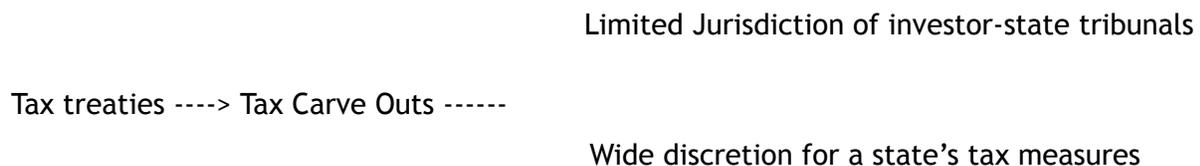
⁶¹⁵ *Ibid.*

⁶¹⁶ *El Paso* award, *supra* note 440, at para 290.

⁶¹⁷ *Ibid.*, at para 291.

Paso tribunal recognises the latter as reflected in its observation that tax carve outs only create a best-effort obligation on states. However, this does not adequately articulate the uniqueness of tax-related investment disputes and the role of tax treaties in contributing to the uniqueness. In my view, the appropriate order of analysis is as follows:

FIGURE 1: Tax Treaties, Tax Carve Outs and Uniqueness of Tax-Related Investment Disputes



The meaning and implication of the phrase ‘best-effort obligation’ employed by the *El Paso* tribunal is unclear. If the aim is to highlight the uniqueness of tax-related investment disputes, it could in my view, be better articulated by using the above mentioned approach.

In endorsing the special category of taxation, the tribunals in the *Yukos* awards were less emphatic than the *Feldman*, *EnCana* and *El Paso* tribunals. The tribunal in the *Valores* award observed that ‘the notion that states have a considerable margin of discretion in enacting and enforcing tax laws should not lead to any confused idea that they have a discretion as to whether or not to comply with an international treaty.’⁶¹⁸ The tribunal made this observation to underscore the point that the mere use of the label ‘taxation’ does not shield the host state from expropriation claims. If it were so, the investment protection through international law would become an illusion and state could avoid all responsibility by dressing up all its measures as taxation.⁶¹⁹ The tribunal acknowledged that taxation affords a greater discretion to the states - but a state cannot breach its obligations under international law merely by using the term ‘taxation.’⁶²⁰

In a similar vein, the tribunal in *RosInvest* observed that ‘States have a wide latitude in imposing and enforcing taxation laws even if resulting in substantial deprivation without

⁶¹⁸ *Valores* award, *supra* note 374, at para 179.

⁶¹⁹ *Ibid.*

⁶²⁰ See generally Christopher S. Gibson, ‘Yukos Universal Limited (Isle of Man) v The Russian Federation A Classic Case of Indirect Expropriation’ (2015) 30 ICSID Rev-FILJ 303.

compensation.’⁶²¹ In *Tza Yap Shum* award, the tribunal noted that as a general rule a state is not responsible for a loss of value or other disadvantages resulting from the imposition in good faith of general taxes and regulations. Even though the tribunal recognised the wide discretion that the states enjoy in taxation matters, it also expressly stated the limitations that this discretion provided.⁶²² However, no reasons were mentioned as to why states enjoy wide discretion in adopting tax measures.

Additionally, in the *Sergei Paushok* award, the tribunal made a few observations that hinted at the need to view taxation measures of a state through a different lens. While discussing the burden of the windfall profit tax imposed by the government of Mongolia, the tribunal observed that just because Mongolia also paid a heavy price following the adoption of the windfall profit tax does not mean the tax was arbitrary and unreasonable. The tribunal observed it was not willing to take that step ‘especially when it comes to dealing with fiscal legislation.’⁶²³ At a different place in the same award, the tribunal observed that just because Mongolia adopted a tax regime which was different from other states and may not be wise economic policy does not mean that it constitutes a breach of a BIT ‘particularly in the area of taxation, in respect of which States jealously guard their sovereign powers.’⁶²⁴ The tribunal’s intent was to emphasise, though in a limited manner, that taxation constituted a special category and the rationale for that is partially derived from the sovereignty concerns of the states.⁶²⁵

However, not all tribunals have endorsed taxation as a special category. For instance, in the *Burlington* award, the claimant made a specific argument made that taxation is a special category in investment disputes. The respondent state also made an elaborate counter argument. However, the tribunal, in its findings, side-stepped the issue and avoided making any observation on the issue. In the award, the tribunal makes several important observations on various issues relating to tax-related investment disputes, but disappointingly considered

⁶²¹ *RosInvest Co* award, *supra* note 374, at para 580; Also see para 496; *Yukos Universal* award, *supra* note 160, at paras 500-525 (the authorities may change the interpretation and application of their tax laws and the states enjoy a certain discretion in this respect).

⁶²² See *Tza Yap Shum* award, *supra* note 511, at paras 171 and 217 (The tribunal also noted that the deference that is due to a State in this respect is nonetheless limited by the international law principle of reasonableness and non- arbitrariness, and that an indirect expropriation can result from the actions of taxation authorities if their effect is confiscatory, arbitrary, abusive or discriminatory).

⁶²³ *Sergei Paushok* award, *supra* note 469, at para 321.

⁶²⁴ *Ibid*, at para 310.

⁶²⁵ Also see *El Paso* award, *supra* note 440, at para 290 (‘The tax policy of a country is a matter relating to the sovereign power of the State and its power to impose taxes on its territory. The Tribunal agrees that the State has the sovereign right to tax to enact the tax measures it deems appropriate at any particular time.’).

the issue of taxation constituting a special category as one to be avoided. The omission is particularly disappointing since the claimant specifically made an argument to that effect.⁶²⁶

The above mentioned awards suggest that various tribunals have articulated that tax-related investment disputes are in a separate category by using different rationales. However, despite the diversity of views or perhaps because of it, several questions remain unanswered. If taxation constitutes a special category for expropriation purposes, is a higher standard of expropriation the only (and necessary) consequence of recognising a separate category?

In my view, the *EnCana* award suggests the correct rationale for treating expropriation by taxation as a special category. The tribunal acknowledged that every tax due to its nature reduces the economic benefit of the investment and further suggested that the states enjoy a wide margin in so far as the tax is not ‘extraordinary, punitive in amount or arbitrary in its incidence.’ Thus, nature of tax contributes in making tax-related investment disputes as unique and an important implication of the same is a high threshold for expropriation by taxation.

The tribunal in *El Paso* referred to tax carve outs to justify that states enjoy a wide margin of appreciation in matters of taxation. However, the tribunal failed to convincingly elaborate on the connection between tax treaties, tax carve outs and the uniqueness of tax-related investment disputes. I discussed the rationale for tax carve outs in Chapter 3 above where I elaborated that taxation is carved out from IIAs because states perceive that taxation matters are better addressed under tax treaties.⁶²⁷ The reference to the existence of tax treaties could be used by future tribunals to highlight the uniqueness of tax-related investment disputes, and to give a wide margin of appreciation to the states.

Further, as mentioned above, the tribunal in the *Sergei Paushok* award referred to sovereignty to distinguish tax from other measures. Sovereignty, per se, is not a convincing legal reason to conclude that taxation deserves a wider margin of appreciation. In my view, an alternate approach could be to refer to the police powers doctrine in tax-related investment disputes.

⁶²⁸ Doctrine of police power excludes state liability for bona fide and non

⁶²⁶ See *Burlington* award, *supra* note 551, at paras 391-404 (the tribunal discusses in detail the standards of expropriation without once addressing the argument of taxation forming a special category in investment disputes).

⁶²⁷ See Chapter 1, Section V.A above.

⁶²⁸ See Jorge E. Viñuales, ‘Sovereignty in Foreign Investment Law’ in Zachary Douglas et al (eds.), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 326 (stating that sovereignty is not a single legal concept but a mosaic of actionable legal concepts and that the police powers

discriminatory regulation.⁶²⁹ Gebhard Bücheler observes that under the ‘mitigated police powers’ doctrine - the tribunal can consider both the effect of a state measure and the purpose for which it was adopted.⁶³⁰ This is unlike the strict application of ‘police powers’ doctrine which focuses only on the purpose of the state measure.⁶³¹ A mitigated police powers doctrine would allow a process of balancing the public interest and property rights of the investor. Using the police powers doctrine in their analysis may allow the tribunals to ground their awards in a more convincing legal reason instead of vague assertions of sovereignty considerations of the states.

Apart from the *Burlington* award, *Feldman* award is the closest that any tribunal has come in referring the police powers doctrine in tax-related investment disputes. In the *Feldman* award, the tribunal observed that governments should be free to act in public interest by new and modified tax regimes.⁶³² The tribunal continued that reasonable governmental regulation that involves increase or decrease of tariffs cannot be achieved if every adversely affected business is allowed to seek compensation.⁶³³ Almost on an opposite spectrum, the tribunal in the *Hydro award* suspended criminal proceedings against the claimant to protect procedural integrity of arbitration - directions which can be interpreted as interfering with the police powers of a state.⁶³⁴ However, interference with police powers is a rare occurrence and needs to meet a high threshold.

Finally, in future disputes, I would suggest that the tribunals should also indicate if the opinions of the competent authorities under the provision of tax veto constitute decisions of experts or specialised decision makers. The competent authorities that exercise tax veto are typically officials of taxation departments of the relevant states. Thus, if the opinion of tax authorities is considered as expert opinions, the tribunals will also need to state the extent of doctrine is one of the actionable expressions of sovereignty used in foreign investment disputes); In tax-related investment disputes the most prominent use of the police power doctrine was in the *Burlington* award. See Section II above; Also see Annexure 1 below.

⁶²⁹ See *Emanuel Too v Greater Modesto Insurance* (1989-III) 23 Iran-US CTR 378; *Sedco Inc v National Iranian Oil Co*

9 Iran-US CTR 378.

⁶³⁰ Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Oxford University Press 2015) 129-132.

⁶³¹ See *Saluka Investments* award, *supra* note 165, at paras 255-276.

⁶³² *Feldman* award, *supra* note 562, at para 103.

⁶³³ *Ibid.*

⁶³⁴ *Hydro S.r.l. and others v Republic of Albania* ICSID Case No. ARB/15/28 (Order on Provisional Measures, 3 March 2016), at paras 3.16-3.20; Also see *City Oriente Limited v Republic of Ecuador* ICSID Case No. ARB/06/21 (Decision on Provisional Measures, 19 November 2007) (where the tribunal suspended the criminal and collection proceedings against the claimant initiated by the respondent to collect pending payments under the new laws enacted by it. The tribunal observed that that the respondent by using its sovereign right to prosecute and punish is securing payment of amount and thereby aggravating the dispute that was pending before the tribunal).

restraint that needs to be shown in reviewing their decisions.⁶³⁵ The opinion of tax authorities should be considered expert opinion and shown deference by tribunals unless their interpretation of tax laws is mala fide or without adequate reasoning.

VII. INVESTOR-STATE TRIBUNALS AND THEIR LIMITED ENGAGEMENT WITH INTERNATIONAL TAX LAW

Arbitral awards on tax-related investment disputes have one common and recurring shortcoming- their limited engagement with ITL. The limited jurisdiction of most tribunals in tax-related investment disputes combined with the nature of disputes has rarely presented the tribunals with an opportunity to meaningfully engage with ITL. However, some tribunals have addressed certain taxation issues, the prominent ones being - customary norms of taxation and the incorporation of shell companies by investors in low tax regions to reduce their tax liabilities. On both aspects, the analysis of the tribunals has been unsatisfactory.

The first troublesome aspect of the interface of international tax and investor-state tribunals arises in the context of customary law limitations on taxation. Some tribunals refer to customary norms limiting a state's power to tax. But, as I argued in Chapter 1 above, there are no customary norms in ITL, only general principles of law. Tribunals do not adequately probe the existence of customary norms in ITL; the superficial treatment of CIL is perhaps one of the most glaring omissions by the tribunals adjudicating tax-related investment disputes. It is contended, that such an approach belies a correct understanding of ITL as a sub-discipline of general international law.

In *Sergei Paushok*, the tribunal dismissed the argument of the claimant that the windfall profit tax was contrary to international standards. The tribunal observed that the claimants 'have not established the existence of such standards.'⁶³⁶ In my view, a better approach would have been to rely on general principles of law in ITL. In a similar vein, the tribunal in *Feldman* observed that states are free to adapt new or modified tax regimes, the grant or withdraw government subsidies, reductions or increases in tariff levels, and the like. The

⁶³⁵ This of course will only be applicable to those IIAs where it is provided that the opinions of competent authorities are of persuasive value before an investor-state tribunal and not where exercise of tax veto prevents arbitration altogether; Also see Gus Van Harten, *Sovereign Choices and Sovereign Constraints Judicial Restraint in Investment Treaty Arbitration* (Oxford University Press 2013) 90 (arguing that arbitral tribunals have not mentioned terms that might signal restraint when reviewing specialized or science based decision making such as chemical regulation or quality water control).

⁶³⁶ *Sergei Paushok* award, *supra* note 469, at para 303.

tribunal stated that business cannot seek compensation from reasonable governmental regulation of this type and ‘*it is safe to say* that customary international law recognizes this.’⁶³⁷ The tribunal’s erroneous observation relied on the US Restatement; the latter stated that it was the police power of the state to change laws - it did not state that there were customary norms in ITL.

In *Burlington* the claimant challenged Ecuador’s legislation which increased its tax liability. It was argued that it amounted to a measure ‘tantamount to expropriation’. The tribunal observed that the concept of confiscatory taxation corresponds to expropriatory taxation. It observed ‘the most important factor to distinguish permissible from confiscatory taxation is the effect of the tax. The effects required for a tax to be deemed confiscatory do not appear to be different from those required to assess the existence of an indirect expropriation. In other words, confiscatory taxation constitutes an expropriation without compensation and is unlawful.’⁶³⁸ In its analysis of the standard for expropriatory taxation, the tribunal relied on the CIL on taxation. The tribunal noted that there are two limitations to a state’s power to tax under CIL - it should not be discriminatory and it should not be confiscatory.⁶³⁹ In my view, these two limitations are not based in customary law. For example, it is possible to understand non-discriminatory taxation as a general principle of law due to its incorporation in almost every tax treaty, but it would be premature to view it as a customary norm.

The tribunals in *Burlington* and *Feldman* suggested that customary law limits a state’s power to tax, but did not rely on any authoritative source. There was, for instance, no mention of the fact if customary limitations on state power to tax are incorporated in any of the tax treaties, tax information exchange agreements or even in any domestic tax laws of the states. Until now, neither the issue of international tax avoidance nor customary norms in ITL have decisively influenced the decision of any tribunal, but partial and incorrect references to ITL are problematic.

Further, the allegations of expropriation at times intersect with the disputes generally considered within the purview of tax treaties - disputes relating to international double taxation, under taxation or tax evasion. In the *Yukos Universal* and *Hulley* awards, tribunals referred to the tax avoidance techniques adopted by Yukos such as the incorporation of shell companies in low tax regions without a contemporaneous economic activity in those regions.

⁶³⁷ *Feldman* award, *supra* note 562, at para 103 (emphasis added).

⁶³⁸ *Burlington* award, *supra* note 551, at para 395.

⁶³⁹ *Ibid*, at para 392.

The tribunal accepted that the Russian federal legislation and the legislation of the low-tax jurisdictions did not mandate that trading companies actually conduct their trading operations in the territory of the low-tax jurisdictions. Nevertheless, the tribunal observed, ‘there are indications in the record that Yukos itself had doubts, or at least apprehensions, about the legality of aspects of its *modus operandi*. There is also the issue of the questionable use by Claimants of the Cyprus-Russia DTA.’⁶⁴⁰ Even though the conduct of the claimant in this case did not prevent the tribunal from deciding in its favour, from the perspective of international tax, these observations have several shortcomings. Claimants’ doubts about the use of low tax regions for reducing their tax liabilities and its permissibility under the tax treaty were not unique, such doubts are widespread.⁶⁴¹ MNEs across the globe frequently use these techniques and have to consistently defend the legality of their techniques.⁶⁴²

In view of such uncertainty in tax laws it is appropriate to look at the observations in the *Yukos Universal* award on the ‘unclean hands’ doctrine and ‘contributory fault’. The tribunal held that it is not persuaded that there exists a general principle of law recognized by civilized nations under Art 38(1)(c) of the ICJ Statute that would bar an investor from making a claim because it has ‘unclean hands.’⁶⁴³ In the context of tax-related investment disputes, ‘unclean hands’ would generally translate to tax evasion by the investor. The *Yukos Universal* award, rejected the unclean hands doctrine but relied on two other concepts to address the tax evasion by the investor - making and performing an investment and contributory fault. With respect to the former, the tribunal observed that the allegations of tax evasion against the claimant were not related to the making of the investment but largely concerned post-investment illegalities. Thus, the tribunal had jurisdiction to hear the claims. With respect to the latter, the tribunal attributed ‘contributory fault’ to Yukos - that through its own wilful and negligent acts it contributed to its own destruction.⁶⁴⁴ Based on its findings, the tribunal concluded that the faults of Yukos were much lesser in comparison to those perpetrated by the host state.

⁶⁴⁰ *Yukos Universal* award, *supra* note 160, at para 1576.

⁶⁴¹ See OECD, *Addressing Base Erosion and Profit Shifting* (2013) 33-39.

⁶⁴² See, for instance, Economic References Committee, Official Committee Hansard, *Australian Senate: Hearing on Corporate Tax Avoidance* (testimony of Maile Carnegie, Google Australia; Tony King, Apply Pvt Ltd and Bill Sample, Microsoft) (2015) 45-55.

⁶⁴³ *Yukos Universal* award, *supra* note 160, at para 1358.

⁶⁴⁴ See generally Aloysius Llamzon, ‘The State of the ‘Unclean Hands’ Doctrine in International Investment Law: Yukos as both Omega and Alpha’ (2015) 30 ICSID Rev-FILJ 315.

The observations of the *Yukos Universal* tribunal leave a few questions unanswered. It is unclear if tax evasion is viewed part of transnational public policy or is it merely an issue to be viewed on a temporal dividing line - to characterise the issue as one of jurisdiction or merits. It is also possible to argue that an investor's obligation to pay tax in the host state is a recognised principle of law in ITL. Additionally, it remains unclear how contributory fault is assessed and ascribed. The *Niko* tribunal has observed that there has to be a relation of reciprocity between the relief sought by the claimant in the arbitration and the claimant's acts in the past which the respondent state may characterise as involving unclean hands.⁶⁴⁵ The tribunal in *Yukos Universal* did not examine this aspect adequately.

VIII. CONCLUSION

Tribunals, in tax-related investment disputes, have usually not found that the measures of the host state constitute expropriation unless there is a direct, obvious and an undeniable curtailment of the investor's rights. In the *Burlington* and the *Yukos* awards, the tribunals only held the actions of the host state to be expropriatory when the host state interfered with the physical possession of the investor's assets. This deferential approach to 'expropriation by taxation' is because tax-related investment disputes constitute a unique category. The tribunals in awards such as the *EnCana* award have expressly endorsed this position. Other tribunals, for instance, in the *Yukos* awards have adopted a deferential approach and have given a wide leeway to the states in taxation measures; but they have not expressly articulated the unique nature of tax-related investment disputes.

Apart from the physical dispossession or interference with property rights of an investor, tribunals have relied on the substantial deprivation and the continued profitability test in tax-related investment disputes. There is no upper limit of tax rates beyond which taxation becomes expropriatory - a tax rate of 99% in *Burlington* award was not held to be expropriatory until it was accompanied by a physical takeover by the host state. Thus, the ability of the investor to generate profits even after the imposition of a strenuous tax and the continued physical possession are important factors that tribunals consider in arguments relating to expropriation in tax-related investment disputes. I've argued that that the arbitral

⁶⁴⁵ *Niko Resources (Bangladesh) Ltd v Bangladesh Petroleum Exploration and Production Company Limited and others* ICSID Case No. ARB/10/11 (Decision on Jurisdiction, 19 August 2013) para 484.

awards in tax-related investment disputes reveal that tribunals have offered a wide margin of appreciation to the states in taxation matters.

The rationale and justification for wide margin to states, however, differs. Some tribunals have referred to tax carve outs, others have mentioned the sovereignty considerations in taxation matters still others underscored the involuntary transfer of money. The latter, I argue, is the most pertinent and important factor that distinguishes taxation from other measures such as public health measures. Future arbitral tribunals dealing with tax-related investment disputes should recognize a separate category of 'expropriation by taxation'. Equally, I highlight that tribunals should refer to the regulation of tax by tax treaties which has also contributed to the unique nature of tax-related investment disputes.

Another aspect that I highlight is the under appreciation of IIL by investor-state arbitral tribunals. Thus far, reference to customary norms in IIL and tax evasion by MNEs is rare. I suggest that some of the principles in tax treaties constitute general principles of law and not customary norms. These principles should, in turn, inform how IIL enables a state to impose taxes. However, one sees that tribunals tend to treat IIL as self-sufficient even when they examine the arguments of the parties on tax evasion and the application of tax laws. I suggest that investor-state tribunals need to take into account the general principles of IIL.

