International

Tax Law Disputes before Investment Arbitration Panels: Practical Experience

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This article studies the experience gained in respect of dispute resolution under international investment agreements to determine whether or not it might provide input for the enhancement of the tax treaty dispute resolution mechanism, which is currently limited to the mutual agreement procedure.

1. Introduction

Investment treaties and tax treaties belong to the same broader category of international investment agreements (IIAs);[1] both are aimed at and connected with the encouragement of foreign direct investment.[2] The use of bilateral investment treaties (BITs) has expanded considerably in the last 50 years, following the signing of the first BIT, the Germany-Pakistan BIT (1959).[3] By the end of 2014, the IIA regime had grown to 3,271 treaties (2,926 BITs and 345 "other IIAs") and, while the annual number of newly signed BITs continues to decrease, more and more countries are engaged in IIA negotiations at the regional and subregional level. In 2014, after 84 new tax treaties were concluded, the network of tax treaties and BITs grew together, and there are now over 3,000 tax treaties in force worldwide. BIT and tax treaty networks largely overlap; two thirds of BIT relationships are also covered by a tax treaty. [4]

Bilateral investment treaties offer a variety of options as far as dispute resolution is concerned.[5] The most widely used mechanism is arbitration,[6] based on the Model Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).[7] In addition to the extended network of BITs, certain multilateral investment treaties also exist that confer rights directly upon private parties: these include free trade agreements (FTAs) and the Energy Charter Treaty (1994). [8]

In general, the scope of application of such investment treaties does not extend to international taxation issues. Taxation matters, however, often form the core of a dispute that arises under an investment treaty and direct taxation disputes are heard by arbitration panels. It could be useful, therefore, to study the experience gained under this regime to determine whether or not it might provide helpful input for the enhancement of the tax treaty dispute resolution mechanism, which is currently limited to the mutual agreement procedure, which provides for an arbitration-like procedure.

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1. *See* the UNCTAD classification, available at www.unctad.org/iia.
2. For a discussion on the broader context of the relationship between tax treaties, BITs and foreign direct investment *see* K.P. Sauvant & L.E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009).
3. *Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments* (25 Nov. 1959). Information on bilateral investment treaties can be found on the official website of the International Centre for Settlement of International Disputes (ICSID), available at http://icsid.worldbank.org/ICSID/FrontServlet.
4. Information contained in the UNCTAD 2015 World Investment Report, available online at http://unctad.org/en/PublicationsLibrary/wir2015_overview_en.pdf, pp. 23-24. For an analysis on the use of tax treaties, especially from a developing countries' point of view, *see* J. Braun & M. Zagler, *An Economic Perspective on Double Tax Treaties with(in) Developing Countries*, 6 World Tax J. (2014), Journals IBFD. For a thorough analysis of the role of tax treaties in facilitating FDI in developing countries, allocating taxable income between developed and developing countries and protecting the tax base in developing countries *see* M. Lang & J. Owens, *The Role of Tax Treaties in Facilitating Development and Protecting the Tax Base*, WU Intl. Taxn. Research Paper Series No. 2014-03 (2014) (available at http://epub.wu.ac.at/4094/1/SSRN-id2398438.pdf).
5. For a general discussion on the arbitration of tax disputes under the law of investment treaties, *see* A.E. Gildemeister, *L'arbitrage des différends fiscaux en droit international des investissements* (LGDJ 2013). It should be noted that the current system of investor-state arbitration suffers from a legitimacy crisis and a pressing need for reform has emerged. Reform options include improving the existing system of investment arbitration (refining the arbitral process, circumscribing access to ISDS), adding new elements to the existing system (for example, an appeals facility, dispute prevention mechanism) or replacing it (for example, with a permanent international court, state-state dispute settlement and/or domestic judicial proceedings); *see* UNCTAD 2015 World Investment Report, available online at http://unctad.org/en/PublicationsLibrary/wir2015_overview_en.pdf, p 28.
6. For an overview of investment treaty arbitration *see* K. Hober, *Investment treaty arbitration: a brief overview,* 42 Intertax 3, p. 189 (2014) and P.H.M. Simonis, *BITs and taxes,* 42 Intertax 4, p. 234 (2014).
7. *See* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=RulesMain. In 2014, investors initiated 42 known ISDS cases pursuant to IIAs; these developments brought the overall number of known ISDS claims to 608, lodged against 99 governments worldwide. Some 40% of new cases were lodged against developed countries. In 2014, the number of concluded cases reached 405. States won 36% of cases (144) and investors 27% (111). The remainder of cases were either settled or discontinued; *see* UNCTAD 2015 World Investment Report, available online at http://unctad.org/en/PublicationsLibrary/wir2015_overview_en.pdf, p. 26.
8. *The International Energy Charter: Consolidated Energy Charter Treaty with Related Documents* (Dec. 1994, consolidated 15 Jan. 2016) (ECT), available at http://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/.

