BETWEEN THE SCYLLA AND CHARYBDIS: TAX CARVE-OUTS AND TRIBUNAL JURISPRUDENCE

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Abstract

Can tribunals overlook a tax carve-out? Succinctly put, the answer is in the affirmative. However, in light of how sparingly, tribunals have done so, there is room for discussion on this view. When interpreting carve-outs, the tribunal is often faced with a predicament. Despite a carve-out exclusion, if a tribunal were to rule on the claims, it may overstep its competence. On the other hand, the reluctance of the tribunal to hold the State accountable for usurping the investors' properties by taxes maybe an abdication of justice. This article, in light of this predicament, deliberates on three questions—tribunals' interpretation of carve-outs, the effectiveness of such carve-outs and finally, those instances when a tribunal would likely overlook a carve-out.

I. Introduction

The imagery of tax as a powerful instrument of State policy and a symbol of sovereignty is a universally recognised dictum. However, with the advent of Bilateral Investment Treaties ["**BITs**"] and the provision to resort to investor-State arbitrations, powerful nations have been held accountable for their abusive use of sovereign powers. The practice, although invidious to some nations, in recent years, has been extended to matters of fiscal measures. It is no secret that through their renunciations, treaty limitations and denials to enforce awards, States have sought to reduce the oversight of international law into their sovereign matters.

A growing practice suggests that States resort to tax exclusions in treaties to leave out matters of tax from the protections afforded to investors by the treaty. This includes the latter's right to arbitration.[1]

No doubt the sovereign may contract and negotiate as they may wish, however, these exclusions present an interesting problem. On the one hand, should a State usurp properties by tax, an indignant investor would be left without remedies if the treaty prohibits such tax-based claims (the *Scylla*). On the other hand, if a tribunal were to rule on such issues, it may overstep its competence (the *Charybdis*). To prevent such injustice, a tribunal must, within its competence, navigate between this Scylla and Charybdis when interpreting tax exclusions.

In light of the above predicament, this article examines three questions. *First*, how do tribunals interpret specific exclusions? *Second*, are tax exclusions effective? *Third*, can tribunals overlook the tax exclusion? Accordingly, our study is divided into four parts. Part II elaborates the tax disputes of the last century, the differential treatment of tax and the methods used to regulate the competence of the tribunal in matters of tax. Part III then examines the primary questions of our study before concluding in Part IV.

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[1] In making this assertion, the author relies on the State practice of including tax exclusions in treaties dating nearly half a century ago, which continues to this day. As would be discussed later, such exclusions have evolved to comprise more subject matters and consequently limit the tribunal's competence in tax matters.

II. The Preliminaries on Tax Carve-Outs

Before proceeding to the deliberation of the three questions, it would be necessary to first comprehend and examine the background surrounding tax carve-outs.

A. Tax Disputes of the last Century

A century ago, the notion that absent a treaty or an agreement, payment to foreign aliens for sovereign takings was arguably, an anachronistic opinion.[2] The early twentieth-century views are appropriately summarised by Sir Williams:

> "*[…] where no treaty or other contractual or quasi-contractual obligation exists by which a state is bound in its relations to foreign owners of property, no general principle of international law compels it not to expropriate except on terms of paying full or "adequate" compensation.*"[3]

It is in this backdrop that the early tax disputes were adjudicated. It is not our purpose that we pinpoint the exact date when these archaic notions lost their support. Its mention here is to enlighten readers that tax disputes were adjudicated by international bodies even when the modern-day notions on confiscatory takings, were in their infancy. Naturally, our analysis is not an exhaustive examination of all the tax disputes from that era but only those that fit our purpose.

In the *Brewer, Moller & Co.* case, the Claimants sought a refund of taxes paid to the municipality of San Cristobal on irregular assessments.[4] The Umpire denied the claims reasoning that the presumption of regularity and validity of all acts of public officials would apply and also suggested that the actions of the municipal district could not be attributed to the Republic of Venezuela. However, the Umpire did note that the claims would have a better chance if they could prove that such tax levied was due to their nationality and hence discriminatory.

In the same year, in the *Santa Clara Estates* case, the umpire ordered the return of those taxes exacted by the Government for the period when the municipal district was under the control of revolutionaries; outside the sovereignty of the government.[5] Two years later, a Tribunal in an inter-State dispute between Japan on one side and Britain, France, and Germany on the other, deduced that a certain treaty provision grants exemption from tax payments, not only to land, but also to the buildings on such properties. Japan had contended otherwise.[6]

In the *George W. Cook* v. *United Mexican States*, the Claimant sought to recover a sum, "*illegally*" collected by the municipal authority.[7] Illegal because the tax levied was on his property, which he constructed on the promise that the Governor shall recommend for its exemption from any real estate tax. The General Claims Commission disallowed the claim; one of its reasons being that the specific tax levied did not fall within the exemption.

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2 Although this notion was unpopular it was not non-existent. Commentators on this subject have as back as 1925, have noted that there may arise such an obligation under international law. *See* Alexander P. Fachiri, *International Law and the Property of Aliens*, 10 BRIT. YEAR BK. INT'L L. 32, 33 (1929) [*hereinafter* "Fachiri"].

3 John Fischer Williams, *International Law and the Property of Aliens*, 9 BRIT. YEAR BK. INT'L L. 1, 28 (1928).

4 Brewer, Moller & Co. Case (first), 10 R.I.A.A. 423 (1903).

5 Santa Clara Estates Case, 9 R.I.A.A. 455, 459 (1903).

6 Japanese House Tax (Ger., Fran. and Brit. v. Japan), PCA Case No. 1902-02, Award, at 5 (Perm. Ct. Arb. May 22, 1905).

7 George W. Cook v. United Mexican States, 4 R.I.A.A. 593 (Mex.-U.S. General Cl. Comm'n, 1930).

Much later, in the claims of *John Lusdyk*, the Foreign Claims Commission considered the claimant's property to be nationalized by a law which "*compelled owners of buildings with a gross rental income of more than 15,000 Czech crowns or more to deposit a certain portion of the rent in special account*."[8] It observed that despite the owners remaining owners on record, they lost control over their property. Another tribunal noted that the State shall not be responsible for loss of property resulting from "*bona fide general taxation*" and other police powers absent discrimination or expropriation.[9]

It may be questionable as to why claimants, today, face the prospect of tax exclusions, but a century ago, such claims were brought with considerable ease before international bodies. Most likely, early tax disputes were brought under agreements between States, which were worded broadly enough to encompass all kinds of liabilities and claims that may be incurred by the nationals of the contracting States. Tax exclusions only appeared in international investment agreements after the late 1960s.[10]

These decisions from the last century demonstrate that it would be a misnomer to think the subject-matter of tax was never assailable to the interventions by international bodies. The above claims demonstrate that recourse to international forums in matters of tax was prevalent from the start of the last century. Although there were questionable deliberations, tribunals did not hesitate to hold States liable for abuses of tax powers as demonstrated in *Santa Clara* and *Lusdyk*.

B. How are taxes excluded from Treaties?

Permutations of carve-outs, vetoes and claw-backs are devices used by contracting States to regulate the competence of a tribunal when deciding matters relating to tax. A tax carve-out is a clause that exempts the protections of the treaty from tax. Simultaneously, it also limits the ability of an investor to bring tax claims under the treaty.[11] A wide carve-out such as in the India-UAE treaty excludes all taxation measures from the review of the tribunal.[12] Tax vetoes are clauses that empower fiscal authorities of the host State and home State of the investor to substantiate the validity of the tax-based claim.[13] The function of such authorities is to make "*a preliminary cut between normal and abnormal taxes*."[14] For instance, the Benin-Canada BIT stipulates that investors must bring their tax claims first to the taxation authorities, before advancing to arbitration.[15] Hence, vetoes provide insulation against frivolous claims by investors. Claw-backs are exceptions to the exclusions; they claw-back the protections of the treaty which were carved out. Article 21(5)(a) of the Energy Charter Treaty ["**ECT**"] is one such specimen of a claw-back; Article 21(1) carves out all taxation measures, but Article 21(5)(a) allows the investor protection from expropriation.[16]

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8 Claim of John Lusdyk, Claim No. CZ-2517, at 3–4 (Foreign Cl. Settlement Comm'n, 1961) [*hereinafter* "Lusdyk"]; *see also* G. C. Christie, *What Constitutes a Taking of Property under International Law*, 38 BRIT. YEAR BK. INT'L L. 307 (1962).