CHAPTER 5

FAIR AND EQUITABLE TREATMENT IN TAX-RELATED INVESTMENT DISPUTES

I. INTRODUCTION

As discussed in Chapter 3, taxation measures of a state are generally required to meet only a limited set of substantive obligations. The prominent ones are - expropriation, FET standard and the non-discrimination standard. Chapter 4 examined expropriation, in this chapter I shall focus on the FET standard.⁶⁴⁶

The FET standard has become the most important standard in investor-state arbitration.⁶⁴⁷ Its content is, however, indeterminate and contingent on the decentralised working of the IIL regime.⁶⁴⁸ Unsurprisingly, the form and content of ‘fair and equitable treatment’ has attracted different opinions.⁶⁴⁹ Most commentators have argued that the FET standard has an autonomous content.⁶⁵⁰ A few others have, however, argued that the FET standard should be understood in reference to the international minimum standard.⁶⁵¹ The purpose of this chapter is not to engage with the different opinions about the content and nature of the FET standard. Instead, this chapter aims to examine the FET standard in the specific context of tax-related investment disputes.

⁶⁴⁶ See Chapter 6 below for a discussion on the non-discrimination standard.

⁶⁴⁷ See generally Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxford University Press 2013); Roland Kläger, ‘Fair and Equitable Treatment’ in *International Investment Law* (Cambridge University Press 2011); Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford University Press 2008); NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (31 July 2001), at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/NAFTA-Interpr.aspx?lang=eng>

⁶⁴⁸ CH Brower, ‘Structure, Legitimacy, and NAFTA’s Investment Chapter’ (2003) 36 Vand J Int’l L 37, at 63 (describing fair and equitable treatment as ‘an intentionally vague term, designed to give adjudicators a quasi- legislative authority to articulate a variety of rules.’).

⁶⁴⁹ See R. Dolzer, C. Schreuer, *Principles of International Investment Law* (Oxford University Press 2008) 128-130.

⁶⁵⁰ See, for instance, Jeswald W. Salacuse, *The Law of Investment Treaties* (Oxford University Press 2015) 228; Also see Stephen Vascianne, ‘The Fair and Equitable Treatment Standard in International Investment Law and Practice’ (1999) 70 British Y’Bk Int’l L 99, at 144.

⁶⁵¹ See Martins Paparinskis, *supra* note 647, at 171-180; Also, several arbitral tribunals have held that the law of the international protection of foreign investors has considerably evolved since 1926 when the *Neer* decision restated the minimum treatment standard existing at that time. See, for instance, *Enron Corporation and Ponderosa Assets, L.P. v Argentina*, ICSID Case No. ARB/01/3 (Final Award, 22 May 2007) para 257; *Mondev International Ltd. v United States of America*, ICSID Case No. ARB(AF)/99/2 (Final Award, 11 October 2002) paras 116-117.

Legal concepts such as fair and equitable treatment attract academic attention from various perspectives. For instance, some focus on broad theoretical arguments and examine the position of fair and equitable treatment in IIL and general international law.⁶⁵² The aim in this chapter is to attempt a more specific analysis. This chapter seeks to understand how the concept of fair and equitable treatment is applied during the adjudication of tax-related investment disputes. Examining the concept of fair and equitable treatment in the context of tax-related investment disputes reveals in granular detail how this substantive obligation works in practice.

This chapter proceeds as follows: Section II of the chapter discusses the relation between taxation and the FET standard. It discusses the approach of the tribunals to tax-related investment disputes and how the FET standard is applied to certain actions of the states such as amendment of taxation laws, abusive tax administration and discriminatory taxation. Section III looks at the interaction between the FET standard and IITL. I highlight the limited and unsatisfactory engagement of tribunals with IITL. Section IV elaborates that in so far as the FET standard is concerned it is unclear if tribunals view tax as a separate category. Section V concludes.

II. TAXATION AND THE FET STANDARD

A. Stability of Tax Laws

This Section proceeds on the assumption that legitimate expectations are an element of the FET standard.⁶⁵³ It relies on the work of Jonathan Bonnitcha who has shown that the tribunals have adopted four approaches towards legitimate expectations: the legal rights approach, the representations approach, the stability approach and the business plan approach.⁶⁵⁴ In tax-related investment disputes, one observes that the tribunals have frequently adopted either the legal rights approach or the representations approach. The first requires that the expectations of the investor must rest on specific rights acquired under domestic law while

⁶⁵² See generally Martins Paparinskis, *supra* note 647; Also see M. Sornarajah, 'The Fair and Equitable Standard of Treatment: Whose Fairness? Whose Equity?', in F Ortino et al (eds.), *Investment Treaty Law: Current Issues II* (British Institute of International and Comparative Law 2007); A Falsafi, 'The International Minimum Standard of Treatment of Foreigners' Property: A Contingent Standard' (2007) 30 *Suffolk Int'l L Rev* 317, at 354-363.

⁶⁵³ The suggestion that legitimate expectations are the core of FET standard is contested. See, for instance, Martins Paparinskis, *supra* note 647, at 227.

⁶⁵⁴ Jonathan Bonnitcha, *Substantive Protection under Investment Treaties A Legal and Economic Analysis* (Cambridge University Press 2014) 161-194.

the second requires that expectations must rest on specific unilateral representations of government officials.⁶⁵⁵

The expectations of the investor may not only derive from the laws of the host state but also from contractual undertakings - drafted specifically to attract foreign investment. In the latter case, as a result of the conduct of the host state, the expectation of the foreign investor may 'rise to the level of legitimacy and reasonableness in the light of the circumstances.'⁶⁵⁶ Tribunals have upheld that 'specific commitments' limit the right of the host state to adapt the legal framework to changing circumstances.⁶⁵⁷ The finding of breach of legitimate expectations thus at times involves distinguishing a contractual commitment from an expectation that emerges from the general regulatory framework of the host state.⁶⁵⁸

1. Legitimate Expectations and Windfall Profit Tax

The question of legitimate expectations in the context of tax was examined by the tribunal in *Sergei Paushok*. The tribunal rejected the claim of the investors that they had legitimate expectations; the basis for rejection was that the investors did not sign a stability agreement with the host state.⁶⁵⁹ In this dispute, the claimant challenged the imposition of the windfall profit tax on its gold mining business by the respondent state - Mongolia. The tax, it was claimed, violated their legitimate expectations. The tribunal rejected the argument and observed:

[F]oreign investors are acutely aware that significant modification of taxation levels represents a serious risk, especially when investing in a country at an early stage of economic and institutional development. In many instances, they will obtain the appropriate guarantees in that regard in the form of, for example, stability agreements which limit or prohibit the possibility of tax increases.⁶⁶⁰

⁶⁵⁵ *Ibid.*

⁶⁵⁶ C. Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 J World Trade 357, at 374; Also see Jeswald W. Salacuse, *The Three Laws of International Investment* (Oxford University Press 2013) 159-301 (a detailed discussion on contractual legal framework in international investment law).

⁶⁵⁷ See *CMS Gas Transmissions Company v Argentina*, ICSID Case No. ARB/01/8 (Decision on Jurisdiction, 17 July 2003) para 27 ('A direct relationship can, however, be established if those general measures are adopted in violation of specific commitments given to the investor in treaties, legislation or contract.').

⁶⁵⁸ See generally Michael W. Reisman, Mahnoush H. Arsanjani, 'The Question of Unilateral Government Statements as Applicable Law in Investment Disputes' (2004) 19 ICSID Rev-FILJ 328.

⁶⁵⁹ *Sergei Paushok* award, *supra* note 469; Also see *El Paso* award, *supra* note 440, at para 294.

⁶⁶⁰ *Sergei Paushok* award, *supra* note 469, at para 302.

The tribunal concluded that other companies had secured such agreements and the claimant in the absence of such an agreement had not succeeded in establishing that they had legitimate expectations against exposure to significant tax increases in the future. The tribunal in *Sergei Paushok* linked the windfall profits and legitimate expectations with ‘economic and institutional development stage’ of a state. In my view, taxation of sudden or unexpected profits cannot be justified on the ground that the state is at an early stage of economic development. Windfall profit taxes need to be justified on principles of equitable sharing of profits - for instance, the fact that the profits are derived from a state’s resources. The sharing of profits should be without any reference to the stage of development of the particular state.

In *Total v Argentina*, the tribunal had to distinguish between the legitimate expectations derived from general regulatory framework and those derived from specific unilateral commitments.⁶⁶¹ I shall discuss two arguments made by Total to elaborate on the aforementioned distinction. First, Total claimed that Argentina’s unilateral modification of the legislation and regulations entailed a breach of the legitimate expectations of Total. Argentina argued that it had not breached any promise or guarantee made to Total because neither did it enter into any contract with it nor did it ‘induce’ Total to invest in Argentina.⁶⁶² Total’s second argument was in relation to the export taxes.⁶⁶³ Export taxes on crude oil were imposed by Argentina in order to increase government revenues and address the emergency in its banking and financial sector. Total argued that taxes were confiscatory and complained that the indirect effect of the export taxes was on the domestic price of oil. Total contended that the export taxes had the effect of reducing its domestic price and interfered with its right to sell crude oil at a freely negotiated price.

With respect to the first argument, the tribunal stated that the principle of legitimate expectations needs to be addressed with reference to the ‘stability’ of the legal framework of the host state.⁶⁶⁴ In elaborating on the subject of stability, the tribunal observed that ‘the form and specific content of the undertaking of stability invoked are crucial.’⁶⁶⁵ It observed that more specific the commitment of the state, the more credible the investor’s claim of

⁶⁶¹ *Total award*, *supra* note 18.

⁶⁶² *Ibid*, at para 99; Also see *Glamis Gold v United States of America* (UNCITRAL Award, 8 June 2009) (where a NAFTA tribunal rejected a claim of legitimate expectations stating that no ‘quasi-contractual inducement’ had been offered by the state to the investor.).

⁶⁶³ *Total award*, *supra* note 18, at paras 393-404.

⁶⁶⁴ *Ibid*, at para 102.

⁶⁶⁵ *Ibid*, at para 121.

reliance on it. The tribunal did not find any specific commitments made by Argentina and correctly rejected Total's argument. Elaborating further, the tribunal held that if the licence provisions of Total are regulated by a defined legal regime it 'cannot be regarded as a source of contractual legal obligations of a specific character assumed directly by Argentina towards Total.'⁶⁶⁶

Addressing the second argument, the tribunal observed that Argentina never restricted the right of Total from selling crude oil and further such right was subject to the right of the executive to fix the domestic price of crude oil.⁶⁶⁷ The tribunal stated that the increase in export taxes in 2007 were intended to recoup resources from the extra profits of exporters due to the extraordinary increase in international oil prices. It then rejected Total's argument that the taxes confiscatory and the purpose of taxes was to manipulate the market. The taxes, the tribunal observed, were part of general fiscal legislation and Total cannot invoke any promise from Argentina to be exempt from general fiscal legislation; these taxes were part of general fiscal stability.⁶⁶⁸ The tribunal then added that windfall profit taxes were 'common' and had been introduced in many oil producing states. Hence, the tribunal concluded, the export taxes enacted by Argentina were not in violation of Total's legitimate and reasonable expectations.⁶⁶⁹ Tribunal's reference to the regularity of windfall profit taxes was unusual. In tribunal's understanding, the fact that other states had imposed windfall profits tax too was important to determine if there was a breach of legitimate expectations. However, the exact meaning of the word 'common' used by the tribunal is uncertain. For instance, it is unclear how many states should have imposed a windfall profit tax for it to be considered 'common'.

⁶⁶⁶ *Ibid*, at para 101.

⁶⁶⁷ *Ibid*, at para 434.

⁶⁶⁸ The observations of the tribunal in *Total* echo Rudolf Dolzer's argument that: '[T]he rational and justification for the recognition of legitimate expectations seems obvious. The investor makes its calculations and decisions in the light of the law of the host state as it is made available to it by the host state, and the investor's assumptions about the return for its investment will depend upon the stability and predictability of those laws.'; See Rudolf Dolzer, 'Fair and Equitable Treatment: Today's Contours' (2014) 7 Santa Clara J Int'l L 7, at 17; Rudolf Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39 Int'l Lawyer 87; *Electrabel S.A. v Hungary* ICSID Case No. ARB/07/19 (Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012) para 7.75 (FET standard not only protects legitimate commercial expectations but it is also its 'most important function.');

⁶⁶⁹ E Snodgrass, 'Protecting Investors' Legitimate Expectations - Recognising and Delimiting a General Principle' (2006) 21 ICSID Rev - FILJ 1; Jorge E. Viñuales, *Foreign Investment and the Environment in International Law* (Cambridge University Press 2012) 350-355.

⁶⁶⁹ *Total* award, *supra* note 18, at para 436.

In *Occidental (II)*, the tribunal held that Ecuador's Law 42 that imposed windfall profit tax flouted the legitimate expectations of the investor and thus breached the FET standard.⁶⁷⁰ The tribunal examined the participation contract between Occidental and Ecuador which provided that both the claimant and the respondent would receive a share in the production of crude oil which would be exclusively dependent on production volume. However, after the rise in oil prices, in April 2006, Ecuador amended the participation contract which made its participation in oil revenues dependent on oil prices. This was an amendment to the original contract where participation of the parties was without any reference to the price of oil.

The findings of the tribunal were influenced by three factors: first, Ecuador's legislative amendment to the contract struck at the heart of the rights acquired by Occidental and its acceptance of the risk of losses in a low price scenario; second, the curtailment of Occidental's right to freely dispose of the oil by amendment to the participation contract; third, Ecuador had made explicit representations during the negotiations of the contract which were later crystallised in the contract itself - and thus, Occidental was 'justified in expecting that this contractual framework would be respected and certainly not modified unilaterally by the Respondent.'⁶⁷¹ The findings of the tribunal were accurate and succinct. However, the tribunal in *Occidental (II)* did not elaborate whether the obligation to re-negotiate the contract was mandatory or optional.⁶⁷² In the latter scenario, a unilateral modification of a sharing contract cannot always amount to breach of legitimate expectations of the investor.

While I do not disagree with the findings of the tribunals in *Sergei Paushok, Total*, and *Occidental (II)*, I've certain reservations about the reasoning adopted by the tribunals with respect to the FET standard, legitimate expectations and windfall profits tax. I doubt if the question of windfall profits and FET standard should be decided under the doctrine of legitimate expectations. The very nature of windfall profits is that they are unexpected and cannot be foreseen.⁶⁷³ Even if the contractual arrangement between an investor and host state stipulates that a state can impose windfall profits tax - the nature, duration and extent of windfall profits can never be contemplated or agreed beforehand. I submit that windfall profit taxes do not fall under any of the four approaches identified by Jonathan Bonnitcha. An

⁶⁷⁰ *Occidental (II)* award, *supra* note 452, at para 527.

⁶⁷¹ *Ibid*, at para 526.

⁶⁷² See *Burlington* award, *supra* note 551, at para 395 (for a discussion if re-negotiation mandatory or optional). ⁶⁷³ See *Perenco* award, *supra* note 587, at para 582 (where the tribunal observed that the substantial increase in the oil prices fell outside the expectations of the parties to the dispute).

unexpected change in market conditions and rise in prices creates a specific context of its own - a separate category.

The question of whether the windfall profits tax breaches the FET standard should in my view be decided in the backdrop of the market factors that cause such profits. For instance, a cyclical increase in the prices of the commodity may warrant a less harsh windfall profit tax while if the change in prices is unprecedented the windfall profit tax could have a higher threshold without breaching the FET standard. The tribunal's obligation should be to assess if the imposition of taxes by the state was proportional to the windfall profits. However, the reference in *Total* to the tax being 'common' while in *Sergei Paushok* the reference to the 'stage of development' of the state suggests that the parameters to assess the breach of the FET standard are not certain. In this context, it is important to refer to the observations of the tribunal in the *Murphy* award.⁶⁷⁴

The award also involved the Law 42 enacted by Ecuador under which a windfall profit tax was imposed. The tribunal addressed the question if the tax had breached the legitimate expectations on the investor. The tribunal observed that the initial tax rate of 50% did not disturb investor's legitimate expectations since it would be unreasonable to expect that the contracts terms would remain unchanged if the oil prices rise significantly.⁶⁷⁵ However, the tax rate of 99%, in tribunal's view violated the investor's legitimate expectations since - it fundamentally changed the nature of the contract, involved coercive conduct of respondent in re-negotiating and the respondent also created a hostile and coercive investment environment.⁶⁷⁶

In the *Murphy* award, the tribunal relied on the fact that the imposition of the windfall profit tax changed the very nature of the contract between the claimant and the respondent in the backdrop of a changing business environment in Ecuador. To conclude, I would like to say that unless in tribunal's opinion, the windfall profit tax fundamentally alters the relation between the investor and the host state, it should not ordinarily be addressed in reference to legitimate expectations.⁶⁷⁷

⁶⁷⁴ *Murphy* award, *supra* note 455.

⁶⁷⁵ *Ibid*, at para 276.

⁶⁷⁶ *Ibid*, at paras 281-292.

⁶⁷⁷ Also see *Perenco* award, *supra* note 587, at paras 562-563 (where the tribunal noted that the contracts between the claimant and the host state were anchored in a legislative policy which set the framework and rationale of contractual commitments. The contracting party, thus, had a reasonable expectation that the contract's structure would not be altered unilaterally by a state action).

2. Changes in Tax Law and Violation of the FET Standard

The tribunal in *Occidental* handled the claim of fair and equitable treatment unconvincingly. The claimant, Occidental, argued that the revocation by Ecuador of its previous decisions⁶⁷⁸ was a frustration of its legitimate expectations and thus a breach of the obligation of Ecuador to accord fair and equitable treatment. The tribunal did not address the concept of ‘legitimate expectations’ and its relation with fair and equitable treatment. The tribunal based its findings on the ‘stability’ of the legal and business framework which it considered to be an essential element of fair and equitable treatment.⁶⁷⁹ The tribunal observed that ‘the framework under which the investment was made and operates has been changed in an important manner.’⁶⁸⁰ It further observed that the ‘tax law was changed without providing any clarity about its meaning and extent and the practice and regulations were also inconsistent with such changes.’⁶⁸¹ However, in analysing the stability of the business framework the tribunal conflated the two concepts of transparency and stability. The tribunal failed to clearly enunciate the lack of stability combined with the absence of transparency establishes that the respondent failed to ensure treatment in accordance with the FET standard. Instead, in tribunal’s analysis non-transparency was subsumed within the concept of stability itself rather than constituting a separate parameter to determine the breach of the FET standard.⁶⁸² While the issues of non-transparency and stability may overlap, the tribunal failed to convincingly articulate these concepts.⁶⁸³

On the other hand, the tribunal in the *PSEG* award was more nuanced for it expressly mentioned the non-transparent negotiations conducted by the host state.⁶⁸⁴ The tribunal noted that the ‘fair and equitable treatment was seriously breached by what has been described above as “roller-coaster” effect of the continuing legislative changes. This is

⁶⁷⁸ Ecuador used to reimburse the VAT paid by Occidental on purchases necessary for its oil exploration activities. However, later Ecuador denied all further applications for VAT refunds and required the return of the amounts previously reimbursed.

⁶⁷⁹ *Occidental* award, *supra* note 211, at para 183.

⁶⁸⁰ *Ibid.*

⁶⁸¹ *Ibid.*, at para 184. The tribunal, to support its observations, relied on the *Metalclad* and *Tecnicas Medioambientales* awards - both awards emphasised on the need for stability, consistency, transparency and lack of ambiguity.

⁶⁸² See *Siemens A.G. v The Argentine Republic* ICSID Case No. ARB/02/8 (Award, 6 February 2007) paras 289-321 (failure to act transparently in administrative decision making was used as a separate element on which to ground the finding of a breach of the FET standard).

⁶⁸³ For a detailed critique of the *Occidental* award see Aloysius P. Llamzon, ‘The Final Award in *Occidental v Ecuador*’, in Guillermo Aguilar Alvarez, W. Michael Reisman (eds.), *The Reasons Requirement in International Investment Arbitration Critical Case Studies* (MartinusNijhoff 2008) 211.

⁶⁸⁴ *PSEG Global Inc. v Republic of Turkey* ICSID Case No. ARB/02/5 (Final Award, 19 January 2007).

particularly the case of the requirements relating, in law or practice, to the continuous change in the conditions governing the corporate status of the Project ... This was also the case, to a more limited extent, of the changes in tax legislation.’⁶⁸⁵ The tribunal commented on the inept handling of the negotiations by the administration and observed ‘that key points of disagreement went unanswered and were not disclosed in a timely manner, that silence was kept when there was evidence of such persisting and aggravating disagreement, that important communications were never looked at, and there was a systematic attitude not to address the need to put an end to negotiations that were leading nowhere...’.⁶⁸⁶ This separation of the reasons - lack of transparency in negotiations and the constant changes in the PSEG award was more convincing in comparison to the *Occidental* award.