9 Too v. Greater Modesto Insurance Associates, 23 IRAN-U.S. CL. TRIB. REP. 26 (1989).

10 Matthew Davie, *Taxation-Based Investment Treaty Claims*, 8 J. INT'L DISP. SETTLEMENT 202, 212 (2015) [*hereinafter* "Davie"].

11 *Id.*

12 Agreement between the Government of the Republic of India and the Government of the United Arab Emirates on the Promotion and Protection of Investments, India-U.A.E., art. 2, Dec. 12, 2013.

13 William W. Park, *Arbitration and the Fisc: NAFTA's "Tax Veto"*, 2 CHIC. J. INT'L L. 231, 236 (2001) [*hereinafter* "Park"].

14 *Id.* at 237.

15 Agreement between the Government of Canada and the Government of the Republic of Benin for the Promotion and Reciprocal Protection of Investments, Can.-Benin, art. 17, Jan. 09, 2013.

16 Energy Charter Treaty, art. 21, Dec. 17, 1994, 2080 U.N.T.S. 100 [*hereinafter* "Energy Charter Treaty"].

Commentators have classified taxes into multiple groups based on permutations and combinations of these devices. One author identifies seven such groups;[17] another classifies them into five groups.[18] We need not go into such modalities for our study. In short, these practices demonstrate that States widely write into their treaties, a carve-out to "*jealously*" protect their fiscal powers.

C. Why is tax treated differently?

In modern-day treaties, the subject-matter of taxation receives arguably some form of preferential treatment. Treaties frequently provide elaborate schemes on the treatment of tax. For instance, some treaties despite stipulating a cooling-off period for arbitration, further mandate that the investor should first submit the tax claim before the competent authorities before commencing arbitration.[19] In another instance, although preferential treatment between foreign aliens would likely violate treaty obligations, some treaties allow contracting States to afford preferential treatment to foreign aliens through double taxation treaties.[20] Some BITs have detailed provisions, applicable if an expropriation by tax is alleged.[21]

As to why tax is looked at differently eludes a satisfactory answer. The common justification is that matters of tax are an integral component of the sovereignty of the State; fiscal sovereignty. As one author notes, States include tax exclusions to avoid any restrains to their tax powers.[22] However, this argument fails to throw light on why the State would subject other parts of its sovereignty to scrutiny but not the power to tax. Perhaps States view their power to tax as paramount to their existence, since taxation provides the "*necessary means to carry out their governmental functions.*"[23]

Other authors opine a different reason. Professor Park notes that the very nature of taxation allows the State to regulate foreign investments.[24] As Professor Wälde elaborates on this point, the "*squeezing*" of foreign investors by taxation appears to be less obvious in contrast to other methods of taking, owing to the "*inherent complexity of such fiscal measures.*"[25] Although taxation shares a

17 Julien Chaisse, *Investor-State Arbitration in International Tax Dispute Resolution - A Cut above Dedicated Tax Dispute Resolution?*, 35 VA. L. REV. 149 (2016).

18 Davie, *supra* note 10.

19 *See* Agreement between Australia and the Oriental Republic of Uruguay on the Promotion and Protection of Investments, Austl.-Uru., Apr. 5, 2019. Despite providing for a six-month duration to resolve all disputes through consultation and negotiation, the treaty also separately provides taxation measures shall be submitted to the authorities before proceeding to arbitration.

20 Thomas Wälde & Abba Kolo, *Investor-State Disputes: The Interface Between Treaty-Based International Investment Protection and Fiscal Sovereignty*, 35 INTERTAX 424, 432–434 (2007) [*hereinafter* "Wälde & Kolo"]; *see* Agreement between the Government of the United Kingdom of great Britain and Northern Ireland and the Government of the United Mexican States for the Promotion and Reciprocal Protection of Investment, U.K.-Mex, art. 5, May 12, 2006. Article 5 disallows the application of the National Treatment and Most Favoured Clause to "any agreement or arrangement relating wholly or mainly to taxation or any domestic legislation relating wholly to mainly to taxation."

21 *See* Agreement between the Government of the Republic of Singapore and the Government of the Republic of Rwanda on the promotion and Protection of Investments, Rwanda-Sing., art. 29, June 14, 2018.

22 Davie, *supra* note 10.

23 Stadtwerke Munchen GmbH v. The Kingdom of Spain, ICSID Case No. ARB/15/1, Award, ¶ 169 (Dec. 2, 2019) [*hereinafter* "Stadtwerke"].

24 Park, *supra* note 13.

25 Wälde & Kolo, *supra* note 20.

resemblance to expropriation, general taxation does not constitute expropriation. This very nature of taxation makes challenging taxation measures an "*uphill battle*" for most claimants.[26]

Commenting on the incorporation of tax vetoes in treaties, one author points out that vetoes perform a political function rather than legal—the contracting States can "*off-set*" one tax claim as against a political favour.[27] With regard to the preferential treatment negotiated by taxation agreements, although discriminatory taxes are illegal, no tribunal has condemned preferential treatment afforded by these agreements to violate the law.[28]

Thus, it is submitted that it is highly unlikely, in the distant future, for any tribunal to hold States accountable for these practices, or for States to abandon these practices.

III. The Three Questions

In this part, we shall discuss the three questions posed earlier. Each of the questions is discussed under Part III.A, Part III.B and Part III.C with sub-themes that follow under each.

A. Tribunal Jurisprudence

There is no consensus on the total number of tax-based claims presented before international tribunals. However, out of the known number of claims, tribunals have extensively deliberated on the scope and limitations of the various carve-outs. We shall examine, in this Part, how tribunals have construed and applied tax exclusions in tax-related disputes.

i. What is tax?

In light of our study on carve-outs, the distinction between fiscal measures as tax or otherwise assumes significance since a State can only avail protections of the carve-out if the alleged measure is a tax under the treaty. Conversely, the claimant can only bring claims if it does not qualify as tax to the extent exempted by the treaty. Treaties seldom define what taxes, taxation measures, and taxation policies are. This leaves the Tribunal with ample authority to define the term. In the laconic sense, tribunal jurisprudence suggests that taxes include customs duties,[29] levies,[30] and export withholdings,[31] amongst other fiscal measures. However, these definitions are contingent on the treaty and other instruments. For instance, although the *Duke Energy* Tribunal held customs duties to be tax, the ECT, however, excludes customs duties from the definition of tax.[32]

The *Encana* Tribunal defines a taxation law as a law that imposes liability on a defined class of persons to pay to the State for public purposes.[33] This definition has been relied on by other

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26 Abba Kolo, *Tax Veto as a Special Jurisdictional and Substantive Issue in Investor-State Arbitration: Need for Reassessment*, 32 SUFFOLK TRANSNAT'L L. REV. 475–492, 491 (2009) [*hereinafter* "Kolo"].

27 Ilias Bantekas, *Interstate arbitration in international tax disputes*, 8 J. INT'L DISP. SETTLEMENT 507, 525 (2017).

28 For an elaborate discussion on this point, *see* discussion *infra* Part III A.iii.

29 Link-Trading Joint Stock Co. v. The Republic of Moldova, UNCITRAL, Award on Jurisdiction, at 9 (Feb. 6, 2001) [*hereinafter* "Link-Trading"]; Duke Energy Electroquil Partners & Electroquil S.A. v. The Republic of Ecuador, ICSID Case No. ARB/04/19, Award, ¶ 177–179 (Aug. 18, 2008) [*hereinafter* "Duke Energy"].

30 Stadtwerke, ICSID Case No. ARB/15/1, Award, ¶ 171 (Dec. 2, 2019).

31 El Paso Energy International Co. v. The Argentine Republic, ICSID Case No. ARB/03/15, Decision on Jurisdiction, ¶ 112 (Apr. 27, 2006) [*hereinafter* "El Paso"]; Pan American Energy LLC & BP Argentina Exploration Co. v. The Argentine Republic, ICSID Case No. ARB/04/13, Decision on Preliminary Objections, ¶ 136 (July 27, 2006) [*hereinafter* "Pan Energy"].