However, the tribunal in the *PSEG* award was examining the negotiations between the foreign investor and the host state. The tribunal in the *PSEG* award commented on the frequent changes in the laws and attitudes of the host state during its negotiations with the investor. It affected the investors’ assessment of its future tax liabilities. The tribunal observed:

While in complex negotiations, such as those involved in this case, many changes will occur beyond the control of the government, as was particularly the case with the increased costs, the issue is that the longer term outlook must not be altered in such a way that will end up begin no outlook at all. In this case, it was not only the law that kept changing but notably the attitudes and policies of the administration.⁶⁸⁷

The state was held to be in violation of the FET standard. The tribunal held that even if the conduct of the state was in good faith, it was still an evident breach of the FET standard.⁶⁸⁸

Another example of a change in the attitude of the host state is the withdrawal of tax concessions or tax holidays - with retrospective effect. In the *Total* award, one of Total’s complaints was that in the year 2006, Argentina retroactively eliminated the exemption from customs duties that it was guaranteed with respect to investments made in Tierra del Fuego.

⁶⁸⁵ *Ibid*, at para 250.

⁶⁸⁶ *Ibid*, at para 246.

⁶⁸⁷ *PSEG* award, *supra* note 684, at para 254.

⁶⁸⁸ *PSEG* award, *supra* note 684, at para 256; *Tecnicas Medioambientales Tecmed S.A. v The United Mexican States* Case No. ARB (AF)/00/2 (Award, 29 May 2003) paras 153-154 (the tribunal observed that the fair and equitable treatment is part of the bona fide principle recognised in international law, although bad faith from the state is not required for the violation of the FET standard); Martins Paporinkis, ‘Good Faith and Fair and Equitable Treatment in International Investment Law’ in A Mitchell et al (eds.), *Good Faith and International Economic Law* (Oxford University Press 2015) 143.

In addressing the argument of the retroactive revocation the tribunal relied on statements made by Argentina's administrative authorities in 2002 and 2004. The tribunal said that in response to Total's specific requests, the competent authorities of Argentina had confirmed the non-applicability of the taxes for almost four years. This, the tribunal observed, 'makes the change of position of Argentina's authorities in 2006 a breach of a specific promise made to Total and, therefore, a breach of the fair and equitable treatment clause in BIT.'⁶⁸⁹ The tribunal did not specifically elaborate on the retrospective aspect of elimination of tax benefits but instead only focused on the fact that Argentina through its officials had made a specific commitment.⁶⁹⁰

Similarly, in the *Micula* award, the claimants challenged the withdrawal of tax incentives by the respondent.⁶⁹¹ Under an Ordinance in 1998, Romania had extended tax incentives for investments in its disadvantageous regions. The claimant argued that it made investments by relying on the promise of tax incentives and that Romania's premature withdrawal of the tax incentives violated the FET standard under the IIA.⁶⁹² The tribunal observed that in order to prove the breach of the FET standard it is not sufficient to prove that Romania made a promise and the claimant relied on it; the claimant also needs to prove that its reliance on the promise was reasonable.

The tribunal observed that even though the Competition Council in 2000 had declared that the tax incentives as were incompatible with the European Agreement, Romania failed to enforce the Council's decision.⁶⁹³ Romania did not remove the tax incentives. In view of the continuation of the tax incentives despite the Council's decision, the investor's were reasonable in expecting that the tax incentives were legal and would continue for ten years.

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Retrospective denial of benefits can occur by enacting a new law or by a change in the interpretation of the existing law. However, retrospective denial needs to be distinguished

⁶⁸⁹ *Total* award, *supra* note 18, at para 441.

⁶⁹⁰ *Ibid*; Also see *Charanne B.V. and Construction Investments S.a.r.l v The Kingdom of Spain* (SCC Arbitration No. 062/2012) (Final Award, 21 January 2016) paras 368-372 (where the claimant argued that the respondent state adapted its regulatory system retroactively).

⁶⁹¹ *Ioan Micula, Viorel Micula v Romania (I)* ICSID Case No.05/20 (Final Award, 11 December 2013).

⁶⁹² The claim was filed under the BIT between Sweden and Romania.

⁶⁹³ *Micula* award, *supra* note 691, at para 717.

⁶⁹⁴ *Ibid*; Also see *AMTO* award, *supra* note 492, at 84 (where the tribunal dismissed the claimant's argument that it was subject to 'aggressive tax inspection' and that its experience during the bankruptcy proceedings amounted to denial of justice. The tribunal observed that the expectations of the claimant from the bankruptcy proceedings were unrealistic and the host state complied with its obligation to conduct proceedings in good faith).

from grant of rights that are subject to further review. This can be illustrated in reference to the dispute between Eli Lilly and Canada. For instance, Eli Lilly has challenged the invalidation of its two patents - for the drugs Straterra and Zyprexa - that were held to be invalid in separate judgments of Federal Courts of Canada.⁶⁹⁵ Eli Lilly's core grievance is against the application of the 'promise' doctrine by which the Canadian judiciary invalidated previously granted patents.⁶⁹⁶ Here, it needs to be emphasised that the situation involves a challenge to the validity of patent laws as interpreted in the domestic courts of Canada. The courts invalidated patents that were previously granted by the Patent Office and it resulted in denial of rights but the court decisions were part of an established legal process. The patentee could also foresee the possibility of invalidation of patent, if, for example, there was no invention. Thus, the court's decision was not a retrospective decision to deny the patents.

3. Abusive Administration of Tax Laws

Administrative failures can also amount to breach of the FET standard.⁶⁹⁷ A dishonest application of law may involve a hostile attitude of the authorities towards investor(s), questionable interpretations of the laws and all this may occur without any change in the letter of the law.⁶⁹⁸ Applying existing laws in a hostile manner may in fact leave the investor in a worse off position compared to amendment(s) in laws that impose onerous conditions on the investor.⁶⁹⁹ The *Yukos* awards are perfect examples where the host state did not bring any change in the letter of the law but the implementation and interpretation of the law was changed to the detriment of the economic activities of the investor organised through various corporate entities.⁷⁰⁰ The tax authorities (re) assessed the earnings of the investor and claimed additional taxes by relying on questionable interpretation of tax laws and

⁶⁹⁵ *Eli Lilly and Company v Government of Canada*, Notice of Arbitration (12 September 2013), available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/eli-03.pdf>

⁶⁹⁶ *Ibid.*

⁶⁹⁷ See, for instance, *Middle East Cement v Egypt* ICSID Case No. ARB/99/6 (Award, 12 April 2002) para 143 (where the seizure and auctioning of the ship of the claimant was not notified in the manner prescribed and the tribunal held it to be a breach of the FET standard.).

⁶⁹⁸ See Paul B. Stephan, 'Comparative Taxation Procedure and Tax Enforcement', in Stephan W. Schill (ed.), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 599; Also see Katia Yannaca-Small, 'FET Standard: Recent Developments', in August Reinisch (ed.), *Standards of Investment Protection* (Oxford University Press 2008) 111, at 124 (The investor's perceptions and their expectations towards the government activity becomes an essential element of their perception of the host country's ordering function of law.).

⁶⁹⁹ Also see *Oostergetel* award discussed in Chapter 6 below.

⁷⁰⁰ *Yukos Universal* award, *supra* note 160.

retrospectively imposed additional tax burdens worth billions of dollars. These actions completely nullified the benefits that the tax law conferred on the investors and violated general legal principles of stability, consistency and prospective application.⁷⁰¹ It ultimately led to complete deprivation of the property of the investors.

In the *RosInvest Co* award, one of the arguments made by the investor related to discriminatory treatment by the Russian tax authorities. The tribunal held that there was no discrimination between the nationals and foreigners and the focus of the Russia's measures was on Yukos irrespective of its domestic and foreign shareholders. However, with regard to the discrimination against Yukos as compared to other companies, the tribunal noted:

In this respect, the Tribunal can refer to its above considerations which concluded that, indeed, in the application of the tax law, in the tax assessments and in the conduct of the YNG auction, Yukos was treated by Respondent quite different to the treatment accorded to its competitors and other comparable tax payers and no convincing reasons have been shown by Respondent for this differentiation.⁷⁰²

The tribunal, though, did not conclude that this constituted a violation of the FET standard but said that that 'there remain doubts whether they can be seen as a fair and equitable treatment.'⁷⁰³ It needs to be pointed out that the tribunal's hesitation to find a violation of the FET standard was not because of doctrinal reasons but because the approach the tribunal adopted in adjudicating the dispute.⁷⁰⁴ The tribunal listed various arguments topically and made its observations to conclude each section. The tribunal divided and sub-divided the various arguments of the parties and examined the facts of the case chronologically with a focus on answering only question - whether the cumulative effect of the totality of the Russia's conduct was a breach of the BIT? Thus, the tribunal thought it unnecessary to make a separate determination on the FET standard. In my opinion, if the tribunal had adopted a different approach or if it was a non-tax related investment dispute, the tribunal would have

⁷⁰¹ See Paul B. Stephan, 'Taxation and Expropriation - The Destruction of the Yukos Oil Empire' (2013) 35 *Houston J Int'l L* 1.

⁷⁰² *RosInvest Co* award, *supra* note 299, at para 556.

⁷⁰³ *Ibid*, at para 557.

⁷⁰⁴ See Chapter 4 above; Also see *Occidental (II)* award, *supra* note 452, at paras 442-452 (where the tribunal examined the proportionality of the host state's response to conclude that it had violated its obligation to provide a fair and equitable treatment. The tribunal noted that 'the overriding principle of proportionality requires that any such administrative goal must be balanced against the Claimants' own interest and against the true nature and effect of the conduct being censured.').

arrived at an unambiguous conclusion that the conduct of the Russian authorities was a violation of the FET standard.⁷⁰⁵

B. Inconsistency between State Organs

The issue of inconsistency addresses the contradictory approaches that the different organs of the state may adopt towards the same investor on the same issue.⁷⁰⁶ The inconsistency may result from a lack of co-ordination, miscommunication or even a tussle between the different branches of the government such as the executive and the judiciary. The courts may, in a certain dispute, interpret the tax laws in a manner that may be considered as departure from the earlier settled position of law. In such a situation, the investor may seek to renegotiate its contract with the host state or in its absence claim a violation of the FET standard. The *EnCana* dispute was a result of Ecuador's change in its tax policy. The claim was brought under the Canada-Ecuador BIT. The tribunal observed that 'it could well be' a breach of fair and equitable treatment if a state entity enters into an investment agreement on a certain basis and then denies the other party the right to renegotiate the agreement in the event that the basis for it has been changed as a result of decisions of other state organs.⁷⁰⁷ The tribunal noted that under the FET standard, 'the State must act with reasonable consistency and without arbitrariness in its treatment of investments. One arm of the state cannot finally affirm what another arm denies to the detriment of the investor.'⁷⁰⁸ In other words, the different branches of the government - legislature, executive and judiciary cannot adopt conflicting views about the same issue. For instance, if a foreign investor incorporates its parent company in a tax haven and its subsidiary in the host state; in such a case, the inconsistency will arise if the executive (tax administration) claims it is an illegal practice while the judiciary interprets it to be a perfectly legal tax avoidance strategy. However, this

⁷⁰⁵ See *International Thunderbird Gaming Corporation v The United Mexican States* (UNCITRAL Award, Separate Opinion, Thomas Wälde, December 2005), at para 109 (stating that a breach of investment backed legitimate expectation took place the moment enforcement was initiated against the claimant - Thunderbird without a similar enforcement effort being visible against any other entity).

⁷⁰⁶ See *MTD Equity Sdn. Bhd. And MTD Chile S.A. v Republic of Chile* ICSID Case No. ARB/01/7 (Award, 25 May 2004) paras 162-189 (where the national agency of Chile approved investor's application for transfer of funds into Chile but the local authority refused to approve the request for rezoning the land for redevelopment. The inconsistency of action by two arms of the same government towards the same investor was held to be breach of investor's expectation.).

⁷⁰⁷ *EnCana* award, *supra* note 211, at para 158.

⁷⁰⁸ *Ibid.*

is different from an investor's obligation to comply with different laws and regulations of the host state simultaneously.⁷⁰⁹

The question of inconsistent views among the different branches of the government was addressed by the tribunal in the *PSEG* award.⁷¹⁰ At a certain stage in the negotiations with Turkey, PSEG proposed that the corporate structure should be a Turkish Branch Office of a Dutch company that would be specifically incorporated in order to channel the investment. However, the Turkish government required that the project company be a limited liability company incorporated in Turkey. The tribunal observed that foreign branch corporate structure and the implementation contract was recognised under the law and by Danıştay (administrative court of Turkey) but was ignored by the Ministry of Energy and Natural Resources. The court observed that such inconsistent administrative acts 'might be unlawful under Turkish law, but in light of the provisions of the Treaty they are also in breach of the standard of fair and equitable treatment.'⁷¹¹

C. Concluding Remarks

Tax laws are one of the most important instruments used by a state to attract foreign investment and investors. States may suspend the application of tax laws in certain sectors to encourage foreign investment; they may reduce tax rates for a certain category of economic activities or offer subsidies.⁷¹² However, once an investor commits to a long term investment, a state may rescind its tax incentives or subsidies - and it is ordinarily well within the regulatory power of a state to do so.⁷¹³ In such instances, the actions of the state will need to meet the standards of treatment prescribed in the IIAs, such as the FET standard.⁷¹⁴

⁷⁰⁹ For instance, an investor has to comply with the anti-corruption laws, the tax laws and various other related laws of the host state simultaneously. This obligation is distinct from the different branches of the state interpreting and applying the laws in contradiction with each other.

⁷¹⁰ *PSEG* award, *supra* note 684, at para 248.

⁷¹¹ *Ibid*, at para 249.

⁷¹² See Wanda Tseng, Harm Zebregs, 'Foreign Direct Investment in China: Some Lessons for Other Countries', in Wanda Tseng, Markus Rodlauer (eds.), *China Competing in the Global Economy* (International Monetary Fund 2002) 68-71 (warning that, at times, the foreign direct investment in export processing zones may be due to round tripping by domestic capital).

⁷¹³ *Charanne B.V.* award, *supra* note 690 (it is the first award among a series of claims filed against Spain for retroactively revoking its subsidies in the energy sector); Also see Georg Kofler, Miguel Poiates Madruo et al. (eds.), *Human Rights and Taxation in Europe and the World* (IBFD 2011) 156-157.

⁷¹⁴ See Turki Althunayan, *Dealing with the Fragmented International Legal Environment* (Springer 2010) 102 (the author, in the context of international tax treaties, argues that states do not have absolute and unfettered rights of state sovereignty and rights of states are determined by interaction of international law and national law).

The above discussion reveals that there is no precise manner to identify when the tax measures of a state violate the state's obligation to provide fair and equitable treatment. The approaches of the tribunals differ and the facts of the case are usually determinative in identifying if a particular tax measure is in violation of the FET standard. There is no uniform and consistent approach. The tax measures are also of varied kinds - windfall profit tax, abuse of tax administration among others. Tribunals tend to rely on the nature of the state action to determine violation of the FET standard. Also, unlike arguments relating to expropriation by taxation, there is ambiguity if taxation constitutes a unique and separate category is so far as the fair and equitable treatment standard is concerned.⁷¹⁵

III. THE FET STANDARD AND INTERNATIONAL TAX LAW

The interaction of FET with international law and specifically CIL has been the subject of various investor-state tribunal awards.⁷¹⁶ However, the awards where the issues of FET standard and ITL intersect simultaneously are only a handful. Nonetheless, it is important to make a few observations in order to gain a glimpse of the evolving relationship and throw a light on the approach of the tribunals on this aspect. This Section highlights the approach of the tribunals towards ITL when addressing arguments on the FET standard. I emphasise on two aspects: the lack of any reference to general principles of law in ITL; and, examine the relevance of tax practices of an investor such as the allegations of tax evasion. States have either claimed that their tax measures seek to prevent tax evasion in order to escape liability or states argue that due to the investor's illegal conduct such as tax evasion, the tribunal lacks jurisdiction. I examine the observations of the tribunals, identify a few shortcomings and suggest recognising tax evasion as a legitimate public purpose for tax measures.

A. No Reference to General Principles of International Tax Law

The tribunal, in *Occidental* had the opportunity to address the applicability of fair and equitable treatment to taxation measures.⁷¹⁷ The tribunal commented on the vagueness and lack of clarity in the tax laws of the respondent and concluded that by failing to maintain a stable framework for investment and maximum effective utilization of economic resources (an essential element of fair and equitable treatment), the respondent breached its

⁷¹⁵ For details on this aspect see Chapter 4 above. Also see Section III below.

⁷¹⁶ The most prominent award where the relation of FET standard and CIL became a focal point is *Pope & Talbot Inc. v The Government of Canada* (UNCITRAL, Award on the Merits of Phase 2, 10 April 2001).

⁷¹⁷ *Occidental* award, *supra* note 211, at paras 180-192.

obligation to provide a fair and equitable treatment under Article II (3)(a) of the BIT. The tribunal also addressed the issue of whether the fair and equitable treatment mandated by the IIA was a more demanding standard than that prescribed by CIL. The tribunal noted that the BIT in question did not provide a standard that was different from that required under international law and clarified that the case only involved the question whether the legal framework met the requirements of stability and predictability under international law.⁷¹⁸ In this case, it held, the respondent's treatment of investment fell below those standards. The tribunal, though had an opportunity, did not elaborate on the nature of the FET standard and its relevance to tax-related investment disputes. There was no mention of the nature of tax laws and whether the FET standard should meet a higher threshold because of the nature of taxation. Also, any mention of ITL and its relevance was completely absent.

The tribunal in the *Cargill* award made a similar error. The tribunal examined, at length, the differing opinions of the claimant and the respondent about the content of the FET standard. The awards of various tribunals were cited and discussed at length in order to explain the debate on the content of the FET standard.⁷¹⁹ However, even though one of the claimant's challenges essentially centred on an allegedly discriminatory tax, there was a surprising lack of any discussion about ITL or customary norms. Neither was there any reference to the general principles of law in ITL and their importance or relevance in a tax-related investment dispute.⁷²⁰ The tribunal gave the impression that it considered IIL as self-sufficient and adequate to adjudicate taxation matters.⁷²¹

Another missed opportunity to delve into the relation of taxation, FET and international minimum standard was the *Sergei Paushok* award. In this case, the claimant argued that the windfall profit tax was contrary to CIL and in particular inconsistent with the international minimum standard.⁷²² The tribunal observed that the claimant has not argued that the standard would be broader than contained in the BIT; and since the tribunal has already

⁷¹⁸ *Ibid*, at para 191.

⁷¹⁹ *Cargill, Inc* award, *supra* note 566, at paras 266-305.

⁷²⁰ This omission is also more prominent because the tribunal acknowledged that the CIL minimum standard of treatment is dynamic and is constantly evolving. In my opinion, the facts of the case and the arguments of the parties presented an appropriate context to explore if customary norms are evolving in ITL as well.

⁷²¹ See generally R. Hofmann, C.J. Tams (eds.), *International Investment Law and General International Law: From Clinical Isolation to Systemic Integration?* (Nomos 2011).

⁷²² *Sergei Paushok* award, *supra* note 469, at para 328.

concluded that the tax does not breach the BIT, it goes by itself that the tax is not contrary to the international minimum standard.⁷²³

The reason this award is a missed opportunity to explore the relation of taxes and general international law is the narrow interpretation of the term CIL. The claimant argued that the windfall profit was not in accordance with CIL and the tribunal equated it to international minimum standard. The international minimum standard though constitutes part of CIL certainly does not comprise the entire universe of customary norms.⁷²⁴ Some commentators have used CIL and international minimum standards interchangeably in the context of FET standard.⁷²⁵ It was an error on the part of the tribunal to presume that in a tax-related investment dispute the reference to CIL was only restricted to IIL (and in turn only to the international minimum standard) and did not extend to ITL.

The tribunal in *Sergei Paushok* award also referred to ‘international standards’. However, the tribunal failed to define the term international standards and neither could it convincingly explain the term, its relevance and significance in tax-related investment disputes. In this dispute, one of the arguments of the investor was that the windfall profit tax imposed by Mongolia was contrary to international standards. In rejecting the argument, the tribunal observed that the claimant had failed to establish the existence of such standards. The tribunal observed that the fact that a particular country at a particular time has the highest taxation level affecting a certain industry does not automatically mean that there has been a breach of the BIT. The international standards referred to in the award were not dwelled upon in any length. The term ‘international standards’ is clearly an indeterminate term and can possibly include international practices or customary norms or both. The tribunal did not mention it specifically, but its reference to the taxation levels in other states suggested that tax rates in other states are part of ‘international standards’. It is uncertain if it is an inclusive or exhaustive interpretation of the term international standards.