32 Energy Charter Treaty, art. 21(7)(d).

33 EnCana Corporation v. The Republic of Ecuador, LCIA Case No. UN3481, Award, ¶ 142 (Feb. 3, 2006) [*hereinafter* "EnCana"].

tribunals in *Burlington Resources Inc.* v. *The Republic of Ecuador* [“**Burlington**”],[34] *Duke Energy Electroquil Partners & Electroquil S.A.* v. *The Republic of Ecuador* [“**Duke Energy**”],[35] *9REN Holdings Holdings S.A.R.L.* v. *Kingdom of Spain*,[36] *Stadtwerke Munchen GmbH* v. *The Kingdom of Spain* [“**Stadtwerke**”],[37] *Cube Infrastructure Fund SICAV* v. *The Kingdom of Spain* [“**Cube Infrastructure**”],[38] and *Foresight Luxembourg Solar* v. *The Kingdom of Spain*.[39] However, later tribunals have also observed that not every mandatory payment made by a class of persons to the State for public purposes without direct benefit is necessarily a tax.[40] For instance, fines may share a likeness with taxes, however, they cannot qualify for the protection of the carve-out.[41] Neither do fees to obtain licenses, permits, or authorizations.[42]

Hence to further distinguish such unilateral payments, tribunals also rely on other factors, such as the characterisation of the tax in domestic law[43] or its legal operation.[44] In *Antaris Solar GmbH* v. *The Czech Republic* claims, the Tribunal declined to afford the exemptions of the tax carve-out to the solar “*levy*” of the Czech government on finding that the Administrative Court of the State had not characterised the measure as a tax despite the State contending so before the Tribunal.[45] The Nissan Tribunal performs an inquiry into the domestic characterisation using the “*who,*” “*what*” and “*why*” approach.[46] The “*who*” determines which entities are empowered to perform tax functions under the domestic law and whether their conduct forms part of the investor’s claims, the “*what*” determines the qualitative nature—whether such a tax is “*customarily*” used in the State, and the “*why*” examines the purpose of the tax. On the other hand, the economic effect of the tax gains is only gauged to identify the propriety of the tax.[47]

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34 Burlington Resources Inc. v. The Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Jurisdiction, ¶ 166 (June 2, 2010) [*hereinafter* “Burlington”].

35 Duke Energy, ICSID Case No. ARB/04/19, Award, ¶ 174 (Aug. 18, 2008).

36 9REN Holdings S.A.R.L. v. Kingdom of Spain, ICSID Case No. ARB/15/15, Award, ¶¶ 198–202 (May 31, 2019) [*hereinafter* “9REN”].

37 Stadtwerke, ICSID Case No. ARB/15/1, Award, ¶ 166 (Dec. 2, 2019).

38 Cube Infrastructure Fund SICAV v. The Kingdom of Spain, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum, ¶¶ 230–231 (Feb. 19, 2019) [*hereinafter* “Cube”].

39 Foresight Luxembourg Solar v. The Kingdom of Spain, SCC Case No. 2015/150, Final Award, ¶¶ 255–256 (Nov. 14, 2018).

40 Murphy Exploration & Production Company – International v. The Republic of Ecuador, UNCITRAL, Partial Final Award, ¶ 191 (May 6, 2016) [*hereinafter* “Murphy”]; Nissan Motor Co. Ltd. v. The Republic of India, PCA Case No. 2017-37, Decision on Jurisdiction, ¶ 385 (Perm. Ct. Arb. Apr. 29, 2019) [*hereinafter* “Nissan”].

41 Nissan, PCA Case No. 2017-37, Decision on Jurisdiction, ¶ 385 (Perm. Ct. Arb. Apr. 29, 2019).

42 *Id.* ¶ 385.

43 Murphy, Partial Final Award, ¶ 185 (May 6, 2016).

44 EnCana, LCIA Case No. UN3481, Award, ¶ 142 (Feb. 3, 2006).

45 Antaris GmbH v. The Czech Republic, PCA Case No. 2014-01, Award, ¶ 233 (Perm. Ct. Arb. May 2, 2018) [*hereinafter* “Antaris”].

46 Nissan, PCA Case No. 2017-37, Decision on Jurisdiction, ¶ 386 (Perm. Ct. Arb. Apr. 29, 2019).

47 Burlington, ICSID Case No. ARB/08/5, Decision on Liability, ¶¶ 395, 397 (Dec. 14, 2012).

The broadest definitions of taxation would include the levy of tax,[48] assessment[49] and collection of taxes,[50] measures providing relief from the tax,[51] and decisions taken by tax authorities or courts.[52]

ii. *Whether the standard of treatment obligation within the exclusion is enforceable before the Tribunal?*

Tax exclusions in most BITs signed by the United States before the 2000s provided that:

> "*[…] [E]ach Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.*"[53] ["**Clause**"]

Although the U.S. seems to have changed its approach, treaties with this exclusion remain in force and hence the relevance of this discussion.[54] Whether the above Clause imposes any duty on the Contracting Parties, so that the violation of such duty is a breach of the BIT, has been a matter of debate among the various tribunals. The *Enron Corporation* v. *The Republic of Argentine* ["**Enron**"] and *Occidental Exploration* v. *The Republic of Ecuador* ["**Occidental**"] Tribunals answer this question in the positive. In *Enron*, the Tribunal notes that to "*strive to accord fairness and equity*" is not a meaningless reference.[55] The *Occidental* Tribunal opines that the obligation imposed is a less mandatory duty, although similar, to the original Fair and Equitable Treatment ["**FET**"] obligation contained in the BIT elsewhere.[56] The Tribunal was of the view that the Clause opens up the standards of treatment if the alleged expropriation is proved.[57] In a similar vein, the *Enron* Tribunal further opines that the Clause attains its significance when expropriation is invoked since "*questions of transparency and the availability of effective remedies*" must be analysed in this context.[58] Similarly, the Tribunal in *Pan American Energy LLC & BP Argentina Exploration Co.* v. *The Argentine Republic* observed that the Clause attains significance in light of the expropriation claims, if proved.[59]

On the other hand, the Tribunal in *El Paso Energy Int'l Co.* v. *The Argentine Republic* ["**El Paso**"] thinks that the Clause "*creates only [a] best-effort obligation*" since any possibility of review is limited by the Treaty.[60] However, the Tribunal does observe that the obligation is not "*no law*" but affirms that its competence over tax matters is as per the limited grounds as under the Treaty.[61] The

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48 Vincent J. Ryan, Schooner Capital LLC and Atlantic Investment Partners LLC v. Republic of Poland, ICSID Case No. ARB (AF)/11/13, Award, ¶ 284 (Nov. 24, 2015) [*hereinafter* "Ryan"]; EnCana, LCIA Case No. UN3481, Award, ¶ 142 (Feb. 3, 2006).

49 Ryan, ICSID Case No. ARB (AF)/11/13, Award, ¶ 284 (Nov. 24, 2015); Enron Corporation and Ponderosa Assets L.P. v. The Republic of Argentine, ICSID Case No. ARB/01/03, Decision on Jurisdiction, ¶ 67 (Jan.14, 2004) [*hereinafter* "Enron"].

50 Ryan, ICSID Case No. ARB (AF)/11/13, Award, ¶ 284 (Nov. 24, 2015).

51 EnCana, LCIA Case No. UN3481, Award, ¶ 142 (Feb. 3, 2006).

52 Spyridon Roussalis v. Romania, ICSID Case No. ARB/06/1, Award, ¶ 493 (Dec. 7, 2011) [*hereinafter* "Spyridon"].

53 Treaty between the united states of America and the Republic of Moldova concerning the Encouragement and Reciprocal Protection of Investment, Mold.-U.S., art. 10, Apr. 21, 1993.

54 A perusal of the United States BITs, starting from the Model BIT 1984 demonstrates the use of language to ensure fairness in tax policies—"With respect to its tax policies, each Party should strive to accord fairness and equity […]." Such a "duty" fails to find mention in BITs concluded after 1998. Seemingly, the U.S. has abandoned such an interpretation as reflected in its Model BIT 2004.

55 Enron, ICSID Case No. ARB/01/03, Decision on Jurisdiction, ¶ 65 (Jan.14, 2004).

56 Occidental Exploration and Production Company v. The Republic of Ecuador, LCIA Case No. UN 3467, Final Award, ¶ 70 (July 1, 2004) [*hereinafter* "Occidental"].

57 *Id.* ¶ 75.

58 Enron, ICSID Case No. ARB/01/03, Decision on Jurisdiction, ¶ 66 (Jan.14, 2004).

59 Pan Energy, ICSID Case No. ARB/04/13, Decision on Preliminary Objections, ¶¶ 132–136 (July 27, 2006).

60 El Paso, ICISD Case No. ARB/03/15, Award, ¶ 291 (Oct. 31, 2011).

61 El Paso, ICSID Case No. ARB/03/15, Decision on Jurisdiction, ¶ 110 (Apr. 27, 2006).

Tribunal further opines that a violation of a stabilisation clause is a matter of FET standard, not expropriation (unless the tax is "*totally confiscatory*").[62] In this context, even if there is a violation of the FET standards due to the excessiveness of the tax or a breach of a contractual obligation, the tribunal shall have no jurisdiction.[63]

Almost a decade later in *Vincent J. Ryan, Schooner Capital LLC, and Atlantic Investment Partners, LLC* v. *Republic of Poland*, the Tribunal carried an extensive discussion on this subject. The Tribunal declined to entertain the idea that if an investor succeeds to demonstrate an expropriation, "*it opens the gate*" to all other claims including those excluded by the Treaty.[64] The Tribunal reasoned that such an interpretation would likely deviate from the intention of the contracting parties and render the carve-out meaningless.[65] Perhaps, sharply contrasting with the interpretation by the *Enron* and *Occidental* Awards, the Tribunal here dismisses the idea that a finding on expropriation would invite independent claims to arise under other provisions of the BIT. The Tribunal, however, does not diminish violations of the standards of treatment prescribed in the Clause. In the opinion of the Tribunal, the failure on part of the State to observe such standards under the BIT would play a role in damages in matters concerning expropriation.[66]

iii. *<u>What is the ambit of generic tax exclusions?</u>*

As discussed earlier, states reserve their power to treat foreign aliens preferentially. Ubiquitous in most treaties, this obligation is frequently worded such that, in substance, it resembles the exclusion in the Lebanon-Malaysia BIT:

> "*The provisions of this Agreement relative to the granting of treatment not less favourable than that accorded to the investors of any third State shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege resulting from […] any international agreement or arrangement relating wholly or mainly to taxation or any domestic legislation relating wholly or mainly to taxation.*"[67]

The exclusion illustrates that States, even in modern times, retain their power to treat foreign aliens preferentially, in terms of benefits accorded by separate tax treaties. The purpose of this exclusion is to "*strike a balance*" between the State's obligations of non-discrimination and its fiscal sovereignty.[68] Typically, this exclusion finds a place in the standards of treatment provision of the treaty. This primitive, but inalienable, sovereign power is very much accepted by tribunals and is out of the question. However, tribunals do deliberate on the ambit and nature of the exclusion.

In the *Fouad Alghanim & Sons Co. for General Trading & Contracting, W.L.L and Mr. Fouad Mohammed Thunyan Alghanim* v. *Hashemite Kingdom of Jordan* ["**Alghanim**"] claims, the Tribunal notes that the exclusion does not hinder any claims relating to any arbitrary measure, but merely restricts those

62 El Paso, ICISD Case No. ARB/03/15, Award, ¶ 448 (Oct. 31, 2011).
63 *Id.* ¶ 449.
64 Ryan, ICSID Case No. ARB (AF)/11/13, Award, ¶¶ 261–262 (Nov. 24, 2015).
65 *Id.* ¶¶ 262–265.
66 *Id.* ¶ 267.
67 Agreement between the Government of the Lebanese Republic and the Government of Malaysia for the Promotion and Protection of Investments, Leb.-Malay., art. 3, Feb. 02, 1998.
68 Wälde & Kolo, *supra* note 20, at 433.

claims arising from the preferential treatment of investors through agreements.[69] However, the silence on the application of this exclusion does not imply that an investor can bring any tax-related claim. This situation reminds the author of the words of Professor Park;

> "*While the doll [matryoshka] releases smaller figures, treaty exceptions often reveal other exceptions that prove as capacious […].*"[70]

Although Professor Park was talking about tax exclusions in general, a singular characteristic of this generic exclusion is that the wording matters.

Take the case of this exclusion in the Netherland-Venezuela BIT.[71] The BIT was worded to separate FET from the Most-Favoured Nations ["**MFN**"] and National Treatment ["**NT**"] provisions; the latter containing the carve-out and exclusively dealing with "*taxes, fees, charges, and to fiscal deductions and exemptions.*" Contrast this wording to the Jordan-Kuwait BIT in the *Alghanim* claims, the MFN and NT standards were worded in the same provision as FET and the carve-out.[72] In *Venezuela Holdings* v. *Bolivarian Republic of Venezuela*, the Tribunal chanced to examine if the FET (Article 3) standard in the Netherland-Venezuela BIT would apply to fiscal measures, which otherwise find mention in the MFN and NT provision (Article 4).[73] The Respondents proposed that Article 4 and not Article 3 laid down the standard of treatment applicable for fiscal measures. The Tribunal affirmed the Respondent's submissions. In their reasoning, the Tribunal *first* observed that the two different provisions have their own list of exceptions of which this type of carve-out is an exception of the latter provision. If the two provisions were to act in the same paradigm, it would result in an overlap of such exceptions and even render this exclusion meaningless.[74] *Second*, the Tribunal observed that had the Contracting Parties intended to not carve out fiscal measures from Article 4, it would have been easier to include such a carve out as a subset of Article 3 (3) rather than enumerate a similar group of exceptions in addition to fiscal measures as a separate provision.[75] The Tribunal, hence, rejected the Claimant's tax-based claim.[76]

However, variations in the standard of treatment clause are not the only limitation imposed on this carve-out. BITs sometimes limit the disputes that can be brought before the tribunal, as in the case of the Russia-United Kingdom BIT; the dispute resolution provision allowed only certain contentions for arbitration.[77] To circumvent this limitation, States rely on the standards of treatment clause; specifically, the MFN. The matter came before the tribunal in two claims;

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69 Fouad Alghanim & Sons Co. for General Trading & Contracting, W.L.L and Mr. Fouad Mohammed Thunyan Alghanim v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/13/38, Award, ¶ 124 (Dec. 14, 2017) [*hereinafter* "Alghanim"].

70 William W. Park, *Tax and Arbitration*, ARB. INT'L 1, 12 (2020).

71 Agreement on encouragement and reciprocal protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela, Neth.-Venez., art. 4, Oct. 10, 1991.

72 Agreement between the Hashemite Kingdom of Jordan and the Government of the State of Kuwait for the Encouragement and Reciprocal Protection of Investments, art. 4, May 21, 2001.

73 Venezuela Holdings, B.V., et al. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, Award, ¶¶ 245–248 (Oct. 9, 2014).

74 *Id.* ¶¶ 243–245.

75 *Id.* ¶ 246.

76 *Id.* ¶ 247.

77 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Union of Soviet Socialist Republics for the Promotion and Reciprocal Protection of Investments, Russ.-U.K., art. 8, Apr. 6, 1989.

RosInvest v. *The Russian Federation* ["**RosInvest**"] and *Renta4* v. *The Russian Federation* ["**Renta4**"]. In both cases, the dispute resolution clause barred any claims arising from matters other than expropriation and compensation due. The question before the Tribunal was whether the investor can invoke benefits specifically excluded by the basic treaty through the MFN clause. The Claimants in both claims sought to invoke the Danish-Russia BIT to circumvent the restrictive dispute resolution clauses of the Russia-U.K. BIT and Russia-Spain BIT. In *RosInvest*, the Tribunal answered this question in the affirmative. The Tribunal held that the Claimants can invoke the benefits of the Danish-Russia BIT for two-fold reasons. *First*, the protections of the BIT read in light of the MFN provision, allow the investor to submit the claims for arbitration.[78] And, *second*, there does not appear to be any intention of the contracting parties to exclude the extension of the MFN protection to arbitration, despite other MFN exclusions in the Treaty.[79] However, the *RosInvest* Tribunal allowed jurisdiction of the tax claim not on these arguments.[80] Consequently, the Tribunal did not carry out a discourse on whether the imported MFN benefit should be interpreted subject to the tax exclusions of the comparator BIT. However, in *Renta4*, the Claimants were less successful in persuading the Tribunal of its competence by invoking the MFN protection. The Tribunal was dissuaded to extend its jurisdiction due to the narrow scope of the clause.[81] Unlike the Russia-UK BIT of the *RosInvest* claim, the MFN obligations under the Spain-Russia BIT[82] extended only under the FET standards. The Tribunal was doubtful whether such a clause would include the benefit of arbitration.