⁷²³ *Ibid*, at para 329.

⁷²⁴ See generally Dolzer, Von Walter, ‘Fair and Equitable Treatment - Lines of Jurisprudence on Customary Law’ in Ortino, Sheppard, et al (eds.), *Investment Treaty Law: Current Issues Volume 1* (British Institute of International and Comparative Law 2006) 103.

⁷²⁵ Kenneth Vandeveld, *Bilateral Investment Treaties History, Policy and Interpretation* (Oxford University Press 2010) 194 (arguing that the interpretation of FET standard has been uniform ‘whether alone, combined with other general absolute standards of treatment, linked with non-discrimination standards, or linked with customary international law.’); Also see Kenneth J Vandeveld, ‘A Unified Theory of Fair and Equitable Treatment’ (2010) 43 *New York J Int’l L & Pol* (2010) 43.

The tax rates of other states were also referred to in the *Total* award. One of the reasons for tribunal's conclusion that Argentina's imposition of taxes did not violate the legitimate expectations of the investor was that the windfall profit taxes were common and had been introduced in many oil producing states. The references in the *Sergei Paushok* award and in the *Total* awards though are short of any reference to ITL or general principles of law in ITL; they can at best be described as an unconvincing acknowledgement of an undefined concept - international tax practices.

In sum, we see that in relation to the FET standard, tribunals have not relied on or referred to the general principles of law in ITL. Instead, the tribunals have referred to: (i) international standards or tax rates of other states; (ii) reference to CIL is essentially reference to international minimum standard and tribunals have not examined the relevance of general principles of law in ITL or even the possibility of evolution of customary norms in ITL.

B. The Relevance of Tax Practices of an Investor

It has been observed that the conduct of the investor in relation to any undertaking of stability is also 'subjectively' relevant.⁷²⁶ Tribunals have highlighted that BITs 'are not insurance policies against bad business judgments' and that the investor has its own duty to investigate the host State's applicable law.⁷²⁷ The issue of the conduct of the investor assumes an added importance in tax-related investment disputes. The domestic tax laws of the host state and the international tax treaty network together determine the appropriate and legally permissible corporate structure that can be used to channelize investment in the host state.⁷²⁸ The tax liability of the investment activity can be significantly reduced by the choice of the right combination of the corporate structure and the tax treaty network.⁷²⁹ For instance, if a tax treaty exists between the host state and a low tax jurisdiction, then incorporating a parent company in a low tax jurisdiction and its subsidiary in the host state allows minimising tax liability in the host state (which usually has higher statutory tax

⁷²⁶ *Total* award, *supra* note 18, at para 124; Also see Peter Muchlinski, 'Caveat Investor? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard (2006) 55 ICLQ 527.

⁷²⁷ See *Maffezini v Spain* ICSID Case No. ARB/97/17 (Award on Merits, 13 November 2000) para 64; *MTD Equity Sdn.* award, *supra* note 706, at para 178; *Glamis Gold* award, *supra* note 662, at para 621 (state may be tied to the objective expectations that it creates in order to induce investment).

⁷²⁸ See *Vodafone International Holdings B.V. v Union of India* (2012) 12 SCC 613.

⁷²⁹ *Ibid*, at paras 20-30.

rates).⁷³⁰ The question of the corporate structure became an important issue in the negotiations between the claimant and the respondent state in the *PSEG* award.

PSEG was interested in building a thermal power plant in Turkey. Amongst other issues that were discussed between PSEG and Turkey, there were legal difficulties relating to the corporate structure of the investment. The choice of a corporate structure was important as it would have affected the tax liability of the investor which in turn would have significantly influenced the tariff for the sale of electricity - the purpose for which the plant was proposed. The discussion about the corporate structure and the tax burden on the project took place during three time periods: negotiations concerning the implementation contract in 1996, the consideration of a change of structure in 1998 and the disclosure about the effects of tax changes in 1999.⁷³¹ The parties, according to the tribunal, had ‘very different recollections about what was or was not agreed during these meetings.’⁷³² Nonetheless, the tribunal acknowledged that by 1999 the ‘tax issue had become relevant in the context of the dispute.’⁷³³

At the early stage of negotiations, Turkey argued, a Turkish capital company was considered as the appropriate capital structure for the project but this was later changed to a branch office of a Dutch incorporated company at the insistence of PSEG. Turkey argued that PSEG wanted to obtain a tax windfall as a result of the lower tax burden that would accompany the latter corporate structure. However, the claimants, PSEG, argued that when the first feasibility study was submitted in 1995 the law of Turkey required that the project companies be formed as joint stock companies. This law was amended in 1996 and companies were allowed to be structured as branch offices. This change in law, the claimants argued, were to promote foreign investments in Turkey and the amendment in the law was the only reason for change of corporate structure and not to obtain any undisclosed windfall gains. The tribunal found merit in the arguments of the claimant and noted that - ‘Tribunal has no difficulty in concluding that the change from a Turkish joint-stock company to a branch office of a foreign company was both authorized by the law as amended and duly agreed to and approved by the Respondent. Indeed, there were tax advantages and such was the intent of the law, which

⁷³⁰ *Ibid*; The profits that are generally earned in the high-tax jurisdiction with a bigger economy and market are reported in the low-tax jurisdiction thereby reducing the tax liability.

⁷³¹ *PSEG* award, *supra* note 684, at para 114.

⁷³² *Ibid*, at para 35.

⁷³³ *Ibid*, at para 43.

was conceived as an incentive to attract foreign investment capital.⁷³⁴ The tribunal concluded that the respondent cannot argue that such advantages were unknown to its own ministries or to the Turkish government in general.

The second time when corporate structure became relevant was in 1998. The respondent argued that since the claimant submitted a revised plan which increased the size of the project, the claimant was requested to structure the project company as a Turkish capital company - the corporate structure that was in use for other projects in Turkey. The claimants did not object to the change as long as they were compensated for the additional 'costs' by an adjustment in the tariff. The issue that the tribunal was required to address was of compensation and whether the parties agreed to it. The tribunal observed that as 'it has not been established that the change was required by law, it is also possible to conclude that the requirement for such change was more a matter for preference for MENR [Ministry of Energy and Natural Resources] than a legal obligation.'⁷³⁵ The tribunal concluded that 'it was reasonable for the Claimants to proceed to further stages of negotiations on the assumption that in accepting the corporate form of a limited liability company, the revised tariff would reflect this particular choice of form and its associated costs.'⁷³⁶

The third time the issue of corporate structure became relevant was in late 1999. In early 1999, additional tax changes were made which had the effect of offsetting the tax consequences that a limited liability company structure would have incurred as a result of the project. The claimants asserted that they became aware of the change only in October 1999 and they were prepared to accept Turkey's position i.e. the commercial terms approved in 1998. The argument of the claimant was that the respondent state once again changed its position and demanded a new study. Turkey, on the other hand, claimed that the changes in the law were introduced in January 1999 and yet in October 1999 the claimant proposed a tariff that included compensation for the effects of the limited liability corporate structure. The tribunal said that 'it can now positively conclude' that the many successive changes in the law relating to corporate structure led to many disagreements and eventual collapse of negotiations.⁷³⁷

⁷³⁴ *Ibid*, at para 118.

⁷³⁵ *Ibid*, at para 127.

⁷³⁶ *Ibid*.

⁷³⁷ *Ibid*, at para 132.

The tribunal stated that there was no evidence of bad faith or a conspiracy to take away legitimately acquired rights.⁷³⁸ Nonetheless, the tribunal said:

the fair and equitable treatment standard has been breached, and that this breach is serious enough as to attract liability. Short of bad faith, there is in the present case first an evident negligence on the part of the administration in the handling of the negotiations with the Claimants. The fact that key points of disagreement went unanswered and were not disclosed in a timely manner, that silence was kept when there was evidence of such persisting and aggravating disagreement, that important communications were never looked at, and there was a systematic attitude not to address the need to put an end to negotiations that were leading nowhere, are all manifestations of serious administrative negligence and inconsistency.⁷³⁹

After taking into account all the facts of the case, the tribunal concluded that Turkey had violated the FET standard and in its findings relied on three important factors: negligence in handling of negotiations, abuse of authority (particularly in the case of foreign branch corporate structure) and the continuing legislative changes.⁷⁴⁰

The tribunal's finding of breach of the FET standard in the absence of bad faith on the host state's part is unusual, especially if compared to the deference shown by other tribunals towards state actions in tax-related investment disputes. But, the *PSEG* award can be distinguished from other disputes. The findings of the tribunal were related to the host state constantly changing its position on the legal requirements of the appropriate corporate structure and not with the actual application or administration of the tax law itself.

The *Yukos* awards were another instance when the tax practices of the investor were contested by the respondent state while the claimant defended them as perfectly legal. Several arguments were made by the respondent state, Russia, in the *Hulley Enterprises* award to discredit the investor. Russia relied on the concept of 'unclean hands', 'illegal and bad faith conduct' by the claimants and also alleged that the investors ran a 'criminal

⁷³⁸ See *Sempra Energy Intl v Argentine Republic* ICSID Case No. ARB/02/16 (Award, 28 September 2007) paras 298- 299 (The concept of good faith 'permeates the whole approach' to investor protection and is 'at the heart of the concept of fair and equitable treatment.');

Also see *Waste Management, Inc* award, *supra* note 165, at para 138 (good faith is a 'basic obligation' under the FET standard); Martins Paporinkis, *supra* note 647.

⁷³⁹ *PSEG* award, *supra* note 684, at para 246.

⁷⁴⁰ *Ibid*, at paras 246-250.

enterprise.’⁷⁴¹ These factors, it argued, pointed to the tribunal’s lack of jurisdiction and the inadmissibility of the claims by the investor and also justified denying the investor the protection of substantive protections under the ECT (under which the claim was filed). The tribunal rejected all the arguments made by Russia. The tribunal observed that it is not persuaded by Russia’s claim that the claimant must approach the tribunal with ‘clean hands’. Russia, it observed, had neither been able to prove that the doctrine of clean hands was a ‘general principle of law recognised by civilized nations’ nor had Russia cited any majority decision in which the principle was applied and operated to bar a claim.⁷⁴²

In the *RosInvest Co* award, Russia, inter alia, relied on two concepts - bad faith doctrine and the proportionality principle.⁷⁴³ In arguing the former, Russia claimed that by incorporating corporations in the low tax regions of Mordovia, Yukos claimed tax benefits in bad faith; and under Russian tax jurisprudence, taxpayers who acted in bad faith were not entitled to the same protection as those who acted in good faith. The proportionality principle, it was argued, was closely related as to the bad faith doctrine and required that in order for a taxpayer to claim the benefit of the relevant low tax legislation, investments should be made in the territory in proportion to the amount of tax savings claimed by the taxpayer. In addition to this, Russia also claimed that Yukos had tried to conceal its tax practices in the low tax regions. The tribunal rejected all three arguments of Russia.

With regard to the issue of transparency, the tribunal observed that it is undisputed that Yukos disclosed all its billions of tax savings in its financial statements in its annual reports.⁷⁴⁴ The argument of Yukos concealing its tax practices was declared as unpersuasive given the fact that Yukos was one of the largest and most important companies in Russia and frequently discussed in the media. The proportionality principle, the tribunal held was not included in any provision of the law of the low tax region of Mordovia or in any investment agreement concluded by Yukos.⁷⁴⁵ The tribunal termed it as vague and remarked that the principle was never applied before to any competitor of Yukos in a comparable situation. On the bad faith doctrine, the tribunal made similar observations and concluded that its application to ‘Yukos in comparison to other competitors, was to a great extent a novel application of the law, rather vague in content and limits, and expansively used against Yukos in a way not shown to

⁷⁴¹ *Hulley award*, *supra* note 299, at paras 19-20 and para 52.

⁷⁴² *Hulley award*, *supra* note 299, at paras 1349-1363.

⁷⁴³ *RosInvest Co award*, *supra* note 374, at paras 412-455.

⁷⁴⁴ *Ibid*, at para 451.

⁷⁴⁵ *Ibid*, at para 450.

have been used before or against other comparable tax payers.’⁷⁴⁶ The tribunal did not term the action of Russian authorities in violation of the FET standard but termed the application of the Russian tax law as discriminatory and not a bona fide treatment.

The distinctive nature of the above mentioned arguments was the detailed discussion of the international tax practices of corporations - perhaps for the first time by an investor-state tribunal.⁷⁴⁷ The discussion about corporate nationality, at least in IIL literature, rarely discusses the tax aspect.⁷⁴⁸ The investor never seriously contended that the trading shell companies in the low tax regions had a genuine economic substance or that its investment in the economies of low tax regions had been significant in comparison to the tax benefits. It merely contended that the companies were not required to have substance under the relevant domestic laws. This is an extremely contentious territory in international tax literature.⁷⁴⁹ While some commentators would argue that an economic substance is necessary and the adjudicators should lift the corporate veil in such cases, others are of the opinion that a strict interpretation of the laws is more advisable.⁷⁵⁰ It is submitted that the latter opinion, while less popular, is the better approach. As long as the laws of incorporation are adhered to, the investor is well within its rights to channelize its investment in a manner that lowers its tax liability.⁷⁵¹ If the host state requires that the holding company of the foreign investor should be incorporated in its territory, it should be specifically mentioned in its domestic tax laws, investment contracts or IIAs.⁷⁵² In the *Yukos* awards, the job of the tribunals was made easy by the evident high-handedness of the Russian tax authorities. Various legal doctrines were conjured out of thin air and were applied to *Yukos* exclusively and retrospectively. The tribunal was, thus, able to navigate this territory relatively easily. However, if in a tax-related investment dispute the use of shell companies and channelizing

⁷⁴⁶ *Ibid*, at para 449.

⁷⁴⁷ Also see *Amco* award, *supra* note 497.

⁷⁴⁸ See, for instance, Stephan W. Schill, *The Multilateralization of International Investment Law*, *supra* note 196, at 197; Also see Chapter 1, Section V; Chapter 4, Section VI.

⁷⁴⁹ See, for instance, JC Sharman, *Havens in a Storm*, *supra* note 105; Nicholas Shaxson, *Treasure Islands: Uncovering the Damage of Offshore Bankers and Tax Havens* (Bodley Head 2011); Ronen Palan, *supra* note 125.

⁷⁵⁰ See generally, Allison Christians, ‘Avoidance, Evasion, and Taxpayer Morality’ (2014) 44 *Washington Univ J L & Pol’y* 39.

⁷⁵¹ Craig M. Boise, Andrew P. Morriss, ‘Change, Dependency, and Regime Plasticity in Offshore Financial Intermediation: The Saga of the Netherlands Antilles’ (2009) 35 *Texas Int’l L J* 377, at 429; Also see Leandra Lederman, ‘W(h)ither Economic Substance?’ (2010) 95 *Iowa L Rev* 389.

⁷⁵² See *IRC v His Grace the Duke of Westminster* (1936) AC 1; *IRC v W.T. Ramsay Ltd v IRC* [1982] A.C. 300; *CTO v McDowell and Co Ltd* (1985) 154 *ITR* 148.

foreign investment through low tax regions occupies centre stage, the tribunal will have to engage with ITL more comprehensively.

The issue of tax evasion was also briefly discussed in the *Sergei Paushok* award. The tribunal, in this case, effectively endorsed the argument of the respondent state that discriminatory taxation is permissible if it targets the comparatively greater tax evasion opportunities available in a particular industry. The issue related to Mongolia's imposition of the windfall profits tax on the gold mining industry but not imposing the same on the copper industry. In its observations on the issue, the tribunal quoted with approval the argument of the respondent that the distinction between the two industries, in one part, related 'to greater opportunities for tax evasion existing in the gold mining industry.'⁷⁵³ The difficulty with this argument is the often indistinguishable difference between tax avoidance and tax evasion.⁷⁵⁴ While the latter is considered to be unlawful, the former is generally considered to be lawful - though it may, at times, be considered to be in violation of the spirit of the law. If one accepts this distinction, then a few obvious questions follow. If an investor is accused of tax evasion, should the host state initiate legal proceedings under its domestic tax laws or subject the foreign investor to additional tax liability, even though it may be discriminatory? Or should the state pursue both the alternatives simultaneously? Or, in a different situation - if a host state discovers that a foreign investor has been evading taxes over the past one decade, would it be possible to impose retrospective tax liability on the investor? The permissibility of the above mentioned alternatives for states is unclear and there are no certain answers whether they would constitute a violation of the FET standard.

I would suggest that the issue of tax evasion by an investor can be addressed through various means. First, if an investor is accused of tax evasion during the course of investment, the tribunals should further develop the scope of the unclean hands doctrine. Second, curbing tax evasion should be understood as part of transnational public policy and investor's obligation to pay tax in host state as part of general principles of law in ITL. It is not an issue that affects only a single state and hence it is possible to view as part of shared responsibility of the states. Third, preventing tax evasion should be understood as a legitimate public purpose.⁷⁵⁵ In fact, tribunals have shown an inclination to test public purpose in tax-related

⁷⁵³ *Sergei Paushok* award, *supra* note 469, at para 316.

⁷⁵⁴ See *Union of India v Azadi Bachao Andolan*, *supra* note 333.

⁷⁵⁵ Tribunals have certainly endorsed excess profits earned by an investor as a legitimate purpose for tax measures. See Chapter 4 above.

investment disputes.⁷⁵⁶ Thus, states can justify imposing additional taxes, subjecting foreign investors to additional tax assessments as means to serve the public purpose of tax compliance. The tribunals can of course evaluate the proportionality of the tax obligations imposed on the investor with the avowed public purpose of curbing tax evasion.

IV. TAXATION AS A UNIQUE CATEGORY

Tribunals in interpreting and applying the concept of fair and equitable treatment in tax-related investment disputes have not expressly endorsed taxation as a separate category. In addressing the arguments on fair and equitable treatment, tribunals have never expressly articulated that taxation is different from other measures used by the state to regulate investment. This is a contrast to the approach of the same tribunals when they address arguments related to expropriation where tribunals have repeatedly shown an inclination to consider it as a separate category and have endorsed a higher threshold for expropriation by taxation.

There are only a few hints that in comparison to a state's non-tax measures, tribunals are marginally more vary of intruding in the taxation powers of a state. For instance, in the *Total* award, the tribunal interpreted the phrase 'investor shall be compensated for any restriction or duty' as to not include the import taxes imposed by the host state. The hesitancy of the tribunal to interpret the term restriction or even duty to include a tax that affected the export capacity of the investor can be attributed to the deference accorded to the taxation powers of a state.⁷⁵⁷ In the *Sergei Paushok* award, the tribunal observed that in the absence of a tax stabilisation agreement between the host state and an investor, a 'clear demonstration' of breach of an international obligation is required.⁷⁵⁸ This statement was made in the context of a radical change in the taxation of the gold mining industry. Here again, the 'clear demonstration' demanded by the tribunal was indicative of a more strenuous FET standard. These examples are however not determinative and the arguments are weak and insufficient to show any tendency on the part of the tribunals to interpret fair and

⁷⁵⁶ See Section IV below; Also see Chapter 6 below.

⁷⁵⁷ *Total* award, *supra* note 18, at para 434; *Link Trading* award, *supra* note 422 (where a tribunal interpreted a custom duty as a tax).

⁷⁵⁸ *Sergei Paushok*, *supra* note 469, at para 305.

equitable treatment restrictively in tax-related investment disputes. At the same time, in some awards, the tribunals have provided a wide leeway to the states.⁷⁵⁹

While addressing arguments on the FET standard, the tribunals in tax-related investment disputes have also referred to the rationale or purpose of the state's measure. In the *Mamidoil* award, it was observed 'the Tribunal has no authority to replace the State's policy rationale by its own.'⁷⁶⁰ The tribunal observed that the legal system of the state can be outdated and oriented to favour the generation of tax revenues. But, that 'is a problem to be addressed in the reform of tax policy. If the State defines reasonableness of the tax law by the maximization of revenue, it is entitled to do so.'⁷⁶¹ A similar margin of appreciation has been recognised by the tribunals in the *Feldman* and the *Bogdanov* awards.

In the latter, the tribunal upheld the imposition of an environmental tax and recognised that that protection of environment is a legitimate aim, the environmental charges have an objective and reasonable justification and the nexus between the environment charges and the protection of environment was proved.⁷⁶² In a similar fashion, the tribunal in *Feldman* referred to public purpose.⁷⁶³ The tribunal recognised that cigarette smuggling was a significant problem for Mexico and it was a rational public purpose of state policy to curb grey market exports and illegal re-exportation of the cigarettes. The tribunal further stated that even if there was no evidence to link the claimant with the smuggling, the state was justified in its actions for 'Mexican authorities feel they have greater control' over cigarette producers who export (due to licensing agreements) than over independent re-sellers.⁷⁶⁴ However, even by referring to the above tribunals such as *Mamidoil*, *Feldman*, *Bogdanov* awards, it is difficult to suggest that tax is a separate category in relation to the FET standard.