iv. *Whether tax veto is mandatory?*

Why shouldn't tribunals overlook a procedural device for convenience? Tax vetoes are after all an archaic remainder from the age of diplomatic intervention.[83] As one author puts it, it goes to the very consent of the contracting parties to the arbitration.[84] However, its acceptance among the contracting States is arguably positive. States have employed vetoes in their treaties as recently as in 2019.[85] Its purpose is to give the authorities the power to distinguish between legitimate taxes and abusive taxes.[86] Either of the two events follows when the investor submits to the tax veto procedure. There may be an agreement between the authorities named in the veto clause, that the actions are not expropriatory, as in the *Marvin and Elaine Gottlieb* v. *Canada* claims,[87] or the competent authorities may not reach an agreement as to the true nature of the actions of the

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78 RosInvest Co. UK Ltd. v. The Russian Federation, SCC Case No. V079/2005, Award on Jurisdiction, ¶¶ 130–133 (Oct. 1, 2007) [*hereinafter* "RosInvest"].

79 *Id.* ¶ 135.

80 RosInvest, SCC Case No. V079/2005, Award, ¶ 271 (Sept. 12, 2010).

81 Renta4 S.V.S.A Ahorro Corporacion Emergentes F.I., Ahorro Corporación Eurofondo F.I., Rovime Inversiones SICAV S.A., Quasar de Valors SICAV S.A., Orgor de Valores SICAV S.A., GBI 9000 SICAV S.A. v. The Russian Federation, SCC Case No. 24/2007, Award on Preliminary Objections, ¶ 119 (Mar. 20, 2009) [*hereinafter* "Renta4"].

82 Agreement for Reciprocal Promotion and Protection of Investments between Spain and the USSR, Spain-Russ, art. 5, Oct. 10, 1990.

83 A consequence of the present day investor-State arbitration is the minimal role of the home State to support, initiate or involve in the dispute of the investor. However, such "modernity" is not reciprocated in matters of tax where tax veto provision involves the diplomatic agencies of the Host and Home States. *See also* Kolo, *supra* note 26, at 477–479.

84 Davie, *supra* note 10, at 226.

85 Agreement between the Government of the Republic of Singapore and the Government of the Republic of the Union of Myanmar on the Promotion and Protection of Investments, art. 31, Sept. 4, 2019.

86 William Park, *Tax Arbitration and Investor Protection*, *in* INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY 115, 131 (Graham Coop & Clarisse Ribeiro eds., 2008).

87 Marvin & Elaine Gottlieb v. Canada, 2008 (Withdrawn)—the fiscal authorities of the investor's home and host States agreed that the tax measure did not constitute as expropriation.

Respondent, as in *EnCana* v. *The Republic of Ecuador* ["**EnCana**"] claims.[88] Our enquiry is limited to whether an investor can bring tax-related claims directly to the Tribunal without submitting to the tax veto procedure.

Perhaps the strongest affirmation to our question is by relying on the *Yukos* v. *Russian Federation* ["**Yukos**"] claims. The Tribunal dismissed Russia's objections as to Yukos' inability to first bring their claims before the Russian tax authorities. The Tribunal dismissed the objection not at the jurisdictional stage, but at the awards stage in light of the "*enormous*" evidence and facts to illustrate that there was an expropriation.[89] It is in this context that the Tribunal held such a step to be meaningless for a timely determination, and futile owing to the evidence of expropriation.[90] There is, however, consensus that the Yukos claims were indeed an extraordinary case.[91] Would the tribunal choose to approach in this way in less extraordinary claims?

In *Plama* v. *The Republic of Bulgaria*, the investor did not first submit to the veto procedure, however, the Tribunal did not deliberate on whether, on that ground, the claim may be dismissed.[92] The *Eiser* v. *Kingdom of Spain* award throws more light on this question. The Tribunal, here, outright rejected the Claimant's claims owing to their non-compliance with the tax-veto procedure.[93] Relying on the above authorities, it is deduced that in ordinary claims, tribunals would disallow those which have not complied with the procedure in the veto clause.

It may also be argued whether the tax veto clause would be inapplicable if the tax measure is found not to be bona fide. Although in the *SoIEs Badajoz GmbH* v. *Kingdom of Spain* ["**SoIEs**"] claims, the Respondent objected to the Claimants bringing their expropriation claims, since they did not first submit the alleged expropriation measure before the competent tax authorities as under the ECT.[94] The Tribunal, however, did not deliberate on this objection. It nevertheless held that it did not have jurisdiction, based on the State's less "*extraordinary conduct*" to subvert the presumption of the legitimacy (bona fide conduct of the State).[95] Presumably, this would mean if the State's conduct is not bona fide, the tribunal may not consider the tax veto as an essential precedent to arbitration based on the "*futility*" or "*good faith*" defence.

B. <u>Whether tax exclusions are effective?</u>

Indeed, this question was examined in a 2015 paper by Matthew Davie.[96] Any re-examination of this question would be, hence, unnecessary. However, while I respectfully acknowledge the learned opinion, some clarification on this matter is necessary. Hence the following discourse.

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88 EnCana, LCIA Case No. UN3481, Award, ¶ 109 (Feb. 3, 2006).

89 Yukos Universal Limited (Isle of Man) v. The Russian Federation, PCA No. AA/227, Final Award, ¶¶ 1422–1424 (Perm. Ct. Arb. July 18, 2014) [*hereinafter* "Yukos"].

90 *Id.* ¶ 1424.

91 Masdar Solar &Wind Cooperatief U.A.E. v. Kingdom of Spain, ICSID Case No. ARB 14/1, Award, ¶ 284 (May 16, 2018) [*hereinafter* "Masdar"].

92 Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Award, ¶ 266 (Aug. 27, 2008) [*hereinafter* "Plama"].

93 Eiser Infrastructure Limited and Energia Solar Luxembourg S.A.R.I. v. Kingdom of Spain, ICSID Case No. ARB/13/36, Award, ¶ 296 (May 4, 2017) [*hereinafter* "Eiser"].

94 SoIEs Badajoz GmbH v. Kingdom of Spain, ICSID Case No. ARB/15/38, Award, ¶ 173 (July 31, 2019) [*hereinafter* "SoIEs"].

95 *Id.* ¶ 276.

96 Davie, *supra* note 10.

Davie asserts that tribunals have "*shown a willingness to read down or even ignore carve-out clauses,*"[97] a conclusion arrived at after examination of the tribunal's approach in *Occidental*, *Renta4*, *Rosinvest* and *Yukos*. For better understanding, the decisions are discussed here.

The Ecuador-U.S. BIT, as discussed earlier, provided that the State should strive to accord FET standard to tax measures. The carve-out directed States "*strive*" for fairness in their tax policies on one hand and on the other specified those instances in which investors can bring disputes in regard to tax-based claims. This position leaves much to the interpretation of the tribunal. Whether the interpretation was wrong or right is a different debate but as on facts, the Treaty did not prohibit FET standard to be applied to tax measures. Furthermore, the Spain-Russia and Russia-U.K. BITs did not prohibit the protection of the BIT to tax measures. I shall not repeat the challenges faced by the tribunals which were elaborated in Part III.A.

To summarise their findings, despite the *Renta4* Tribunal, as Davie notes, observing a tax carve-out not to be a loophole for abuses of the power to tax, the Tribunal found it has no competence under the Spanish BIT to entertain the claims relating to tax.[98] In *RosInvest*, the Tribunal, in the absence of any explicit carve-outs in the jurisdiction stage, ruled that it has jurisdiction to FET but declined to entertain the discussion as to whether such benefits would be extended if the comparator BIT limited the benefit.[99] Nevertheless, from none of the above claims should it be deduced that the tribunal ignored or read down any exclusions.

As to the *Yukos* claims, the ECT, from which the claims arise, does not bar the competence of a tribunal, but heavily regulates it. In *Yukos*, the Tribunal, alternatively, had jurisdiction despite the conduct of the State because of the expropriation claw-back present in Article 21 of the ECT.[100]

Davie then expostulates with the Tribunals' reliance on the good faith principle as an essential component of taxation measures.[101] There is merit in his apprehension that claimants may bring up the defence of good faith to engage States in "*lengthy battles*" over legitimate taxation measures to persuade the tribunal otherwise. The claims of *Eiser* v. *Kingdom of Spain*,[102] *Isolux* v. *Kingdom of Spain*,[103] *Masdar* v. *Kingdom of Spain*[104] and *Novenergia* v. *Kingdom of Spain*[105] are a testament to that effect. Also, there is merit in his observations regarding the underdevelopment of these aspects, i.e., what degree of good faith would render a carve-out inoperative.[106] However, the reluctance of the Tribunal to overlook the exclusion demonstrates that tribunals, for now, are not willing to read down the exclusions absent extraordinary circumstances.

His argument that States may not have considered bad faith as a "*decisive consideration*" is, in my opinion, fallible. If States had intended to cover only its *bona fide* intentions, it would be highly

[97] *Id.* at 223.
[98] Renta4, SCC Case No. 24/2007, Award on Priliminary Objections ¶ 74 (Mar. 20, 2009).
[99] RosInvest, SCC Case No. V079/2005, Award on Jurisdiction, ¶ 137 (Oct. 1, 2007).
[100] Yukos, PCA No. AA/227, Final Award, ¶ 1409 (Perm. Ct. Arb. July 18, 2014).
[101] Davie, *supra* note 10, at 225.
[102] Eiser, ICSID Case No. ARB/13/36, Award, ¶ 258 (May 4, 2017).
[103] Isolux infrastructure Netherlands, B.V. v. Kingdom of Spain, SCC Case V2013/153, Award (July 17, 2016).
[104] Masdar, ICSID Case No. ARB 14/1, Award, ¶ 281 (May 16, 2018).
[105] Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. Kingdom of Spain, SCC Arbitration 2015/063, Final Arbitral Award, ¶ 516 (Feb. 15, 2018) [*hereinafter* "Novenergia"].
[106] Davie, *supra* note 10, at 225.

doubtful, as history illustrates, for investors to get any justice.[107] International investment agreements evolved to protect investors from mala fide and wrongful actions of States. In that light, it is highly doubtful that States, or for that matter customary international law, would empower tax carve-outs to protect the State's mala fide actions. It is also argued here that the Tribunal's reliance on good faith as a decisive factor is not misplaced; it is uncontroversial that the inherent police powers of the State qualify protection of the treaty on condition that they are bona fide.[108]

As for the clarification I tend to bring to the earlier assertion is that tax carve-outs are indeed effective to the extent of its wording and the conduct of the State. I present two arguments to support this proposition.

First, post-*Yukos* jurisprudence suggests that the presumption of good faith is a high wall for a claimant to circumvent. Perhaps, we should turn our attention to the claims relating to Law 15/2012 (on tax policy aimed at energy sustainability) against Spain. Multiple tribunals have more than once agreed that the actions of the Respondent, the Republic of Spain, concerning the tax claims, fall short of constituting the mala fide grounds needed to override the exclusion under the ECT.[109] The *SoIEs* Tribunal notes that the tax carve-out may only be overlooked in "*extraordinary circumstances*."[110] The tribunal can review only "*egregious abuse of tax power*" under the clause. For that matter, the *Yukos* Tribunal itself notes that the tax authorities would be empowered to implement bona fide taxation measures with respect to the "*sham-like nature*" of Yukos' tax payments.[111]

It may be kept in mind that probing the alleged confiscatory or discriminatory measure is not the same as overriding the tax carve-out. There is no controversy regarding the established rule that a tribunal has the right to decide its own jurisdiction. In the former case, the tribunal ascertains whether there are grounds in the claimant's assertions of overlooking the high thresholds of the tax carve-out. Where the tribunal finds that the State's action does constitute such egregious abuse of tax power, it would likely overlook the carve-outs.

Second, State practice indeed supports this proposition. Despite the observations of the tribunal in *Yukos*, States continue to incorporate tax carve-outs as evidenced by the recent treaties between Armenia-Japan,[112] Rwanda-Singapore,[113] and Brazil-United Arab Emirates,[114] among others. Why

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107 Indeed, the Yukos claims demonstrate how States could misuse their bona fide powers to elude international obligations.

108 Too v. Greater Modesto Insurance Associates, 23 Iran-U.S. Cl. Trib. Rep. 26 (1989).

109 Eiser, ICSID Case No. ARB/13/36, Award, ¶ 271 (May 4, 2017); Masdar, ICSID Case No. ARB 14/1, Award, ¶ 292 (May 16, 2018).

110 SoIEs, ICSID Case No. ARB/15/38, Award, ¶ 273 (July 31, 2019).

111 Yukos, PCA No. AA/227, Final Award, ¶ 1404 (Perm. Ct. Arb. July 18, 2014).

112 Agreement between Japan and the Republic of Armenia for the Liberalisation, Promotion and Protection of Investment, Arm.-Japan, art. 20, Feb. 12, 2018.

113 Agreement between the Government of the Republic of Singapore and the Government of the Republic of Rwanda on the promotion and Protection of Investments, Rwanda-Sing., art. 29, June 14, 2018.

114 Cooperation and facilitation investment Agreement between the Federative Republic of Brazil and the United Arab Emirates, Braz.-U.A.E., art. 11, Mar. 15, 2019.

should States include tax exclusion if they are not effective? Even India seems to think that tax carve-outs can help its woes arising from tax-related arbitration.[115]

It is submitted that any space for interpretation for the tribunal shall test the effectiveness of the exclusion. A tightly worded carve-out would presumably convey clear meaning and purpose. A practice amongst contracting States suggests the inclusion of interpretative texts in matters of tax, to bring clarity on the intention of the parties as to the tax carve-out.[116] With respect to the conduct of the State, it is argued that nothing should protect a State's measure against an investor if such measure is shrouded with mala fide intentions.

C. Can tribunals overlook carve-outs?

To put it as succinctly as possible, the answer to this question is yes, tribunals can overlook tax carve-outs. However, this positive assertion is rudimentary in light of how sparingly tribunals have, in practice, done so. Nevertheless, if one were to ratiocinate this proposition, it is well-supported. There is a "*thin line*" that separates bona fide taxation measures from abusive taxation. The *Marvin Feldman* v. *United Mexican States* Tribunal notes that the Restatement of the Law of Foreign Relations of the U.S. recognises taxation as a possible expropriatory action when it is an unreasonable interference with an alien's property.[117] In the *Yukos* claims, the Tribunal was of the opinion that carve-outs may be overlooked if the measure is not bona fide.[118] In *Renta4*, the Tribunal opined that a carve-out cannot provide a loophole for the State to escape its obligations.[119] The *Renta4* Tribunal seem to align itself with the *Yukos* Tribunal to distinguish taxation into legitimate and abusive taxes. The Tribunal in *Novenergia* also opined that carve-outs will be effective only if the tax measures were adopted in good faith.[120]

These observations of the tribunals should not be interpreted to mean that taxation in itself is a breach of international obligations. The herculean task of most tribunals, when faced with tax-related claims, is to determine if the State's tax measures cross that thin line; the line between abusive and legitimate taxes. Crossing that line would result in scrutiny of taxes under the light of a breach and non-application of treaty carve-outs.

Arguably, one may contend that the thin line is a recent invention by tribunals, however, there has always been the discussion of how much is "*too much*" with respect to tax on foreign aliens. Perhaps after the *Yukos* award, the idea that a carve-out cannot provide the State with a loophole to escape its obligations gained traction. Even the narrowest definitions of police powers comprise taxation.[121] There is no dispute that measures are not wrongful if such measures are enacted, are *bona fide*, non-discriminatory and proportionate, and follow due process.

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[115] Although India's early BITs included only generic tax exclusions, as per the BITs available on the public domain, India has in the recent BITs completely excluded any "law or measure regarding taxation." *See* Agreement between the Government of the Republic of India and the Government of the United Arab Emirates on Promotion and Protection of Investments, India-U.A.E., art. 2, Dec. 12, 2013.

[116] *See* Agreement between the Government of the State of Israel and the Government of the United Arab Emirates on Promotion and Protection of Investments, Israel-U.A.E., art 10, Oct. 20, 2020.

[117] Marvin Feldman v. United Mexican States, ICSID Case No. ARB(AF)/99/1, Award, ¶ 106 (Dec. 16, 2002) [*hereinafter* "Feldman"].