This approach of the tribunals creates an inconsistent position - in the context of expropriation claims taxation is evolving as a separate category, but in the context of the FET standard, tax-related disputes are being treated like any other category of disputes. This has implications for jurisprudence in tax-related investment disputes.

⁷⁵⁹ See *Total* award, *supra* note 18.

⁷⁶⁰ *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v Republic of Albania* (ICSID Case No. ARB/11/24 (Award, 30 March 2015) para 787.

⁷⁶¹ *Ibid.*

⁷⁶² *Bogdanov* award, *supra* note 463, at paras 192- 198 (The claimant had argued that charges on raw materials may fulfil protection of environment but not charges on the finished product. But the tribunal rejected the argument stating that finished products (paints and varnishes) may also cause pollution when used).

⁷⁶³ *Feldman* award, *supra* note 562, at para 135.

⁷⁶⁴ *Ibid.*, at para 136.

To begin with, a higher threshold for expropriation is being prescribed in tax-related investment disputes while it is not the case for the FET standard. Thus, while in expropriation a large amount to deference is shown to taxation measures of a state; the same argument is difficult to make in the context of the FET standard. Investors in tax-related investment disputes could use this differentiation to frequently present their claims under the FET standard in order to increase their prospects of success in the arbitration. In fact, some tribunals have indicated that the threshold for the FET standard is lower as compared to expropriation. In *El Paso* award, the tribunal observed:

Regulations that reduce the profitability of an investment but do not shut it down completely and leave the investor in control will generally not qualify as indirect expropriations even though they might give rise to liability of other standards of treatment, such as national treatment or fair and equitable treatment.⁷⁶⁵

Admittedly, it is possible to suggest that expropriation per se is comparatively a more exacting standard as compared to the FET standard.⁷⁶⁶ In other words, certain tax measures that may not be considered as expropriation may violate the FET standard. My aim here is to suggest that in tax-related investment disputes the threshold for violation of the FET standard should be higher in comparison to non-tax related investment disputes; similar to the approach of the tribunals when addressing arguments on expropriation.

Further, prescribing higher threshold for taxation measures in so far as expropriation is concerned but not for the FET standard reflects a certain conceptual confusion. As mentioned in Chapter 4 above, at the heart of the distinction between taxation and other state measures is the fact that - taxation powers, even when exercised as a manifestation of regulatory powers of a state involve an involuntary transfer. States, in the absence of any international obligation to the contrary, have a right to determine their levels of taxation in accordance with their goals of redistribution of wealth or other similar goals. In fact, states have argued that they have broad regulatory powers regarding taxation and it is an area that has

⁷⁶⁵ *El Paso* award, *supra* note 440, at para 255; This view was endorsed by the tribunal in *Mamidoil* award, *supra* note 760.

⁷⁶⁶ See *Perenco* award, *supra* note 587 (where the tribunal observed that the fact that Ecuador's measures were disproportionate were relevant to the finding of violation of the FET standard, it does not mean that the hurdle of proving indirect expropriation has been crossed.) paras 684-689; Also see *Occidental* award, *supra* note 211.

traditionally been the most exacting of investor expectations and thus subject to a high requirement of reasonableness with respect to an investor's expectations.⁷⁶⁷

However, tribunals have either found the argument to be unnecessary or marginal to the dispute or have simply sidestepped the issue. At best, tribunals have framed the issue in a manner and that allows them to avoid addressing the issue of taxation and FET standard. In either case, this approach of the tribunals results in placing tax-related investment disputes in an uncertain category. While the tribunals give the states a greater degree of leeway in 'expropriation by taxation' arguments - the inability to extend it to fair and equitable treatment standards reflects uncertainty and contributes to lack of consistency in the jurisprudence on tax-related investment disputes.⁷⁶⁸ The argument that FET standards have a lower threshold of state liability as compared to expropriation does not explain this inconsistent approach either.⁷⁶⁹

Thus, the differing approach to the expropriation and the FET standard suggests: first, that there is some intelligible differentia between the two standards; second, tribunals are not maintaining a bright line divide between the tax-related investment disputes and other disputes, in so far as the FET standard is concerned. The former is defensible though arguably could be better articulated; the latter approach suggests tribunals are on a slippery slope especially in comparison to their approach to expropriation. For the FET standard, the nature of taxation is being effectively rendered analogous to the other non-tax laws without adequate examination of the factors that lend uniqueness to tax-related investment disputes. In my view, instead of treating taxation as only a nominally different category of law, the tribunals need to acknowledge that the nature of taxation justifies a higher threshold for determining the violation of the FET standard. In arbitral awards, there needs to be a greater reliance on the nature of tax, existence of tax treaties and presence of tax carve outs to justify the uniqueness of tax-related investment disputes,

The tribunal in the *PSEG* award summarised the importance of the FET standard in investor-state arbitration as follows:

Because the role of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable. Yet, it clearly allows for justice to be done in the absence of the more traditional breaches of

⁷⁶⁷ *Sergei Paushok* award, *supra* note 469, at para 261.

⁷⁶⁸ See *EnCana* award, *supra* note 211.

⁷⁶⁹ See Thomas Wälde, Abba Kolo, *supra* note 560.

international law standards. This role has resulted in the concept of fair and equitable treatment acquiring a standing on its own, separate and distinct from that of other standards, albeit many times closely related to them, and thus ensuring that the protection granted to the investment is fully safeguarded.⁷⁷⁰

The tribunal in the above cited paragraph not only underlines the importance of the FET standard but its ability to be in close relation to other standards and yet maintain its distinct identity. This aspect of the FET standard needs to be appreciated in greater detail in tax-related investment disputes. Tribunals need not develop the FET standard independently for tax-related investment disputes, but they need to adopt a differentiated approach. It is nobody's case that taxation measures of a state be treated with unjustifiable deference, but a principled approach towards tax-related investment disputes, especially in arguments relating to the FET standard is absent. This needs correction.

V. CONCLUSION

The applicability of the FET standard to tax-related investment disputes has few limits. One of the issues that I refer to is the tribunal's limited engagement with IIL in tax-related investment disputes. Admittedly, some of the arguments and issues in these disputes need to be analysed within the framework of IIL itself. However, on numerous occasions, the tribunals have not recognised the wide scope of some of the arguments made by either the claimant or the respondent state. Tribunals need to look beyond IIL and take due account of general principles of IIL. Applying these general principles could change how tribunals approach tax evasion by the investor.

Another issue is the categorisation of tax-related investment disputes.⁷⁷¹ As discussed in Chapter 4, tribunals such as in the *EnCana* award, have recognised that for the expropriation standard tax constitutes a unique category;⁷⁷² but when it comes to the FET standard the tribunals have not unambiguously endorsed that tax-related investment disputes constitute a

⁷⁷⁰ *PSEG Award*, *supra* note 684, at paras 238-239.

⁷⁷¹ See generally Andrew Newcombe, Lluís Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International 2009).

⁷⁷² *EnCana* award, *supra* note 211, at paras 133-140.

separate category. The resulting uncertainty makes it easier for investors to challenge state taxation measures under the FET, and increase the chances of regulatory chill.⁷⁷³

Tribunals are more likely to find that the host state has breached the FET standard rather than the expropriation standard. The fact of physical dispossession of an investor is not as important for the FET standard as it is for expropriation.⁷⁷⁴ One could explain this difference in two ways: first, a difference in the nature of both the substantive obligations - expropriation and the FET standard; second, no express endorsement of tax as a separate category for the FET standard. Both, in my view, are equally valid factors. While the former, in my view, is defensible. The latter, on the other hand, reflects a conceptual confusion. The selective recognition of the uniqueness of tax-related investment disputes results in placing these disputes in an uncertain category. An express endorsement of tax in so far as the FET standard could result in correcting this inconsistent approach of the tribunals.

⁷⁷³ See Chapter 4 above for details on uniqueness of tax-related investment disputes in so far as expropriation is concerned.

⁷⁷⁴ *Ibid.*

CHAPTER 6

THE NON-DISCRIMINATION STANDARD IN TAX-RELATED INVESTMENT DISPUTES

I. INTRODUCTION

Tax carve outs usually exclude the applicability of the non-discrimination standard to a state's taxation measures. However, as we saw in Chapter 3, the wording of tax carve outs differs in various IIAs and their scope consequently varies.⁷⁷⁵ The Non-discrimination standard is applicable to states' taxation measures in only a limited number of IIAs and only a few investment tribunals have applied the non-discrimination standard in tax-related investment disputes. Nonetheless, I explore the arguments raised by the parties and the nature of state actions questioned.⁷⁷⁶ It will provide insight into the emerging jurisprudence on tax-related investment disputes insofar as the non-discrimination standard is concerned.

Non-discrimination standard can be considered by tribunals as a standalone obligation even though non-discrimination is now understood to be one of the elements of the FET standard.⁷⁷⁷ Additionally, some IIAs have a separate provision that requires states not to implement arbitrary, unreasonable or discriminatory measures.⁷⁷⁸ The overlap of non-discrimination with the FET standard can create jurisdictional issues in tax-related investment disputes.⁷⁷⁹

If, due to the tax carve out, the obligation of non-discrimination is not applicable to a state's taxation measures - can tribunals address non-discrimination as part of the FET standard? As I discuss in Section II below, there is no clear answer to this question. But, I do suggest that tribunals can address non-discrimination claims as part of the FET standard if they clearly articulate the scope of their jurisdiction.

⁷⁷⁵ See, for example, Table 2 above.

⁷⁷⁶ For a tabular representation of the various kinds of tax measures challenged in tax-related investment disputes see Table 3 above.

⁷⁷⁷ See *Saluka Investments* award, *supra* note 165, at para 307 ('A foreign investor protected by the treaty may in any case properly expect that the Czech Republic implements its policies bona fide by conduct that is, as far as it affects the investor's investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination.');

⁷⁷⁸ *Eureko B.V. v Republic of Poland* UNCITRAL Arb (Partial Award, 19 August 2005) para 233 (The tribunal held that Poland failed to adhere to its privatization commitments and the failure was attributable to 'purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character.').

⁷⁷⁹ See Argentina-Germany BIT (1991).

For details see Section II below.

Additionally, non-discrimination is also found in almost all tax treaties.⁷⁸⁰ It is applicable to the few specific situations mentioned in the treaty itself. I examine if the concept of non-discrimination as developed under ITL can usefully inform the interpretation of non-discrimination when applied to tax-related investment disputes.

To examine the aforementioned issues, this chapter proceeds as follows: In Section II, I examine the issue of jurisdictional ambiguity when tribunals address the non-discrimination obligation. Due to tax carve outs and exceptions contained in IIAs, tribunals may lack jurisdiction to entertain non-discrimination claims. Thereafter, I discuss the inconsistent approach of tribunals in identifying ‘like circumstances’ or ‘like situations.’ I conclude the Section by examining the meaning of discriminatory taxation as understood by tribunals and the relevance of a state’s policy objectives in determining discriminatory treatment. Section III looks at the evolving relationship between environment and taxes with a specific focus on environmental taxes. I rely on the *Bogdanov* award to discuss the criteria employed to distinguish environmental taxes from non-tax related environmental measures and the implications of the distinction. Section IV highlights the disciplinary bias in tax-related investment disputes. I argue that in interpreting the non-discrimination obligation, tribunals rely unduly on the jurisprudence in international trade law while completely ignoring the meaning of non-discrimination as developed and understood in ITL. Section V concludes.

II. APPLYING THE NON-DISCRIMINATION STANDARD TO TAX-RELATED INVESTMENT DISPUTES

This Section discusses the application of the non-discrimination standard in tax-related investment disputes by examining the observations of arbitral tribunals in the relevant awards. The aim is to understand how tribunals understand the concept and apply it. Claims on non-discrimination usually involve a three-step analysis: first, determining if investors are in like circumstances; second, whether the treatment accorded to foreign investor is less favourable to other investors and third and finally, whether the host state intended to discriminate.⁷⁸¹ I (largely) rely on this three-step analysis to elaborate on non-discrimination

⁷⁸⁰ See, for instance, Art 23 UK-Sweden tax treaty (1983). One of the aspects of non-discrimination in ITL usually involves determining if similarly situated investors have been discriminated by tax authorities. See Section IV below for details.

⁷⁸¹ See Rudolf Dolzer, Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 200; see also the *Archer Daniels* award, *supra* note 566, at 187 (where the tribunal considered if the host state’s tax intended to discriminate between the Mexican sugar producers and the US-based HFCS producers).

standard as applied in tax-related investment disputes. To begin with, I examine the sometimes ambiguous jurisdiction over non-discrimination claims in a tax-related investment dispute.

A. The Non-Discrimination Standard and Jurisdiction

In Chapter 3, I discussed that the question of jurisdiction in tax-related investment disputes has special relevance due to tax carve outs and tax veto. In so far as the non-discrimination standard is concerned, the question of jurisdiction can arise in three ways: first, if due to tax carve outs both the non-discrimination standard and the FET standard are not applicable to a state's taxation measures, the tribunal lacks jurisdiction as a rule.⁷⁸²

Second, where the non-discrimination standard is not applicable to taxation measures, but the FET standard is applicable - can the tribunal address non-discrimination as part of the FET standard?⁷⁸³ In the *Toto* award, the claimant signed a contract to execute a highway project in Lebanon. After completing the project, Toto filed claims for costs due to change in custom duties, faulty design information and change in regulatory framework.⁷⁸⁴ Eventually, it filed a claim before an investor-state tribunal alleging breach of contract and violation of state obligations under the relevant IIA. One of the claims was that the state violated the FET standard. The tribunal observed that the IIA required Lebanon to treat Toto's investment not less favourably than investments of its own nationals or of investors of third countries.

The interesting part of the award, for the purpose of our discussion was that the tribunal discussed the national treatment standard as part of the FET standard without considering its jurisdiction to address claims relating to custom duties.⁷⁸⁵ This can be problematic from a jurisdictional standpoint. In the *Toto* award, the question of change in custom duties was not central to the dispute and the jurisdictional question did not acquire prominence. But, it may arise in future disputes.⁷⁸⁶ In my view, if tribunal has jurisdiction to address the FET standard,

⁷⁸² See, for example, Nigeria-Singapore BIT (2016); also see Table 2 above.

⁷⁸³ However, non-discrimination in itself is not always sufficient to establish a breach of the FET standard. See, for example, *RosInvest* award, *supra* note 299, at paras 553-557 (where the tribunal observed that the treatment by the host state to the claimant was quite different from the treatment accorded to its competitors and other comparable taxpayers and no convincing reasons were shown for this differentiation. The tribunal, however, added that if it is doubtful it is sufficient to find a breach of the FET standard).

⁷⁸⁴ *Toto Costruzioni Generali S.p.A v Republic of Lebanon* ICSID Case No. ARB/07/12 (Award, 7 June 2012).

⁷⁸⁵ *Ibid*, at paras 151-167; This issue was never argued before the tribunal either. See *Toto Costruzioni Generali*

S.p.A v Republic of Lebanon ICSID Case No. ARB/07/12 (Decision on Jurisdiction, 11 September 2009).

⁷⁸⁶ Also see *Grand River Enterprises Six Nations, Ltd, et al v United States of America* (UNCITRAL, Award, 12 January 2011) paras 123-124; 158-172 (where the tribunal addressed the argument on non-discrimination by bifurcating

it can address arguments on non-discrimination; but tribunals need to articulate their jurisdiction more carefully.

Third, the jurisdiction issue becomes more complex when one considers tax carve outs and general exceptions in IIAs together. For instance, in CETA, the non-discrimination standard is not applicable to taxation measures.⁷⁸⁷ At the same time, a state is allowed to pursue its public welfare objective of protecting the environment - as long as the measures to protect the environment are non-discriminatory.⁷⁸⁸ One of the implications of both these provisions is that an investor can challenge an environmental tax as non-discriminatory and initiate arbitral proceedings.⁷⁸⁹ In my view, the tribunal in such a case will have jurisdiction to entertain the non-discrimination claim. Thus, while a cursory reading of several IIAs such as the CETA may suggest that non-discrimination standard is inapplicable to tax measures; a careful reading suggests that the exclusion of tax measures may not be across the board and for all cases.

B. The Elusive Meaning of Discriminatory Taxation

This sub-section is further divided into three sections to understand the scope and meaning of non-discrimination standard as applied in tax-related investment disputes.

1. Inconsistency in Identifying ‘Like Circumstances’ for Discriminatory Taxation

The issue of national treatment and non-discrimination occupied central place in the *United Parcel Service* award.⁷⁹⁰ United Parcel Service (UPS) alleged that Canada had conferred numerous advantages to Canada Post such as: exempting Canada Post from penalties and fines for late or non-payment of duties or taxes, failing to collect duties and taxes on large volumes of packets imported by Canada Post, exempting Canada Post from the goods and services tax on a certain handling fee that it charged among others. These exemptions and advantages were not provided to UPS and it filed a claim alleging that Canada by extending the above mentioned benefits to Canada Post had violated its national treatment obligation under the Article 1102 of the NAFTA. The tribunal rejected the claimant’s argument by

the tax-related arguments and the non-tax related arguments. It only made observations on the latter since it did not have jurisdiction over the former).

⁷⁸⁷ See Art 28.7(1) and Art 28.7(4), CETA, *supra* note 301.

⁷⁸⁸ *Supra* note 297; *Methanex* award, *supra* note 390 at para 7 (the tribunal observed that a non-discriminatory regulation which is enacted in accordance with due process and affects a foreign investor or investment is not deemed to be expropriation or compensable).

⁷⁸⁹ For a detailed discussion on environment tax see Section III below.

⁷⁹⁰ *United Parcel Services of America, Inc v Government of Canada* (Award on Merits, 11 June 2007).

holding that inherent differences between postal services and courier services meant that both were not ‘in like circumstances.’⁷⁹¹ The tribunal made several distinctions between UPS (a courier service) and Canada Post (a postal service). The differences were their differing objectives, transport and delivery systems, and the fact that courier services generally had contractual relationship with its clients while postal services did not. In effect, the tribunal held that the different characteristics of the claimant and Canada Post meant that they were not in like circumstances and thus Canada had not violated its national treatment obligation and there was no discrimination between UPS and Canada Post.

The above-mentioned comparison was selective in its comparison of UPS and Canada Post.⁷⁹² This is an important observation especially if one considers that even though Canada Post was a postal service, the tribunal failed to address the specific point that it was exempt from paying duties for its courier services, while UPS had to pay the same duty when offering its courier services.⁷⁹³ At the same time, the tribunal framed the term ‘like circumstances’ in very precise and narrow terms:

It is not sufficient for a complaining investor to show that the investor or investment is in the same economic sector as, or competes with, an investor or investment of the NAFTA Party charged with violating its national treatment obligation. Sharing the same economic sector may be evidence that two businesses are in like circumstances. So, too, being in competition, even if businesses might be classified in different economic sectors, may be evidence of like circumstances. Yet, neither showing is conclusive of like circumstances.

⁷⁹⁴

Thus, despite a narrow definition of like circumstances, the tribunal overlooked an important aspect as mentioned above.

A narrow definition of like circumstances was also adopted by the NAFTA tribunal in *Feldman*.⁷⁹⁵ In *Feldman*, the tribunal distinguished between resellers and exporters of

⁷⁹¹ *Ibid*, at para 102.

⁷⁹² Andrew D. Mitchell, et al., *Non-Discrimination and the Role of Regulatory Purpose in International Trade and Investment Law* (Elgar International 2016) 86 (highlights the need to define investment by particular business of the entity rather than the entire business).

⁷⁹³ See generally *Nykomb* award, *supra* note 529, at para 99.

⁷⁹⁴ Separate Statement of Dean Ronald A. Cass, 24 November 2007, at para 16.

⁷⁹⁵ See *S.D. Myers, Inc v Government of Canada* (UNCITRAL, Partial Award, 13 November 2000) (where the tribunal observed that the phrase ‘in like circumstances’ should be interpreted keeping in mind the ‘overall legal context’. The tribunal elaborated that the phrase ‘in like circumstances’ usually refers to investments in the same sector of

cigarettes. The tribunal held that all the foreign-owned and domestic firms that were in the business of reselling/exporting cigarettes were in like circumstances. But, it added that producers of cigarettes who are also exporters are excluded from the comparison and cannot be said to be in like circumstances. The tribunal said that there was a rational decision for treating producers and resellers differently - protecting intellectual property rights, prohibiting gray market sales and for better control over tax revenues. The latter reason was an important factor in the decision of the tribunal.⁷⁹⁶ A comparison of the approaches of the tribunal in the *United Parcel Service* award and the *Feldman* award shows that both the tribunals defined like circumstances narrowly.

On the other hand, the tribunal in the *Occidental* award adopted a very broad definition of like circumstances. *Occidental* claimed that denying it VAT refunds was a breach of national treatment because other companies such as exporters of flowers, seafood were still entitled to VAT refunds. The tribunal, in a questionable analysis, observed that the purpose of national treatment is to protect investors as compared to local producers. This objective, the tribunal observed, cannot be achieved by addressing 'exclusively the sector in which that particular activity is undertaken.'⁷⁹⁷ The tribunal further added that no exporter should be put at a disadvantage as compared to other exporters.⁷⁹⁸ The tribunal interpreted the term like situation very broadly by comparing different and unrelated sectors. The tribunal, it appears seems 'to have conflated national treatment with any kind of disadvantageous distinction, unrelated to nationality-based discrimination.'⁷⁹⁹

In the *El Paso* award as well, the comparison was between two different sectors - the banking sector and the oil and gas sector. The claimant belonging to the latter claimed that the banking sector was mainly Argentine owned and the oil and gas sector mainly foreign owned. The claimant alleged that both the sectors were not treated similarly since the withholding tax was imposed only on the oil and gas companies. Thus, there was a *de facto* discrimination

the economy); Also see *Champion Trading Company, Ameritrade International, Inc. v. Arab Republic of Egypt*, ICSID Case No. ARB/02/9 (Award, 27 October 2006)(the dispute revolved around payments made by respondent to certain companies. The tribunal held that all the companies in cotton trading were not in like situations. The state owed money to companies incorporated before 1994 due to government control of cotton prices. The policy changed after 1994 and thus companies incorporated after 1994 were not in like situation with companies incorporated before 1994).

⁷⁹⁶ *Feldman* award, *supra* note 562, at paras 170-172.

⁷⁹⁷ *Occidental* award, *supra* note 211, at para 173.

⁷⁹⁸ *Occidental* award, *supra* note 211, at para 175.

⁷⁹⁹ Andrew Newcombe, Lluís Paradell, *supra* note 771, at 169.

by the respondent state which violated the national treatment obligation under the BIT. The tribunal observed that:

It was thus reasonable for the Government to institute a tax on the unexpected profits made by the oil and gas companies to re-balance the situation of the banking sector. Far from being discriminatory, this measure aimed at equalising the playground of the different economic actors, by distributing more equitably the burden of the country's economic crisis among all those affected.⁸⁰⁰

The tribunal further added that the imposition of the taxes only on one sector was reasonable, not discriminatory and was made with the intent to balance the advantages and disadvantages of each sector with the general economic situation. It was one of the rare instances where the comparison across different sectors of the economy was necessary to explain the lawfulness of the measures adopted by the state - in this case, the imposition of withholding and windfall taxes by the state.

The allegation of discriminatory treatment was made in the *Jan Oostergetel* award as well.⁸⁰¹ The claimant, in this case, alleged that the bankruptcy proceedings against it were a pretext to acquire its assets by the 'financial mafia' through illegitimate court proceedings. Further, the claimant alleged that tax authorities forcibly collected tax arrears from it in violation of the assurances that there was no deadline to pay the tax arrears. The claimant alleged that actions of the court and tax authorities were in violation of the FET standard and constituted expropriation.

In the *Jan Oostergetel* award, the tribunal identified a state's obligation to not adopt arbitrary or discriminatory measures as part of the FET standard. However, in this case, the text of the IIA in question supported this stance.⁸⁰² The tribunal concluded that it 'finds no evidence of a discriminatory application of tax penalties, not to mention that the Claimants assertions about discrimination are unpersuasive in light of long-standing ministerial policy of

⁸⁰⁰ *El Paso* award, *supra* note 440, at para 314.

⁸⁰¹ *Jan Oostergetel* award, *supra* note 532, at para 221.

⁸⁰² Article 3.1 of the Netherlands-Slovakia BIT (1991) provides that: 'Each Contracting Party shall ensure fair and equitable treatment to the investment of the investors of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.'; Also see *CMS Gas Transmission Co v The Argentine Republic* ICSID Case No. ARB/01/8 (Award, 12 May 2005); *Impregilo S.p.A. v The Islamic Republic of Pakistan* ICSID Case No. ARB/03/3 (Decision on Jurisdiction, 22 April 2005) (in both the awards the tribunals did not differentiate between the FET standard and the non-discrimination obligation).

tolerance for tax arrears.⁸⁰³ Further, the tribunal stated that the tax authorities of the respondent had requested bankruptcy against of numerous companies before requesting that bankruptcy proceedings be initiated against the claimant. There was no analysis if the other companies were in like circumstances, but just a broad-brush comparison of the claimant with other companies. The tribunal concluded that the claimant was unable to disprove that it was the sole target of the tax authority and thus it was unable to establish discriminatory treatment by the respondent.⁸⁰⁴

The tribunal concluded that the respondent state by collecting tax arrears did not violate the claimant's legitimate expectations.⁸⁰⁵ In the award, there is considerable overlapping between the non-discrimination analysis and the arguments related to FET/legitimate expectations. This is partially attributable to the wide scope of the provision which the tribunal was required to interpret. At the same time, it is possible to argue that the tribunal did not adequately separate and distinguish the two obligations of non-discrimination and legitimate expectations of the investor. While the tribunal was correct in its conclusions, a more careful delimitation would have been beneficial to understand the application of the non-discrimination obligation in tax-related investment disputes.

2. No Precise Definition of Discriminatory Taxation

The question of discriminatory taxation was also raised in the *Cargill* award.⁸⁰⁶ In this dispute, Mexico's Impuesto Especial Sobre Producción y Servicios (IEPS) tax imposed a 20% tax on soft drinks that contained sweeteners other than cane sugar. The purpose of this tax, the investor alleged, was to restrict access of HFCS producers (US corporations) to the Mexican market. The tax was imposed in the backdrop of Mexico's attempt to resolve the issue of restricted access to Mexican sugar in the US market. The tax applied to all products that contained sweeteners other than cane sugar, which meant that the presence of any HFCS in a beverage was sufficient to trigger the tax. The contention of the claimant was that the tax was discriminatory in effect because, while HFCS was produced and distributed entirely by US-owned companies, cane sugar was produced by Mexican-owned companies. The claimant

⁸⁰³ *Jan Oostergetel* award, *supra* note 532, at para 241.

⁸⁰⁴ *Ibid.*

⁸⁰⁵ *Jan Oostergetel* award, *supra* note 532, at para 254; Also see paras 242-260.

⁸⁰⁶ The argument of discriminatory treatment was raised in the context of denial of national treatment, violation of the MFN treatment and the FET standard. The tribunal examined them separately in the award. Also see Matthew Davie, 'Taxation-Based Investment Treaty Claims' (2015) *J Int'l Dispute Settlement* 1, at 7-9; Patrick Dumberry, 'The Protection of Investors' Legitimate Expectations and the Fair and Equitable Treatment Standard under NAFTA Article 1105' (2014) *1 J Int'l Arb* 47.

argued that because of the tax, the use of HFCS became prohibitively expensive for Mexican beverage producers and there was a substantial drop in HFCS sales in Mexico and Mexican bottling plants cancelled HFCS orders. In addition to the imposition of tax, Mexico established new import requirements - the importers who did not have a permit to import HFCS were subjected to much greater tariff rates as compared to the permit holders. Claimants were denied the permits each time they applied and were not informed of the reasons of refusal or the qualifications needed to obtain a permit.

The claimants argued that through the above described measures, Mexico violated its obligation to provide national treatment under Article 1102 of the NAFTA. The respondent relied on three reasons to argue that the claimant was not in like circumstances with domestic sugar producers. The tribunal rejected all three arguments. The tribunal noted that the first two arguments of the respondent - that the claimant was engaged in distribution of a variety of products and that the sugar industry is more regulated as compared to the HFCS market - are irrelevant to determine if claimant as supplier of HFCS is in 'like circumstances' with domestic suppliers of cane sugar.

The respondent's third argument was that the sugar industry is in dire economic straits and not in like circumstances with an economically healthy industry of the HFCS even though the products are substitutable. The respondent was trying to distinguish the two industries to underline the point that both industries were not in 'like circumstances.' The tribunal observed that the issue is if the difference in the economic circumstances is relevant to the measure taken i.e. imposition of a tax. If the measure was taken to benefit the sugar industry, then the cane sugar and HFCS industry would not have been in 'like circumstances', but:

It is not a case of a measure providing an advantage to an industry in dire economic circumstances that is not available to a more economically healthy industry. It is a measure taken to disadvantage an industry that was in healthy economic circumstances, and which had the effect of driving the industry out of the market.⁸⁰⁷

In view of the above observations, the tribunal found that suppliers of cane sugar were in like circumstances with suppliers of HFCS.⁸⁰⁸ The tribunal also concluded that there is no doubt

⁸⁰⁷ *Cargill Inc award, supra note 566, at para 208.*

⁸⁰⁸ *Ibid, at para 211.*

that the claimant received less favourable treatment - in intent and effect - due to its nationality and that there was a violation of the national treatment obligation under the NAFTA.⁸⁰⁹

In the *PSEG* award, the tribunal dismissed the claimant's argument of being discriminated against due to respondent's repeated changes in its laws. The tribunal summarily observed that the claimant had not been singled out in a discriminatory manner. The tribunal concluded: 'The changes in macroeconomic policy that would have occurred concerned the economy as a whole. The question of foreign investment being particularly intense in the energy sector is a separate matter unrelated to the claim on discrimination. This heading of liability is accordingly dismissed.'⁸¹⁰

While both the *PSEG* and the *Cargill* awards contain a detailed and well-reasoned analysis, they are not helpful in determining the meaning of discriminatory taxation. While discriminatory taxation did not form the core of arguments in the *PSEG* award, the tribunal in *Cargill* award focused more on the effects of the tax than in examining the term 'discriminatory tax' per se. The exact elements of discriminatory taxation remain uncertain. To begin with, a more consistent approach to like circumstances could be a starting point. Also, tribunals could also adopt an approach whereby the terms discriminatory and arbitrary taxation are defined more clearly and preferably as distinct concepts. The tribunal in the *Valores* award provided the most puzzling analysis of the term 'arbitrary or discriminatory'.

The tribunal in *Valores* framed a specific question - Were the tax levies on Yukos beginning in December 2003 arbitrary or discriminatory?⁸¹¹ This question was then further sub-divided into five distinct categories and the tribunal's analysis continued over several pages.⁸¹² In this section of the award, the tribunal did not answer the question. At various places in the award, the tribunal emphasised that it was only seeking answer to one question - whether the cumulative effect of all the acts of the state constituted a breach of the BIT?⁸¹³ In its focus on answering one question, the tribunal missed various opportunities to find if the abusive tax

⁸⁰⁹ Also see *Corn Products* award, *supra* note 566, at paras 109-143 (containing a similar analysis of non-discrimination in respect of the same facts); Also see *Archer Daniels* award, *supra* note 566, at paras 183-213 (where the tribunal held that the intent and effect of the tax measures revealed its discriminatory nature. The intent was to protect the domestic sugar industry of Mexico and its effect was the US producers of HFCS received less favorable treatment than accorded to Mexican sugar producers. For these reasons the tax imposed by Mexico violated the national treatment obligation).

⁸¹⁰ *PSEG* award, *supra* note 684, at para 262.

⁸¹¹ *Valores* award, *supra* note 299, at para 46.

⁸¹² *Ibid*, at paras 46-86.

⁸¹³ *Ibid*, at paras 49, 60, 81.

administrative practices of Russia violated the FET standard and more specifically the obligation of non-discriminatory treatment imposed by the relevant IIA. The tribunal's inability to address the issue of non-discrimination is more confounding because it specifically framed a question on arbitrary and discriminatory treatment but left it unanswered.

In *Mamidoil*, an award under the ECT, the claimant argued that state measures to levy import tax was unreasonable and discriminatory.⁸¹⁴ The claimant argued that levying import taxes on the petroleum products based on fictitious amounts in the bill of lading rather than the actual amount caused it substantial loss. The tribunal, however, did not accept the claimant's argument that the imposition of import taxes by the state was discriminatory.⁸¹⁵ It observed that the taxation policy of the state applied to all the importers equally and merely because some importers were trying to circumvent it did not render the taxes discriminatory in nature. The tribunal essentially directed the claimant to seek a remedy before domestic authorities and courts and refused to intervene in the tax policy of the state.⁸¹⁶ The tribunal endorsed the host state's argument that it had sovereign power to decide on taxation and was not bound by international practice.⁸¹⁷ Here again, the award is unhelpful in ascertaining the meaning and content of the term discriminatory taxation.

3. Relevance of Legitimate Purpose in Discriminatory Taxation

Certain authors have suggested that the issue of whether the investors or investment are like or unlike with respect to a particular regulatory treatment can be determined by ascertaining the purpose of the regulatory measure in question.⁸¹⁸ Others have also argued that the regulatory purpose has been inadequately considered in non-discrimination analysis though it is indirectly relevant.⁸¹⁹ Further, it has been suggested that a state should in general be able to escape liability under non-discrimination provision by establishing that the challenged measure does not have a significant regulatory purpose of protectionism and that the measure

⁸¹⁴ *Mamidoil* award, *supra* note 760, at paras 776-777.

⁸¹⁵ *Ibid*, at paras 786-790.

⁸¹⁶ *Ibid*, at para 789.

⁸¹⁷ *Ibid*, at paras 783 and 787.

⁸¹⁸ Andrew Newcombe, Lluís Paradell, *supra* note 771, at 165.

⁸¹⁹ See Andrew D. Mitchell, et al., *supra* note 792; Also see Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration*, (Cambridge University Press 2015) 175-177 (suggesting that there is a risk that tribunals less sensitive to the need to adopt a balanced interpretation of the obligations of the states are likely to take into account a state's regulatory objectives only in the context of exception clauses).

is necessary to achieve and rationally connected to a legitimate objective.⁸²⁰ That said, the tribunal in *Tza Yap Shum* cautioned that the deference is ‘not unlimited’ and that even if measure is adopted with a legitimate objective it might still be implemented in an arbitrary or discriminatory manner and make the state liable.⁸²¹

The tribunal in the *Micula* award had to determine if Romania’s withdrawal of tax incentives were arbitrary and unreasonable.⁸²² The claim arose from withdrawal and amendment of certain tax incentives that Romania had extended in order to encourage investment in certain ‘disfavoured’ regions. One of claimant’s arguments was that the respondent by withdrawing the tax incentives acted in an unreasonable and arbitrary manner. I will summarise the conclusions of the tribunal relevant for the purpose of our discussion in this chapter.

The tribunal observed that Romania was pursuing a rational policy objective - accession to the EU and the withdrawal of tax incentives was tailored to meet this objective.⁸²³ Thus, ‘there was an appropriate correlation between that objective and the measure adopted to achieve it.’⁸²⁴ Second, the tribunal did not accept claimant’s argument that Romania could have negotiated a transition period for the incentives. The tribunal observed that under the circumstances of the accession negotiations, Romania did not, by and large, act unreasonably.

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The tribunal held that Romania acted unreasonably only with respect to one aspect. The unreasonableness related to Romania’s continuation of its decision that required investors to maintain investments for 20 years in return for receiving tax incentives for 10 years. The investor’s obligations were to be enforced despite removal of all tax incentives. In tribunal’s opinion, Romania should have reduced the investor’s obligations after the removal of tax

⁸²⁰ *Ibid*; Also see *LG & E v Argentina* ICSID Case No. ARB/02/1 (Decision on Liability, 3 October 2006) (the tribunal observed that a measure is discriminatory if the intent of the measure is to discriminate or if the effect is discriminatory - either would suffice).

⁸²¹ *Tza Yap Shum* award, *supra* note 511, at para 147; Also see *Eastern Sugar v Czech Republic* SCC Case No. 088/2004 (Award, 27 March 2007) (the tribunal observed that a measure can be discriminatory and unreasonable even if the intent is not to specifically target the claimant); Also see *Siemens v Argentina* (where the tribunal observed that intent is not important and the effect of the measure is the determining factor to ascertain if a measure has resulted in a discriminatory treatment).

⁸²² *Ioan Micula, Viorel Micula v Romania (I)* ICSID Case No.05/20 (Final Award, 11 December 2013).

⁸²³ Prior to its accession Romania was informed by the European Commission that some of its policies including the tax incentives were not in conformity with the EU state aid rules. Thus, the EU advised Romania to amend or withdraw the tax incentives in order to successfully complete the latter’s accession to the EU. *Ibid*, at para 130.

⁸²⁴ *Ibid*, at para 825.

⁸²⁵ *Ibid*.

incentives and its failure to do so was an unreasonable action. Thus, in essence it can be said Romania was partially unreasonable in pursuing a legitimate policy objective.⁸²⁶

In the *Feldman* award, the tribunal acknowledged the legitimacy of the state's objective - curbing the gray market for cigarettes, but the tribunal found that there was discrimination and violation of the national treatment obligation. The tribunal observed that it is not necessary to prove that discrimination was necessarily as a result of nationality; but in the present case there was "evidence of a nexus between the discrimination and the claimant's status as a foreign investor."⁸²⁷ The dissenting opinion claimed that the claimant was unable to prove discrimination and 'that the treatment received by both investors has essentially been the same.'⁸²⁸ The persuasive value of the dissent notwithstanding, *Feldman* award does demonstrate that the even legitimate objectives can be pursued in a discriminatory manner and the tribunals can hold states liable for the same.⁸²⁹

In *Sergei Paushok*, the investor argued that Mongolia's windfall profit tax applied only to the gold mining industry.⁸³⁰ It was argued that the tax should have applied to all the sectors.⁸³¹ The tribunal observed that the fiscal legislations of states treat various industries differently by providing tax breaks or direct subsidies.⁸³² There is nothing in international law or in the

⁸²⁶ Also see *EDF (Services) Limited v Republic of Romania* ICSID Case No. ARB/05/13 (Final Award, 8 October 2009) (where the tribunal accepted that accession to the EU and removal of corruption were legitimate policy objectives and upheld the respondent's decision to revoke licenses of all the airport duty-free operators in Romania) paras 287-297 and paras 302-306.

⁸²⁷ *Feldman* award, *supra* note 562, at para 182; Also see *J.M. Longyear, LLC v Government of Canada* (Notice of Intent to Submit a Claim to Arbitration, 14 February 2014) (the claimant alleged that it was not being accorded the same property tax treatment as other similarly situated investors because Canadian nationals were not majority shareholders in its investment enterprise. The notice was later withdrawn); *Lacich et al v Government of Canada* (Notice of Intent to Submit a Claim to Arbitration, 2 April 2009) (where the claimants alleged that the change in Canada's tax policy with respect to energy trusts discriminated against American investors. The notice was later withdrawn.).

⁸²⁸ Dissenting Opinion of Jorge Covarrubias Bravo, *Feldman* award, *supra* note 562, at para 6; Also see Julien Chaisse, 'Investor-State Arbitration in International Tax Dispute Resolution - A Cut above dedicated Tax Dispute Resolution? (2016) 41 Virginia Tax Rev 149 (for a detailed discussion on the *Feldman* award).

⁸²⁹ Also see *Corn Products* award, *supra* note 566, at para 142 ('The Tribunal does not doubt that either there was a crisis in the Mexican sugar industry, or that the motive for imposing the HFCS tax was to address that crisis. That does not alter the fact that the nature of the measure which Mexico took was one which treated producers of HFCS in a markedly less favorable way than Mexican producers of sugar. Discrimination does not cease to be discrimination, nor to attract the international liability stemming there from, because it is undertaken to achieve a laudable goal or because the achievement of that goal can be described as necessary.').

⁸³⁰ *Sergei Paushok* award, *supra* note 469, at para 309.

⁸³¹ *Ibid.*

⁸³² Also see *Enron* award, *supra* note 651, at para 282 (where the tribunal observed that quite naturally there are important differences between different sectors and state can employ different measures in each. As long as one sector is not singled out for harsher treatment in respect of others or provide a more beneficial remedy to the

IIA which restrained Mongolia from imposing a tax regime on gold mining which was different from other industries. The tribunal thus ruled that there was no illegal discrimination under the IIA.⁸³³ Also, since the rise in gold prices was the reason for Mongolia's windfall tax - there was a defensible justification for imposing the tax only on the gold mining industry and not on other industries.

The observations of the tribunal in *Sergei Paushok* are similar to the holding in *Pope & Talbot*.⁸³⁴ In the latter dispute, the tribunal determined whether domestic and foreign investors were in an economically competitive relationship and then examined the rationale of the measure itself. The tribunal observed that the investors are not in like circumstances where a measure treats a foreign investor less favourably but is related to a legitimate or a rational regulatory objective.⁸³⁵ Thus, the observations of the tribunal in *Sergei Paushok* that the imposition of windfall profit tax to address the rise in gold prices is defensible, since the objective of the tax was to recover extraordinary profits earned by the investor. Although the observations in *Pope & Talbot* were made in the context of a non-tax measure, they suggest that regulatory purpose is relevant for a non-discrimination analysis by an arbitral tribunal.