[118] Yukos, PCA No. AA/227, Final Award, ¶ 1430 (Perm. Ct. Arb. July 18, 2014).

[119] Renta4, SCC Case No. 24/2007, Award on Priliminary Objections, ¶ 74 (Mar. 20, 2009).

[120] Novenergia, SCC Arbitration 2015/063, Final Arbitral Award, ¶ 521 (Feb. 15, 2018).

[121] Noam Zamir, *The Police Powers Doctrine in International Investment Law*, 14 MANCHESTER J. INT'L ECON. L. 318 (2017).

The presumption for the legitimacy of the regulatory measure is in the positive.[122] Hence it is the burden of the claimant(s) to dispel the legitimacy of the tax.[123] We shall now discuss those circumstances when a tribunal can overlook the tax carve-out.

i. *Confiscatory and discriminatory taxes*

Perhaps the earliest restraints on taxes on foreign aliens recognised by customary international law were confiscatory or discriminatory taxes.[124] Modern-day tribunals too reiterate that a State cannot impose confiscatory or discriminatory taxes on its foreign investors.[125]

Due to the very nature of taxes, tribunals seldom agree on "*what is*" or "*how much*" constitutes a confiscatory tax. In this light, confiscatory tax eludes a proper definition. Tribunal jurisprudence suggests that excessive or high taxes need not always be confiscatory.[126] For example, the *Burlington* Tribunal sine unanimity concluded that the 99% tax on profits is not confiscatory.[127]

The promulgation of confiscatory taxes need not violate domestic law or necessarily be outside the competence of the State.[128] Tribunals have, more than once, relied on the facts and circumstances of the taxation measure when determining whether confiscatory or otherwise. The *Burlington* Tribunal was of the opinion that the legitimacy of the tax depends on the effect of the tax.[129] The dissenting arbitrator of that Tribunal emphasised that the Tribunal should focus on the impact of the tax measure and characterised Eucador's Law 42, relating to a "*windfall tax,*" as a confiscatory measure.[130] Other commentators too have elaborated on other methods to assess the nature of the tax; variation in the tax rate and profitability of the investment are two such methods.[131] The *Link-Trading* v. *The Republic of Moldova* Tribunal observed that "*tax measures may also become expropriatory, without necessarily being arbitrary or discriminatory, when their application violates a specific obligation that the State has undertaken previously […] such as an investor protected under a treaty.*"[132]

For discriminatory taxes, the *Burlington* Tribunal opines that, to violate customary standards, discrimination too "*must still meet the test of substantial deprivation.*"[133] It is submitted that this approach is not followed by other tribunals. The *EnCana* Tribunal looks at discrimination as the treatment of different classes of investors.[134] This approach has been adopted by the Tribunals in *Ampal*

122 El Paso, ICISD Case No. ARB/03/15, Award, ¶ 290 (Oct. 31, 2011).
123 Link-Trading, Final Award, ¶ 67 (Apr. 18, 2002); Novenergia, SCC Arbitration 2015/063, Final Arbitral Award, ¶ 521 (Feb. 15, 2018).
124 A. R. Albrecht, *The Taxation of Aliens under International Law*, 29 BR. YEAR B. INT'L L. 145, 172 (1952); Fachiri, *supra* note 2.
125 Feldman, ICSID Case No. ARB(AF)/99/1, Award, ¶ 103 (Dec. 16, 2002); Burlington, ICSID Case No. ARB/08/5, Decision on Liability, ¶ 393 (Dec. 14, 2012); Stadtwerke, ICSID Case No. ARB/15/1, Award, ¶ 170 (Dec. 2, 2019).
126 *See* El Paso, ICISD Case No. ARB/03/15, Award, ¶ 449 (Oct. 31, 2011) (the tribunal distinguishes between excessiveness of the tax and confiscatory taxes.).
127 Burlington, ICSID Case No. ARB/08/5, Decision on Liability, ¶ 457 (Dec. 14, 2012).
128 Link-Trading, Award on Jurisdiction, at 10 (Feb. 6, 2001).
129 Burlington, ICSID Case No. ARB/08/5, Decision on Liability, ¶ 395 (Dec. 14, 2012).
130 Burlington, ICSID Case No. ARB/08/05, Dissenting opinion of Arbitrator Orrego Vicuña, ¶ 27 (Nov. 08, 2012).
131 Arno E. Gildemeister, *How Much is Too Much: When is Taxation Tantamount to Expropriation?*, 29 ICSID REV. 315, 317 (2014).
132 Link-Trading, Final Award, ¶ 73 (Apr. 18, 2002).
133 Burlington, ICSID Case No. ARB/08/5, Decision on Liability, ¶ 402 (Dec. 14, 2012).
134 EnCana, LCIA Case No. UN3481, Award, ¶ 146 (Feb. 3, 2006).

American Israel Corporation v. *Arab Republic of Egypt* [135] and *Alghanim*,[136] which scrutinized the claimant's allegation of discriminatory tax measures in the fashion that the tax measure was carried out; not quite the substantial deprivation test. As Professor Wälde also notes the "*selective and discriminatory enforcement*" violates obligations.[137]

ii. *Violation of contractual obligations*

It is uncontroversial that a State should honour its commitments arising from a contract with the investor. Accordingly, the *Paushok* v. *The Government of Mongolia* Tribunal opined that an agreement between the State and the investor on those aspects of the taxing power that the investor requires protection from (known as "*stability agreements*"), would allude better protection to the investor than exclusively relying on treaties.[138] The stability agreement is likely to create legitimate expectations and is the "*proper way*" to protect the investment from taxation and other related matters.[139]

Otherwise, there remains no compulsion on the State to adapt its policies for the benefit of the investor; and an investor, without such agreement, cannot protest against an increase in the tax, which is within the regulatory powers of the State.[140] Absent an agreement to the contrary, there is an inherent right of the State to participate in the benefits arising from the claimant's use of the State's inalienable natural resources.[141]

However, not every breach of a contract can give rise to treaty claims. In that light, tribunals are also of the opinion that an investor can bring such claims only if permitted by the treaty. In the *El Paso* claims, the Tribunal notes that violation of agreements between the State and investor, unless confiscatory, are a violation of the FET standards.[142] As a result, if the treaty prohibits FET claims, the tribunal cannot rule on the breaches of contract and such other violations.

Although in the *Bogdanov* v. *The Republic of Moldova* claims, the Tribunal was of the opinion that excessive taxation would qualify as a breach of the treaty if found to be unfair or inequitable;[143] inferring from the *El Paso* award, the competence of the tribunal to rule on such breaches would be dependent on the carve-out. Furthermore, on this point, the *Oostergetel* v. *The Slovak Republic* ["**Oostergetel**"] Tribunal notes that, for the State to "*incur liability,*" its conduct must constitute breaches of not only municipal law but also the treaty.[144]

iii. *Changes in tax policy*

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135 Ampal-American Israel Corporation and others v. Arab Republic of Egypt, ICSID Case No. ARB/12/11, Decision on Liability and Heads of Loss, ¶ 184 (Feb. 21, 2017).

136 Alghanim, ICSID Case No. ARB/13/38, Award, ¶¶ 123, 426 (Dec. 14, 2017).

137 Thomas Wälde, *National Tax Measures Affecting Foreign Investors Under the Discipline of International Investment Treaties*, 102 PROC. ASIL ANNU. MEET. 55, 58 (2008).

138 Sergei Paushok, CJSC Golden East Co. & CJSC Vostokneftegaz Co. v. The Government of Mongolia, UNCITRAL, Award on Jurisdiction and Liability, ¶ 370 (Apr. 28, 2011) [*hereinafter* "Paushok"].

139 *Id.*

140 *Id.* ¶ 370.

141 Occidental Petroleum Corporation, Exploration & Production Co. v. The Republic of Ecaudor, ICSID Case No. ARB/06/11, Dissenting Opinion, ¶ 9 (Sept. 20, 2012).

142 El Paso, ICISD Case No. ARB/03/15, Award, ¶ 448 (Oct. 31, 2011).

143 Yuri Bogdanov & Yulia Bogdanov v. The Republic of Moldova, SCC Case No. 091/2012, Award, ¶ 167 (Apr. 16, 2013).

144 Jan Oostergetel & Theodora Laurentius v. Slovak Republic, UNCITRAL, Final Award, ¶ 228 (Apr. 23, 2012) [*hereinafter* "Oostergetel"].