C. Concluding Remarks

Disputes relating to discriminatory taxation are relatively novel in investor-state arbitration. No overarching trend that has emerged in the various arbitral awards that have addressed the issue of discriminatory taxation. Nonetheless, four aspects about the non-discrimination jurisprudence in tax-related investment disputes are problematic.

The first aspect concerns jurisdiction. Many IIAs carve out national treatment and this standard is not applicable to the state's taxation measures. Thus, if a tribunal is addressing a national treatment claim, this raises the issue of whether the tribunal has jurisdiction to

detriment of others, there is no discrimination); Also see *Total* award, *supra* note 18, at para 434 (where the claimant challenged the imposition of export taxes as discriminatory. The tribunal observed that the taxes were part of general fiscal legislation that were generally applicable and thus there was no discrimination against the investor).

⁸³³ *Ibid*, at para 310.

⁸³⁴ See *Pope & Talbot Inc. v The Government of Canada* (UNCITRAL, Award on the Merits of Phase 2, 10 April 2001) (the tribunal observed that differential treatment would violate national treatment obligation unless there was a reasonable nexus with a rational policy. In this case, the measures undertaken by Canada - to allocate quotas in exporting softwood lumber - were to remove the threat of trade sanctions by the United States. Since the measures affected the claimant in the same manner as it affected Canadian companies, the measures were held to be legitimate, non-discriminatory, and did not violate national treatment obligation under NAFTA.).

⁸³⁵ Also see *GAMI Investments, Inc. v United Mexican States* (UNCITRAL, Final Award, 15 November 2004).

entertain the claim in the first place. The *El Paso* award served as an illustration in Chapter 3.⁸³⁶

Secondly, again from a jurisprudential viewpoint -tribunals do not always precisely identify if they are addressing non-discrimination claims under the FET standard or under the national treatment obligation. For example, I highlighted the approach of the tribunal in the *Toto* award where the national treatment obligation was discussed under the heading of the FET standard. It is important that tribunals draw the distinction between these two separate to clearly establish their jurisdiction.

Thirdly, despite the observations of many tribunals, much remains in flux as to the elements necessary for a tax measure to amount to discriminatory taxation. Tribunals and the literature have recognised nationality-based discrimination as illicit, but as mentioned above tribunals have identified like circumstances inconsistently; and also while all tribunals have recognised the legitimacy of policy goals as a relevant factor, the exact role of state's goals in the analysis is unclear.

Also, neither is the tribunals' understanding of arbitrary and discriminatory taxation clear. For instance, in the *Valores* award, the tribunal addressed the argument of arbitrary taxation along with discriminatory taxation. Similarly, the tribunal in the *Toto* award defined the two terms by considering them as synonymous with each other.⁸³⁷ Other tribunals such as in the *Link Trading* award, by contrast, discussed the issue of abusive taxation separately.⁸³⁸ While the overlap may also be a function of the way certain provisions of the treaties are drafted, at the conceptual level there is little clarity about how tribunals understand abusive, discriminatory taxation. Is abusive taxation different from discriminatory taxation? If yes, how? Do they overlap? If yes, how and under which circumstances?

To answer these questions, the *Burlington* award provides guidance. I discussed in Chapter 4, the *Burlington* tribunal observed that for a tax to be expropriatory, it needs to be confiscatory and discriminatory. The tribunal treated both the concepts as distinct, and

⁸³⁶ See Chapter 3 above where I point out that in *El Paso* award, tribunal analyzes the argument of discrimination for six pages and then later says that its observations are academic since its jurisdiction in tax-related investment disputes extends only to expropriation claims.

⁸³⁷ The tribunal defined an unreasonable or discriminatory measure as (i) a measure that inflicts damages on the investor without serving any apparent legitimate purpose; (ii) a measure that is not based on legal standards but on discretion, prejudice or personal preference, (iii) a measure taken for reasons that are different from those put forward by the decision maker, or (iv) a measure taken in wilful disregard of due process and proper procedure. See *Toto* award, *supra* note 784, at para 157.

⁸³⁸ See *Link Trading* award, *supra* note 422.

further elaborated that the discriminatory character of tax should be treated as secondary. However, a neat distinction between arbitrary and discriminatory measures may not always be possible. For example, in the *Yukos* awards, the claimant's investment was targeted for an arbitrary reason (from a legal perspective) and was subjected to harsh treatment as compared to any other investment.⁸³⁹ In such a scenario, the state's measures can be both arbitrary and discriminatory. Nonetheless, despite the possibility of overlap in some situations, there is scope for tribunals to better articulate their understanding of arbitrary and discriminatory taxation.

In my view, an abusive tax will ordinarily target a single investor or investment. In order to arrive at a finding of expropriation, a comparison with other investors may not always be necessary. On the other hand, in order to determine if tax is discriminatory, some comparison with other investors is necessary. Without comparing the claimant with any other investor, the question of whether the tax is discriminatory in character and whether the investor has been subjected to a harsher tax liability cannot be answered.

III. ENVIRONMENTAL TAXES IN INVESTOR-STATE ARBITRATION

In this Section, I focus on one particular aspect of environment regulation - environment taxes. With the help of the *Bogdanov* award, I examine the issue of environment taxes, and how the tribunal handled the claimant's allegations of discrimination. I also examine the implications of identifying an environment tax as a tax measure and not as an environmental measure, and the criteria to draw such distinction.

There is a certain tension between foreign investment protection and regulatory space of a host state in so far as it concerns environmental regulation.⁸⁴⁰ The goals of environment protection and foreign investment protection do not always complement each other.⁸⁴¹ A few states, in order to attract foreign investment, are willing to lower their environmental

⁸³⁹ See Chapter 4 above for a detailed discussion on the *Yukos* awards.

⁸⁴⁰ See, for example, *Methanex* award, *supra* note 390 (where the decision of California State of US to ban MTBE - an additive to gasoline was the subject of dispute. The additive was considered as contaminating drinking water and posing significant risk to human health and environment); *Chemtura Corporation v Government of Canada* (UNCITRAL Award, 2 August 2010) (where the claimant challenged the ban imposed on a pesticide used in canola farming that was considered to adversely affect human health); *S.D. Myers* award, *supra* note 795.

⁸⁴¹ See Jorge E. Viñuales, *supra* note 668 (for a detailed examination of the interaction and conflicts between foreign investment law and environmental law).

standards which may include prescribing lower penalties for pollution.⁸⁴² The desire to attract investment at times leads to a ‘race to the bottom’ in environmental regulation. Thus, commentators have suggested that certain minimum environmental standards should apply to all states especially those extending tax incentives for attracting foreign investment.⁸⁴³ In this way, it is claimed, the tax and environmental policies of the states can be mutually reinforcing.⁸⁴⁴ At the same time, there are a few states that take measures to safeguard the environment and encourage sustainable activities. One such measure is an environmental tax which was central to the *Bogdanov* award.

In the *Bogdanov* award, claimants owned and controlled two companies in Moldova. One of the companies was incorporated in the free economic zone and the other outside the zone. The two companies entered into an agreement whereby the company in the free economic zone could import raw materials, send it to the other company for processing (production of paints and varnishes), receive the finished goods in the free economic zone and sell it in Moldova and abroad. The structure allowed the company in the free economic zone to not pay any custom duties or VAT (except administrative charges) at any stage of the operations. Thereafter, Moldova introduced environmental charges which were paid by both companies - the charge was calculated as a percentage cost of the raw materials. However, later the environmental charge was amended to be applied on percentage cost of finished goods i.e. paints and varnishes. Thus, it increased the cost significantly since the cost of finished goods was much higher. The claimant contended that the charge was a concealed custom duty or VAT and in violation of the stabilisation clause and the FET standard.

The tribunal first referred to the stabilisation clause and observed that environmental charges are not custom duties or VAT and hence are not within the scope of stabilisation clause and thus there is no violation of legitimate expectations.⁸⁴⁵ Further, the tribunal observed that there was no discrimination against the claimant. For the purposes of its analysis, the tribunal compared the claimant with other entities in the economic zone which imported raw materials and produced finished goods. The tribunal concluded that they were all treated equally. The tribunal further stated that the reason for imposition of charges can be diverse

⁸⁴² See, for example, Shyam Divan, Armin Rosencranz, *Environmental Law and Policy in India: Cases, Materials and Statutes* (Oxford University Press 2001).

⁸⁴³ Mariá Amparo Grau Ruiz, Jacques Malherbe, ‘The Dependence on Foreign Investment as a Potential Barrier for a Sound Environmental Taxation’ in Attila Tanzi et al (eds.), *International Investment Law in Latin America* (Brill 2016) 794.

⁸⁴⁴ *Ibid*, at 806.

⁸⁴⁵ *Bogdanov* award, *supra* note 463, at para 205.

and the claimant's assertion that the charge was discriminatorily and disproportionately applied to them is incorrect and thus correctly rejected the claimant's arguments.⁸⁴⁶ However, the respondent state only gave one reason for the imposition of the charge - the protection of environment. The tribunal's reference to 'diverse' reasons was, in the context of the award, incorrect.

One aspect that was central to the *Bogdanov* award was the question whether an environmental tax should be understood as a tax or as a state regulatory measure. This distinction is important, because as shown above in Chapter 4, in so far as expropriation is concerned, tax-related investment disputes form a separate category. Chapter 4 specifically argues that the threshold of expropriation by taxation is higher in comparison to other state regulatory measures. Thus, the regulatory space available to a state to impose an environment tax is likely to be greater as compared to a non-tax related environmental measure. This leads to a few questions. What are the criteria to distinguish an environmental tax from other taxes? Are tax incentives that are meant to encourage environment friendly businesses/business practices, tax measures or environmental measures? What are the implications that follow from these distinctions?

To begin with, the tribunal may need to determine if an environmental tax is not a concealed duty or an indirect way of increasing the tax liability of the investor. For instance, in the *Bogdanov* award, the argument of the claimant was that the environmental tax was an indirect way to impose a custom duty or VAT. The tribunal rejected this argument by looking at the purpose of the tax - the protection of environment. As long as the primary purpose of the tax is the protection of environment, it should qualify as an environmental tax. At the same time, an environmental tax may have incidental effects such as regulating trade and commerce. But, if the state is able to show that the dominant intent was to safeguard the environment and that the regulation of trade was not the dominating reason, then the measure should qualify as an environmental tax.⁸⁴⁷

Apart from levying taxes, states can also provide tax incentives for encouraging adoption of environment friendly business practices. For instance, by reducing or suspending taxation of solar energy producers.⁸⁴⁸ Here, the question may arise if the tax incentive is an environmental measure or a tax measure? It is difficult to say if tax incentives for

⁸⁴⁶ *Ibid*, at paras 242-246.

⁸⁴⁷ *Bogdanov* award, *supra* note 463 at para 192.

⁸⁴⁸ See *Charanne B.V.* award, *supra* note 690.

environmental friendly activities should be classified as tax measures or environmental measures. The exact classification may depend on the facts of the case and the nature of incentives offered. Nonetheless, even when distinguishing a tax incentive from an environmental measure, the purpose of tax incentives offers guidance to tribunals. If the purpose is to attract more foreign investment in the particular sector and environmental protection is only secondary, the measure may be understood as a taxation measure and vice-versa.

The implications of classifying a state's measure as an environment tax instead of a non-tax environmental measure is that: first, it becomes a tax-related investment dispute subject to procedural requirements of tax veto;⁸⁴⁹ second, it would ordinarily limit the state's substantive obligations due to tax carve outs;⁸⁵⁰ third, as mentioned above, tribunals would accord greater deference to state's measures at least in so far as expropriation is concerned;⁸⁵¹ Additionally, if a state's measure is understood as an environmental measure, it may fall under an exception under certain IIAs such as CETA (as long as it is not discriminatory). However, if it understood as a tax measure, it may not fall under the purview of exception. As this section showed, qualifying a state measure as a tax or as a non-tax measure has important implications for jurisdiction and the extent of deference to be accorded to the state's measure.

IV. RELIANCE ON WTO LAW RATHER THAN INTERNATIONAL TAX LAW IN TAX-RELATED INVESTMENT DISPUTES

In this Section, I suggest that in the arbitral awards on tax-related investment disputes, the concept of non-discrimination is almost always argued and adjudicated by reference to international trade law.⁸⁵² It is undeniable that the body of jurisprudence developed by WTO

⁸⁴⁹ See Chapter 2 above.

⁸⁵⁰ See Chapter 3 above.

⁸⁵¹ See Chapter 4 above.

⁸⁵² Arbitral tribunals interpreting the national treatment obligation in the NAFTA have routinely considered WTO jurisprudence in resolving whether a foreign investor has been accorded less favourable treatment than domestic investors in like circumstances. See, for example, *Corn Products* award, *Cargill, Inc* award, and *Archer Daniels* award, *supra* note 566; *S.D. Myers, Inc. v Government of Canada*, *supra* note 795, at paras 244-247 (the tribunal emphasised that the WTO national treatment obligation must be read in context); Also see *Pope & Talbot* award, *supra* note 834, at paras 45-72 (the arbitral tribunal analyzed WTO jurisprudence and rejected the respondent state's narrow definition of what constituted discriminatory treatment); *Occidental* award, *supra* note 211, at paras 173-177 (the arbitral tribunal compared the text of the national treatment provision in the BIT with the text of the national treatment provision in the WTO. The arbitral tribunal concluded that "like situations" were not the

Panels over the past few decades offers a rich repository of knowledge. When WTO adjudicating bodies address a claim of non-discrimination, they scrutinize whether trade measures discriminate between like products, like services or service suppliers.⁸⁵³ When an investor brings a claim of non-discrimination in investor-state arbitration, it usually involves identifying investors who are in like situations or like circumstances. Thus, it is understandable if tribunals refer to the concept of non-discrimination as understood and developed in international trade law. It certainly helps in illuminating the discussion in the context of IIL.⁸⁵⁴ However, the practice of relying exclusively only on international trade law in adjudicating tax-related investment disputes is not appropriate.⁸⁵⁵

I suggest that tribunals should engage with the non-discrimination standard as understood and developed in ITL. In my view, there is scope to improve tribunals' understanding of non-discriminatory taxation as applied in tax-related investment disputes - and ITL could play an important role in the improvement.⁸⁵⁶

A. Non-Discrimination in International Tax Law

The concept of non-discrimination is an integral part of almost every international tax treaty and the signatory states are required to adhere to it.⁸⁵⁷ Existing non-discrimination provisions in tax treaties encapsulate a capital import neutrality policy: the underlying objective is to ensure that in some economic areas, where an investment is made the state treats resident and non-resident investors similarly.⁸⁵⁸ The aim of the non-discrimination provision in tax

same as "like products"); Jurgen Kurtz, 'The Use and Abuse of WTO Law in Investor-State Arbitration: Competition and its Discontents' (2009) 20 *European J Int'l L* 749.

⁸⁵³ See William J. Davey, *Non-discrimination in the World Trade Organization: The Rules and Exceptions* (Hague Academy of International Law 2012); Nicolas F. Diebold, *Non-Discrimination in International Trade in Services 'Likeness' in WTO/GATS* (Cambridge University Press 2010).

⁸⁵⁴ There is an interaction with the international trade and international investment dispute proceedings which contributes to this disciplinary bias. See Joost Pauwelyn, *supra* note 319.

⁸⁵⁵ See Todd Weiler, 'The Significance of NAFTA Chapter 11 for the Development of International Economic Law' in Todd Weiler (ed.), *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Transnational Publishers 2004) 27 (where the author recommends that NAFTA tribunals should borrow from WTO jurisprudence).

⁸⁵⁶ See generally Kees Van Raad, *Non-Discrimination in International Tax Law* (Kluwer Law International 1986); Niels Bammens, *The Principle of Non-discrimination in International and European Tax Law* (IBFD 2012).

⁸⁵⁷ See, for instance, Art 26, UK-India tax treaty (1993).

⁸⁵⁸ See Art 24, OECD Model; Art 24, UN Model; Also see Hugh J. Ault, Jacques Sasseville, 'Taxation and Non-Discrimination: A Reconsideration' (2010) 22 *World Tax J* 101, at 102 (capital import neutrality ideally requires that all investments in a country bear the same marginal tax regardless of the residence of the investor); M. Bennett, 'Non-Discrimination in International Tax Law: A Concept in Search of a Principle' (2006) 59 *Tax L Rev* 439 (stating that the aim is to ensure that a state does not tax local enterprises owned by resident of another state more harshly than local enterprises owned by resident of the same state).

treaties is to protect taxpayers domiciled in another state and also to protect foreign capital in a state.⁸⁵⁹ Hugh Ault and Jacques Sasseville have observed that non-discrimination provisions of tax treaties cover a limited range of situations while IIAs include more general provisions prohibiting discriminatory treatment.⁸⁶⁰ The former seeks to eliminate discrimination in certain specific instances. For instance, it specifically mentions that there shall be no discrimination against stateless persons, permanent establishments and taxes on interest and royalties.⁸⁶¹

The OECD has further stated that the broader rules of non-discrimination that are found in other international conventions have little relevance for the interpretation and application of non-discrimination standard under ITL.⁸⁶² In turn, I suggest that the arbitral tribunals in tax-related investment disputes can rely on non-discrimination standard as developed in ITL. This would, for example, allow space to examine the existence of general principles of law in ITL; which in turn would lead to outcomes backed by better reasoning.

Tax treaties require states not to discriminate on the basis of nationality and residents who are ‘in the same circumstances’.⁸⁶³ The scope and meaning of ‘in the same circumstances’ in ITL can inform the analysis of tribunals in tax-related investment disputes. As discussed above in Section II, tribunals inconsistently identify ‘like situations’ in tax-related investment disputes. There is room for more coherence and certainty in the approach of arbitral tribunals and one of the contributions of the jurisprudence in ITL can be to contribute to a consistent approach of arbitral tribunals in tax-related investment disputes.⁸⁶⁴ However, on the contrary, one finds that the tribunals do not refer to ITL in their awards. This is an unfortunate trend. I discuss the lack of reference to ITL in the following paragraphs and suggest that it should be corrected.

⁸⁵⁹ *Ibid*, at 102; Kees Van Raad, *supra* note 856.

⁸⁶⁰ Hugh J. Ault, Jacques Sasseville, *supra* note 858, at 119; Also see Art 24, OECD Model Convention.

⁸⁶¹ See Article 24, OECD Model Convention.

⁸⁶² OECD, *Application and Interpretation of Article 24 (Non-Discrimination)*, Public Discussion Draft, 3 May 2007, at 4.

⁸⁶³ See Art 24(1) and Art 24(2), OECD Model Convention.

⁸⁶⁴ This is of course not to suggest that the entire jurisprudence in ITL on non-discrimination is helpful in tax-related investment disputes. To the extent nationality based discrimination and identifying like circumstances is relevant, it can be used by tribunals in tax-related investment disputes. For details on tax discrimination jurisprudence in ITL see Ruth Mason, Michael S. Knoll, ‘What is Tax Discrimination?’ (2012) 121 Yale L J 1014; Jose Manuel Calderon, Alberto Quintas, ‘The ECJ Jurisprudence on Statutes of Limitations in Tax Matters and the Discrimination at the Level of Legal Security’ (2012) 40 Intertax 254; Tom O’Shea, ‘Double Tax Conventions and the European Union’ (2010) 10 EC Tax J 72.

B. Lack of Reference to International Tax Law

In so far as non-discrimination is concerned, a major limitation in the awards of tax-related investment disputes is tribunals have thus far never referred to ITL in interpreting and applying the non-discrimination standard in tax-related investment disputes.

In *Occidental* award, the BIT provided for national treatment in ‘like situations’. The claimant argued that by denying it VAT refunds, the host state had breached its obligation of national treatment; this is because other companies involved in export of other products were receiving VAT refunds. The tribunal held that Ecuador was liable for violation of national treatment standard. The tribunal’s decision relied on two major elements: first, it rejected the narrow definition of ‘in like situations’ and held that it cannot be restricted to companies involved in the same sector of activity; secondly, and more crucially the tribunal observed that it did not consider the practice concerning ‘like products’ developed within the GATT/WTO particularly pertinent.⁸⁶⁵ The first element has been discussed above. The latter element was an instance of disciplinary bias. Even though the tribunal articulated the limited relevance of the GATT/WTO jurisprudence, the tribunal stopped short of stating if the tax jurisprudence or the concept of non-discrimination as understood under tax treaties and ITL is more pertinent in tax-related investment disputes. Since the purpose of national treatment is to ensure parity between foreign investors and local producers, the tribunal could have used this opportunity to consider if the non-discrimination standard as understood in ITL was relevant and perhaps necessary to be considered in tax-related investment disputes.