Changes in tax policies include a high tax, windfall taxes, unwise taxation, and unpredictable taxes, all of which are discussed below. The sovereign right to tax is a well-respected prerogative of the State. Tribunals seldom consider any variation in the taxes, provided they are not confiscatory, discriminatory or in bad faith, as a breach of the treaty obligations. One tribunal worded strongly that it is not their function to "*micromanage*" a State's tax policy,[145] others have emphasised that the prerogative of a State to raise taxes should not come under the review of the tribunal.[146]

A high level of tax does not per se constitute a breach of obligations of the State.[147] Such a tax increase, absent a fiscal agreement, cannot constitute a breach.[148] The *El Paso* Tribunal has observed that States have no duty to "*adapt its tax regime*" to the interests of their investors.[149] The Tribunal in *Link-Trading* furthers this view and elaborates that taxation measures cannot be challenged for creating an unfavourable environment for the investor, absent any "*abusive, arbitrary or discriminatory*" treatment to the investor.[150]

Even the structuring of payments to the State to "*resemble tax*", to circumvent international obligations, is not bad faith according to the *Antaris* Tribunal.[151] A view also shared by the *SolEs* Tribunal.[152] However unwise the decision to tax, the *Stadtwerke* tribunal is of the opinion that it cannot interfere with that discretion of the State.[153]

However, in *Occidental*, the Tribunal was of the opinion that the tax law which was changed, without providing any clarity about its meaning, and the other subsequent conduct of the State that followed violated the FET standard under the BIT.[154]

With respect to retroactive taxation, despite the recent awards in *Vodafone* v. *The Government of India*[155] and *Cairn Energy* v. *The Republic of India*,[156] some commentators believe that mere retroactivity of the tax may not suggest a breach of the treaty obligations.[157] To surmise the findings, Tribunals are seldom likely to find changes in tax policy as credible grounds to overlook a tax carve-out unless there exist extraordinary circumstances.

iv. <u>*Tax collection and enforcement*</u>

More than once, tribunals have disallowed claimants' allegations that the collection or recovery of unpaid taxes was a breach of the treaty obligations.[158] The Tribunal in *Ryan* v. *Poland* noted that it

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145 9REN, ICSID Case No. ARB/15/15, Award, ¶ 203 (May 31, 2019).
146 Masdar, ICSID Case No. ARB 14/1, Award, ¶¶ 281, 291 (May 16, 2018); Eiser, ICSID Case No. ARB/13/36, Award, ¶ 270 (May 4, 2017).
147 Paushok, Award on Jurisdiction and Liability, ¶ 303 (Apr. 28, 2011).
148 *Id.* ¶ 305.
149 El Paso, ICSID Case No. ARB/03/15, Award, ¶ 295 (Oct. 31, 2011).
150 Link-Trading, Final Award, ¶ 72 (Apr. 18, 2002).
151 Antaris, PCA Case No. 2014-01, Award, ¶ 253 (Perm. Ct. Arb. May 2, 2018).
152 SolEs, ICSID Case No. ARB/15/38, Award, ¶ 275 (July 31, 2019).
153 Stadtwerke, ICSID Case No. ARB/15/1, Award, ¶ 174 (Dec. 2, 2019).
154 Occidental, LCIA Case No. UN 3467, Final Award, ¶ 184 (July 1, 2004).
155 Vodafone Group PLC & Vodafone Consolidated Holdings Ltd. v. Government of India, PCA Case No. 2016-35, Final Award (Perm. Ct. Arb. Sept. 25, 2020).
156 Cairn Energy PLC & Cairn UK Holdings Limited v. The Republic of India, PCA Case No. 2016-7, Final Award (Perm. Ct. Arb. Dec. 21, 2020).
157 Markus Burgstaller & Agnieszka Zarowna, *The Growing Importance Of Investment Arbitration In Relation To Tax Measures In The Energy And Natural Resources Sectors*, 4 TURKISH COM. L. REV. 81, 86 (2018).
158 Spyridon, ICSID Case No. ARB/06/1, Award, ¶ 506 (Dec. 7, 2011); Oostergetel, Final Award, ¶ 301 (Apr. 23, 2012).

is reasonable for the State to impose penalties on unpaid dues to the State.[159] As discussed earlier, the decisions taken by the courts and other tax authorities, and the actions of the State's authorities to enforce such decisions qualify as taxes, and fall within the public powers of the State.[160] Again, in the *Oostergetel* claims, the Tribunal observed that the collections of overdue taxes by the State through its organs were "*undoubtedly legitimate.*"[161]

Naturally, undisputedly, tribunals have observed that it is the duty of the claimant, as an investor, to conduct due diligence regarding the tax environment, and for taking the necessary measures to deal with them.[162] However, the conduct of the State, in this aspect, must be legitimate, and such measures shall not qualify for the protections under the carve-out if the actions were taken under the "*guise of taxation*" to adversely affect the investor.[163] Despite holding the State's conduct to not be legitimate, the Tribunal notes that the tax authorities would have been empowered to measures with respect to the "*sham-like nature*" of Yukos' tax payments.[164]

v. Series of expropriatory measures

Two tribunals have opined that tax carve-outs may be overlooked when the taxation measure forms as one of the many acts of expropriation carried out by the State to dispose of control of the investor over the investment. In the *RosInvest* claims, the Tribunal did not consider expropriation by taxation but tax as one of the "*cumulative combinations of measures*" of expropriation by the State.[165] Similarly, in the *Cube Infrastructure* claims, despite the Tribunal not overlooking the ECT carve-out, it was of the opinion, that the Claimants' argument is "*strongest*" when the tax levy is considered as one of the measures intended to adversely affect the investor.[166]

These observations by the above tribunals concur with the notion that tax carve-outs may not apply if the alleged tax measure forms one of the components of a series of expropriatory measures. No doubt that for such taxation measures to exceed protection by the carve-out, the other actions of the State must fulfil the criteria of expropriation.[167]

IV. Conclusion: Sailing between the Scylla and the Charybdis

Undoubtedly, in this age, the petulance of a sovereign to not conform to rule of law invites the scrutiny of international tribunals even into the matters of fiscal sovereignty.

As our study comes to a close, the conclusions of the study are summarised henceforth. With regard to interpreting tax exclusions, tribunals construe such tax-based measures on the presumption of legitimacy. Due to the nature of tax measures, such a presumption is however a high one for the claimant to prove otherwise. Tax exclusions are effective to the extent of their wording and the conduct of the State. Nevertheless, tribunals can overlook such exclusions if the

159 Ryan, ICSID Case No. ARB (AF)/11/13, Award, ¶ 492 (Nov. 24, 2015).
160 Spyridon, ICSID Case No. ARB/06/1, Award, ¶ 493 (Dec. 7, 2011).
161 *Id.*
162 Plama, ICSID Case No. ARB/03/24, Award, ¶ 268 (Aug. 27, 2008); Paushok, Award on Jurisdiction and Liability, ¶¶ 323–25 (Apr. 28, 2011).
163 Yukos, PCA No. AA/227, Final Award, ¶ 1407 (Perm. Ct. Arb. July 18, 2014).
164 *Id.* ¶ 1404.
165 RosInvest, SCC Case No. V079/2005, Award, ¶ 271 (Sept. 12, 2010).
166 Cube Infrastructure, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum, ¶ 226 (Feb. 19, 2019).
167 9REN, ICSID Case No. ARB/15/15, Award, ¶ 208 (May 31, 2019).

conduct of the State is not bona fide or violate international law. However, such power has been, until now, used very sparingly. There is considerable consensus that, to overlook the carve-out, the very extraordinary circumstances remain very much to the conjectures of the tribunal.

It is argued that when faced with the vicissitude of opinions allowing international scrutiny over its fiscal sovereignty, States are likely to counter with broader and comprehensive tax carve-outs in their treaties. On the other hand, post-*Yukos* claimants are likely to bring up tax-based claims to exploit any vulnerability of the carve-out. Hence the persistent tussle between fiscal sovereignty and increased scrutiny. Thus, when navigating between the Scylla and the Charybdis, the Tribunal need not fret for the viciousness of either if it does not overlook carve-outs but for extraordinary circumstances.