In the *Duke Energy* award, the tribunal held that regardless of the existence of the stability agreement or its interpretation, Peru had violated norms of international law. The tribunal managed to avoid referring to either IIL or ITL. With respect to the former, the tribunal avoided a discussion on the international minimum standard by calling it a ‘thorny issue’;⁸⁶⁶ thereby refusing to address the argument of the claimant that Peru had violated its obligation under international customary law. With respect to ITL - like most other tribunals, it did not refer to the existence or any general principles of ITL.⁸⁶⁷ Instead, in order to address the

⁸⁶⁵ See generally, N. DiMascio, Joost Pauwelyn, ‘Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?’ (2008) 102 Am J Int’l L 48 (comparing international trade and international investment jurisprudence on non-discrimination).

⁸⁶⁶ *Duke Energy* award, *supra* note 600, at para 280.

⁸⁶⁷ Also see *Corn Products* award, *supra* note 566, at para 109 (where the tribunal observed that the principle of non-discrimination is of fundamental importance both in international trade law and IIL, while completely ignoring ITL in a tax-related investment dispute).

liability of Peru for changing the interpretation of its tax laws, the tribunal turned to the principle of estoppel under international law.

The above discussion shows that tribunals in tax-related investment disputes have not even acknowledged that ITL can be of assistance or helpful in adjudicating tax-related investment disputes. The bias against ITL can be attributed to various factors - the lack of an institutionalised dispute settlement body and a consequent lack of jurisprudence (apart from one developed by domestic courts), the development of ITL as a largely self-sufficient discipline with minimal interaction with general international law and a perception that ITL is for and by specialists and occupies a limited and closed space. The onus is on both the claimants and the tribunals to broaden their arguments and reasoning. Incorporating ITL in tax-related investment disputes would indicate the willingness of tribunals to engage with other sub-disciplines other than international trade law; it would also allow for a more measured consideration of certain aspects like non-discrimination in ITL and their relevance to investor-state arbitration. This could influence outcomes of the disputes; whether it would be in a desirable way or otherwise would depend on the manner and extent to which tribunals engage with ITL.

While the entire body of jurisprudence on non-discrimination in ITL may not be of relevance in tax-related investment related disputes, the concept of non-discrimination as elaborated in the commentaries of the Model Conventions can be useful in understanding the non-discrimination standard in the context of taxation.⁸⁶⁸ For instance, Article 21(5)(b)(ii) of the ECT provides that if an issue pertains to the question that a tax constitutes an expropriation or whether a tax alleged to constitute an expropriation is discriminatory, it shall be referred to the competent authorities of the state and:

Where non-discrimination issues are concerned, the Competent Tax Authorities shall apply the non-discrimination provisions of the relevant tax convention or, if there is no non-discrimination provision in the relevant tax convention applicable to the tax or no such tax convention is in force between the Contracting Parties concerned, they shall apply the non-discrimination

⁸⁶⁸ See OECD Commentary, *supra* note 168.

principles under the Model Tax Convention on Income and Capital of the Organisation for Economic Co-operation and Development.⁸⁶⁹

Even though the provision is silent on the need to approach the competent authorities when violation of the FET standard or non-discrimination standard is alleged, it would be unusual for adjudicating bodies to be able to refer to ITL for expropriation claims but not where other standards are involved. Also, the ECT expressly provides that the competent authorities refer to the OECD Model. Outside the ECT, there is room for the argument that the tribunals can rely on either the UN or the OECD Model. Since the UN Model reflects the views of developing states, taking into account its provisions too would prevent allegations of bias in favour of the developed states.⁸⁷⁰ However, tribunals and the parties to the dispute have shown little inclination to engage with ITL.

The argument for a greater role for ITL can meet one objection - the limited ability of investor-state tribunals to navigate the maze of taxation law - both, international and domestic.⁸⁷¹ There are two counter arguments: first, the assumption is that tribunals require a lesser degree of competence or skill when dealing with environmental law, health law or even intellectual property law; second, the assumption that tax law is more complex than any of the other branches of law is an unwarranted generalisation. Merely because tax law has a certain internal logic of its own (like any other branch of law) does not mean that investor-state tribunals could not successfully interpret and apply it to the extent necessary for the resolution of tax-related investment disputes.

C. Taxation Assimilated to Other Measures

As elaborated in Chapter 4, the nature of tax as a compulsory levy and tax carve outs in IIAs contribute to the uniqueness of tax-related investment disputes. To briefly recall, for expropriation and the FET standard, some tribunals have endorsed taxation as a unique category. One of the important implications of recognising the uniqueness is that tribunals have set a high threshold for expropriation by taxation. In contrast, in addressing non-discrimination claims, tribunals have not recognised a high threshold for taxation measures.

⁸⁶⁹ There is no other IIA that expressly mentions that the competent authorities in exercise of their power shall rely on any of the Model Conventions. In this respect, the ECT is unique.

⁸⁷⁰ See generally Klaus Vogel, *supra* note 337; Also see Chapter 1 above.

⁸⁷¹ See William W. Park, 'Arbitrability and Tax' in Loukas A. Mistelis, Stavros L. Brekoulakis (eds.), *Arbitrability International and Comparative Perspectives* (Kluwer Law International 2009) 179.

As mentioned in Chapter 5, the inconsistent approach of tribunals reflects confusion as to whether they should treat tax-related investment disputes as a unique category of investment disputes. Alternately, if there are reasons as for prescribing a high threshold for expropriation by taxation and not for discriminatory taxation, the tribunals need to articulate these more clearly.⁸⁷² In my view, it is possible to suggest that expropriation demands a comparatively more exacting standard than non-discrimination. For example, if a particular investor is able to run his enterprise profitably even after the imposition of a tax, tribunals presumably have a good reason to not arrive at a finding of expropriation. At the same time, if the investor is able to show that even though his investment is profitable, it was unfairly targeted and other similarly situated investors were not subject to the tax liability - the tribunal could reasonably conclude that the state breached its obligation of non-discrimination.

Rationalising the differences between different kinds of substantive obligations, however, would still leave open the question - whether there should be a high threshold for tax measures as compared to non-tax measures under the non-discrimination standard? In my view, tribunals should require a higher threshold for non-discrimination in tax-related investment disputes than in investment disputes more generally.

However, the approach of tribunals to non-discrimination, thus far, does not reflect the above distinction. I suggest that adopting the above distinction could reflect the uniqueness of tax-related investment disputes.

V. CONCLUSION

The jurisprudence on discriminatory taxation in investor-state arbitration remains in flux. First, the scope of jurisdiction and the exact meaning and content of non-discriminatory taxation are unclear. I suggest that going forward, if states do not desire taxation measures to be subject to non-discrimination obligation, the best approach is to exclude the applicability of both - the FET standard and the non-discrimination obligation. If only the latter is excluded, in my view, tribunals have jurisdiction to examine non-discrimination as part of the FET standard.

⁸⁷² See Chapter 5 above for more detailed discussion on the implications that result from this inconsistent approach.

Second, tribunals could interpret ‘like situations’ and ‘like circumstances’ more consistently. At times, the like situation is interpreted widely while it is interpreted too narrowly in other awards. This has contributed to different articulations of what constitutes a discriminatory taxation. In my view, it is prudent to compare investors within the same industry unless there is a compelling reason to do otherwise.

One common element of the awards discussed in this chapter is their selective reliance on certain disciplines of international law. I point out that almost all the arbitral awards have relied only on the jurisprudence in international trade law to interpret the meaning of non-discrimination. While at one level this approach indicates a willingness to consider other sub-disciplines of international law, at another level only referring to international trade law while excluding ITL reflects a limitation in the approach of the tribunals. For example, tribunals have not considered the meaning of the term non-discrimination under ITL. This is even though certain IIAs like the ECT encourage tribunals to refer to tax treaties. At the same time, an appreciation of ITL would involve engagement with general principles of law; which, in my view, could inform tribunal’s understanding of the extent to which international law enables and a state’s authority to impose taxes.

CONCLUSIONS

In view of the above discussion, one plausible conclusion is that ITL has had and continues to have limited interaction with general international law. This can be attributed to several reasons - the lack of customary norms in ITL, the OECD's viewing of ITL as a self-contained discipline, lack of a centralised dispute settlement body, the nature of tax law itself which predominantly requires reliance on specific provisions. Additionally, it also needs to be mentioned that international lawyers have not paid adequate attention to ITL. Furthermore, as I discuss in Chapters 3-6, investor-state tribunals have also not meaningfully engaged with, relied on or otherwise referred to ITL while adjudicating tax-related investment disputes. Thus, from the days of the League - which laid the foundations of the ITL - ITL continues to evolve in relative isolation with minimal interaction with other sub-disciplines of international economic law.

One possible way of nudging for a greater interaction between ITL and general international law is by acknowledging the principles contained in tax treaties as general principles of law. I argue in Chapter 1 that the widespread presence of certain principles in tax treaties such as non-discrimination, suggests that some principles in tax treaties have acquired the nature of general principles of law. States could partially rely on these principles to bring counterclaims in tax-related investment disputes as suggested in Chapter 3. Investor-state tribunals, in turn, should examine the general principles of law in their reasoning while adjudicating tax-related investment disputes as suggested in Chapters 4, 5, and 6.

Additionally, a sweeping view of the jurisprudence on tax-related investment disputes reveals an uncertainty - an uncertainty if tax-related investment disputes really constitute a separate category in IIL. As discussed above, the requirement of tax veto, the presence of tax carve outs, the nature of tax which compulsorily reduces profits, sovereignty of states - all cumulatively do point towards acknowledgment of tax-related investment disputes as a separate category of investment disputes. Tribunals have been most forthright (though not unanimous) in acknowledging tax as a separate category when addressing arguments on expropriation. However, when addressing arguments on the FET standard, the tribunals have been ambiguous in their views of whether tax-related investment disputes constitute a separate category. In turn, in addressing arguments on non-discrimination there is little acknowledgment of the distinctiveness of tax-related investment disputes. These anomalies

need to be addressed to bring greater coherence to the jurisprudence on tax-related investment disputes.

Further, there is certainly room for reconsidering and reevaluating the role of states in international tax disputes. As I point out in Chapter 2, in both - tax treaties and IIAs - one sees that states play a more dominant role as compared to the taxpayers and investors respectively. While the nature of the MAP allows the states to marginalise the taxpayer in dispute resolution, the ability of a successful tax veto to prevent arbitration claims from proceeding further grants immense powers to states under IIAs. Combined with the almost opaque nature of both remedies, tax veto and the MAP have limitations that need to be addressed. I suggest that to adequately balance the role of taxpayer/investor and that of states, state-state arbitration should be considered as an alternative dispute resolution mechanism. I will be an improvement over the current state dominated and opaque dispute resolution mechanism - especially in tax treaties.

Finally, a look at the taxonomy of the arbitral awards in Annexure-1 would reveal that the frequency of tax-related investment disputes has increased in the past one decade. This could be due to several reasons such as states increasingly using tax laws and tax administration to regulate trade,⁸⁷³ and investment or investors increasingly realising the efficacy of investor-state arbitration. However, on examining the emerging jurisprudence on tax-related investment disputes in the thesis above, I would like to conclude by observing that: first, international tax dispute resolution - both under tax treaties and IIAs needs to be re-evaluated; second, the interface of ITL with other sub-disciplines of international law needs more attention - by tribunals, states, lawyers and scholars.⁸⁷⁴

⁸⁷³ See Yariv Brauner, 'International Trade and Tax Agreements May Be Coordinated, But Not Reconciled' (2005)

25 Virginia Tax Rev 251, at 253 (suggesting that due to globalization and increasing powers of free trade agreements, tax measures are one of the few remaining measures that states can use to serve their domestic interests or serve protectionist purposes).

⁸⁷⁴ See Julien Chaisse, 'International Investment Law and Taxation: From Coexistence to Cooperation' January 2016, ICTSD and World Economic Forum, at http://www.rieti.go.jp/en/events/16071201/pdf/10_am2-5_chaisse.pdf

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ANNEXURE 1: TAXONOMY OF ARBITRAL AWARDS IN TAX-RELATED INVESTMENT DISPUTES

AWARD (Year of Decision/ Settlement)	IIA	TAXATION MEASURE CHALLENGED	SUMMARY OF AWARD/ SETTLEMENT			VIEWS ON TAXATION AS A UNIQUE CATEGORY
			Expropriation	FET Standard	Non-Discrimination	
<u>Antoine Goetz v Republic of Burundi</u> (1999)	Belgium-Luxembourg Economic Union-Burundi BIT (1989)	Withdrawal of free zone certificate conferring tax and custom exemptions	The settlement provided for reimbursement of taxes and custom duties that the claimants paid after the withdrawal of the certificate. It also instructed the reinstatement of the certificate of free zone			Not addressed due to settlement
<u>Archer Daniels v Mexico</u> (2007); <u>Cargill v Mexico</u> (2009); <u>Corn Products v Mexico</u> (2008)	NAFTA	Imposition of 20% excise tax on soft drinks that used a sweetener other than cane sugar	No expropriation since the degree of interference was not substantial	The import permit requirement ²⁴³ specifically targeted	The claimant received less favourable treatment - in intent and effect - and there was a	Not addressed by the tribunals

			and the investor remained in physical control of the investment	the claimant. It was unjust, in bad faith and violated the FET standard	violation of the national treatment obligation	
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<p><i><u>Bogdanov v Republic of Moldova</u></i> (2010)</p>	<p>Russian Federation - Moldova BIT (1998)</p>	<p>Environmental Charge</p>	<p>-</p>	<p>The charge did not result in denial of legitimate expectations and did not violate the FET standard</p>	<p>The charge applied equally to all residents of economic zones and did not discriminate</p>	<p>Not addressed by the tribunal</p>
<p><i><u>Burlington v Ecuador</u></i> (2012)</p>	<p>US-Ecuador BIT (1993)</p>	<p>Imposition of Windfall Profits Tax with a tax rate of</p>	<p>The act of taxing physical</p>	<p>- 245</p>	<p>-</p>	<p>Not addressed by the tribunal</p>

		50% eventually increased to 99%	possession of oil blocks without waiting for the prescribed statutory period was an expropriation		
<i><u>Duke Energy v Peru</u></i> (2008)	DEI Bermuda - Peru Legal Stability Agreement	Tax assessment in violation of the tax stabilisation clause	By applying the principle of estoppel, Peru was stopped from changing the interpretation of its tax laws because its prior representations had induced reliance by third parties including the Claimant	Not addressed by the tribunal	

<p><i><u>El Paso v Argentina</u></i> (2011)</p>	<p>US - Argentina BIT (1991)</p>	<p>Withholding taxes only on energy companies</p>	<p>Tax measures do not amount to indirect expropriation as they are reasonable and did not neutralise</p>	<p>-</p>	<p>Neither de jure nor de facto discrimination</p>	<p>Tax carve outs grant an important margin of freedom to the host state and only create a 'best-effort' obligation for the state</p>
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			property rights of the claimant			
<u>EnCana v Ecuador</u> (2006)	Canada - Ecuador BIT (1997)	Retrospective denial of VAT refunds	No expropriation since the denial of VAT refunds did not deny the claimant - in whole or significant part - benefits of its investment	-	-	From the perspective of expropriation, taxation is in a special category
<u>Jan Oostergetel v Slovak Republic</u> (2012)	Netherlands-Slovak Republic BIT (1991)	Initiation of bankruptcy proceedings by tax authorities to collect tax dues	No breach of any of the obligations under the IIA		248	Not addressed by the tribunal

<u>Link</u> <u>Tradin</u> <u>g_v</u> <u>Moldo</u> <u>va</u>	US - Mold ova BIT (199 4)	Change in cust om duti es	No exprop riation since there is	-	The cha nge s we re applic able	Not addres sed by the tribuna l
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(2002)			no proof that the measure deprived the investor of its investment		generally and claimant was treated no less favourably	
<i>Mamidoil v Albania</i> (2015)	Greece - Albania BIT (1991)	Import taxes on petroleum products	No expropriation since the claimant remained entitled to use, possess, control and dispose the property	No violation of the FET standard. The legal framework was stable 250 no legitimate expectations were denied	There was rational differentiation which did not amount to discrimination	Not addressed by the tribunal

<p><i>Marvin Feldman v Mexico</i> (2002)</p>	<p>NAFTA</p>	<p>Denial of tax rebates to cigarette exporters</p>	<p>No expropriation since the investment was at all times under</p>	<p>-</p>	<p>Evidence of de facto discrimination which has nexus with the</p>	<p>'[T]ax law and policy changes are intended to be given relatively broad leeway under NAFTA, even</p>
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			the comple te control of the investo r		clai man t's stat us as a forei gn inve stor	if their effect is to make impractical for certain business activities to continue.' (para 116).
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<p><u>Micula v Romania</u> (2013)</p>	<p>Sweden - Romania BIT (2002)</p>	<p>Withdrawal of tax incentives</p>	<p>-</p>	<p>Unreasonable for the host state to insist the investor's maintain their investments even after withdrawal of tax incentives. A violation of the FET standard</p>	<p>-</p>	<p>Not addressed by the tribunal</p>
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<p><u>Murphy v Ecuador</u> (2016)</p>	<p>US - Ecuador BIT (1993)</p>	<p>Imposition of Windfall Profit Tax</p>	<p>-</p>	<p>The wind fall profit tax violated the investor's legitimate expectations as it changed the very nature of the contract between 254 the investor and the host state</p>	<p>-</p>	<p>Not addressed by the tribunal</p>
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<u>Occidental v Ecuador</u> (2004)	US - Ecuador BIT (1993)	Retrospective denial of VAT refunds	No expropriation as there was no	Legal framework was changed in	Claimant received less favourable treatment	Not addressed by the tribunal
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			depriva tion of the use or reason ably expect ed econo mic benefit of the invest ment	an impor tant mann er witho ut provi ding clarit y result ing in violat ion of the FET stand ard	than accord ed to nationa l compa nies and there was violatio n of the obligati on of non- discrim inatio n	
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<u>Occidental (II) v Ecuador (2012)</u>	US - Ecuador BIT (1993)	Imposition of Windfall Profits Tax and issuance of caducidad decree	Taking claimant's investment by means of an administrative sanction was a measure tantamount to expropriation	Caducidad decree was a disproportionate administrative response to alleged wrongdoing by claimant was violated	-	Not addressed by the tribunal
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				the FET standard		
<i>Perenco v Ecuador (2014)</i>	France - Ecuador BIT (1994)	Imposition of Windfall Profits Tax with a tax rate of 50% eventually increased to 99%	Intervention to operate oil blocks after suspension of operations by claimant constituted expropriation	Windfall profit tax at 99% was disproportionate to state objective and is a violation of the FET standard	-	Not addressed by the tribunal

<p><u>Señor Tza Yap Shum v Peru</u> (2011)</p>	<p>China - Peru BIT (1994)</p>	<p>Imposition of back taxes and fines after a tax audit</p>	<p>The interim measures of the state were arbitrary, taken on basis of insufficient legal and factual</p>	<p>-</p>	<p>-</p>	<p>The tribunal noted that the state is not liable for any losses resulting from the good faith application of tax laws and regulations. This deference, the tribunal added, is</p>
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			justification and constituted an indirect expropriation of the investment			reflected in public international law
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<p><u>Sergei Paushok v Mongolia</u> (2011)</p>	<p>Russian Federation - Mongolia BIT (1995)</p>	<p>Imposition of Windfall Profits Tax</p>	<p>No expropriation as the investor was able to keep its enterprise afloat either by taking steps to reduce the impact of the tax or because of past profits</p>	<p>The tax did not alter stability of legal framework or violate specific expectations and there by did not violate the FET standard</p>	<p>The tax burden imposed on claimants was no different than other gold producers and there was no discrimination</p>	<p>Tribunal endorsed the argument that in area of taxation states jealously guard their sovereignty and enjoy a wide discretion to enact tax laws</p>
<p><u>Toto v Lebanon</u></p>	<p>Italy - Lebanon</p>	<p>Change in custom</p>	<p>No violation of any of its obligations under</p>		<p>Not addressed by</p>	

<u>(2012)</u>	BIT (1997)	duties	the IIA			the tribunal
<u>Yukos</u> <u>Awar</u> <u>ds</u> (2010 -2014)	ECT; Spain - Russian Federat ion BIT (1990); UK - Russian Federat ion BIT (1989)	Discriminat ory and retrospectiv e tax assessment; seizure and auctioning of assets due to non- payment of taxes	All actions - interpr etatio n of tax laws, arbitrar y tax assess ments, auction s of assets - cumula tively constit ute exprop riation	-	-	The tribunal observed that states have a considerabl e margin of discretion in enacting and enforcing tax laws, but it does not mean that they are not obliged to comply with an internation al treaty (<i>Valores</i> Award) The tribunal noted that states have a considerabl e latitude in imposing and

						enforcing their taxation laws even if it results in substantial deprivation without compensation <i>(RosInvest Award)</i>
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