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2. BITs and Direct Taxation Disputes

Bilateral investment treaties deal with two types of disputes: disputes between a state and an investor (individual or corporate entity) and disputes between the contracting states.[9] Disputes between qualifying investors and a host state appear to make up the vast majority of disputes that arise in the context of bilateral investment treaties. [10]Under the investment treaty regime, the investor (individual or corporation) is given a number of options for the resolution of the investment dispute with the host state;[11] apart from the option he has to use the municipal courts of the host state, the other main possibilities available are international law options involving arbitration between the investor and the host state.[12]

As many model investment treaties show, the present tendency is to deny the application of the most-favoured nation (MFN) and national treatment clauses to taxation matters,[13] allowing for only a limited application of the protection provided in the BIT in relation to specific taxation matters[14] that materially affect the enjoyment, by an investor, of certain protective rights under the agreement, such as direct or indirect expropriation through taxation measures.[15] Accordingly, the dispute resolution mechanisms provided in BITs deal with direct taxation issues only in limited instances where such direct taxation measures are related to allegations of expropriation or unfair treatment.[16] Even in those instances, however, the priority is (sometimes expressly, sometimes implicitly) given to the tax treaties[17] as *lex specialis*.[18]

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9. For a general discussion on whether international tax disputes can fall within the scope of BITs, *see* L.J. de Heer & P.R.C. Kraan, *Legal Protection in International Tax Disputes – How Investment Protection Agreements Address Arbitration*, 52 Eur. Taxn. 1 (2012), Journals IBFD. For a discussion on the competence of ICSID arbitration tribunals to decide on tax issues based on art. 25(1) of the ICSID Convention, *see* Gildemeister, *supra* n. 5, at 128 et seq. For an overview of the salient features of bilateral investment treaties and, in particular, the BIT standards of investor protection, *see* M. Desax, *Bilateral investment protection treaties – hidden fount of taxpayer protection*, ASA 83, No. 11/12, pp. 879 et seq. (2014/2015). For a discussion on the dangers of frustrating the purposes of tax treaties through BIT arbitration, from a state-to-state dispute perspective, *see* R. Ismer & S. Piotrowski, *A BIT too much: or how best to resolve tax treaty disputes?* 44 Intertax 5, p. 348 (2016). For a comparison between arbitration under tax treaty law and arbitration under BITs, *see* J. Chaisse, *Chapter 17: Arbitration in Tax Treaty Law and Arbitration under Bilateral Investment Treaties* in *International Arbitration in Tax Matters* (M. Lang et al. eds., IBFD 2016), Online Books IBFD.
10. Douglas reports that the only case of a state-state arbitration in the field of investment treaties that has arisen is the case that arose in relation to the *Treaty between Peru and Chile Concerning the Reciprocal Encouragement and Protection of Investments* (2 Feb. 2000): Z. Douglas, *The international law of investment claims* p. 3, no. 8 (CUP 2009).
11. For an examination of the main aspects of investor-state dispute settlement, from the perspective of both the investor and the host state, *see* UNCTAD, *Dispute Settlement: Investor-State*, UNCTAD Series on issues in international investment agreements (2003) (UNCTAD/ITE/IIT/30).
12. These options include ICSID arbitration, UNCITRAL arbitration, ICC arbitration; for a comprehensive list, *see* Douglas, *supra* n. 10, at 4-5; for an examination of the extent to which international tax disputes can fall within the scope of application of BITs, *see* de Heer & Kraan, *supra* n. 9. For the use of ICSID arbitration and a discussion of the interaction between BITs and taxation through several ICSID cases that dealt with taxation issues, *see* S. Castagna, *ICSID Arbitration: BITs, Buts and Taxation – An Introductory Guide*, 70 Bull. Intl. Taxn. 7 (2016), Journals IBFD.
13. *See Taxation*, UNCTAD Series on issues in international investment agreements (UNCTAD 2000) (UNCTAD/ITE/IIT/16), which refers to the provisions of several prototype treaties. On the "tax carve-out" that is contained in some trade agreements, *see* Desax, *supra* n. 9, at 892 et seq.
14. This is described as the "qualified exclusion model" (*see* UNCTAD, *supra* n. 13, at 37) as opposed to the "exclusion of tax issues" model, which involves a blanket denial of the application of the MFN and national treatment clauses to tax matters.
15. *See*, for example, the relevant provisions of the NAFTA, discussed in sec. 3.2. and the ECT, discussed in sec. 3.3.; both fall under the category of the "qualified exclusion model" (id., 41 et seq. regarding the NAFTA and 37 et seq. regarding the ECT). On potential taxpayer protection arguments based on a BIT investor's rights, *see* Desax, *supra* n. 9, at 898 et seq. For a discussion on the distinction between ordinary taxation and expropriatory taxation, *see* Gildemeister, *supra* n. 5, at 339 et seq.
16. As the tribunal put it in ICSID, 7 Dec. 2011, Case No. ARB/06/1, *Roussalis v. Romania*, IIC 516 (2011), para. 493:

    > [t]he Tribunal considers that, among the matters falling within the scope of its jurisdiction are general measures taken by the host State in the exercise of its public powers, *including decisions taken by tax authorities and courts, and actions taken by the State's authorities to enforce such decisions*, which allegedly affect the investment in violation of the BIT. (emphasis added)

    Arbitral tribunals have dealt with direct taxation matters in the context of a BIT in the following non-exhaustive list of cases: ICSID, 10 Feb. 1999, Case No. ARB/95/3, *Goetz and ors v. Burundi*, IIC 16 (1999) (withdrawal of a free zone certificate that resulted in loss of tax exemptions in Burundi); ICSID, 14 Jan. 2004, Case No. ARB/01/3, *Enron Corporation and Ponderosa Assets LP (USA) v. Argentina*, Decision on Jurisdiction, IIC 92 (2004) (stamp tax on various operations of the investor); ICSID, 27 Apr. 2006, Case No. ARB/03/15, *El Paso Energy International Co (USA) v. Argentina*, Decision on Jurisdiction, IIC 83 (2006) (on tax measures constituting expropriation); ICSID, 19 Jan. 2007, Case No. ARB/02/5, *PSEG Global Inc and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey*, Award and Annex, IIC 198 (2007) (concerning the *Treaty between the United States of America and the Republic of Turkey Concerning the Reciprocal Encouragement and Protection of Investments* (3 Dec. 1985) and related to tax changes in the host state that increased the tax burden of the investor); ICSID, 18 Sept. 2007, Case No. ARB/02/16, *Sempra Energy International (USA) v. Argentina*, Award, IIC 304 (2007) (concerning various tax claims related to stamp taxes, provincial gross sales taxes and municipal taxes for the occupation of public domain); ICSID, 29 June 2007, Case No. ARB/02/18, *Tokios Tokelés (Lithuania) v. Ukraine*, Award, IIC 331 (2007) (tax investigations related to tax evasion); ICSID, 2 June 2010, Case No. ARB/08/5, *Burlington Resources Inc (USA) v. Ecuador*, Decision on Jurisdiction, IIC 436 (2010) (breach of tax guarantees regarding maximum income tax applicable and exemption from payment of royalties); SCC, 12 Sept. 2010, Case No. 075/2009, *RosInvest Co UK Ltd (Denmark) v. Russian Federation*, Final Award, IIC 471 (2010) (concerning the question of whether additional tax assessments on profits tax and VAT are expropriatory in nature); Ad Hoc Tribunal (UNCITRAL), 28 Apr. 2011, *Paushok and ors (Russia) v. Mongolia*, Award on Jurisdiction and Liability, IIC 490 (2011) (concerning the validity under the *Treaty between the Russian Federation and Mongolia Concerning the Reciprocal Encouragement and Protection of Investments* (29 Nov. 1995) of the windfall profit tax imposed on the sales price of gold); and ICSID, 14 Dec. 2012, Case No. ARB/08/5, *Burlington Resources Incorporated (USA) v. Ecuador*, Decision on liability, IIC 568 (2012) (expropriatory tax measures).

    For a discussion of the *Paushoc* case concerning the imposition of a windfall profit tax and of the *Tokios Tokelés* case on tax investigations related to tax evasion, *see* Gildemeister, *supra* n. 5, at 310-311 and 327-328, respectively.

    For a discussion on the interaction between tax treaties and BITs, and a discussion on several arbitration cases dealing with tax issues, *see* P.K. Sidhu, *Is the Mutual Agreement Procedure Past Its "Best-Before Date" and Does the Future of Tax Dispute Resolution Lie in Mediation and Arbitration?,* 68 Bull. Intl. Taxn. 11 (2014), p. 598, Journals IBFD.

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3. Multilateral Investment Treaties and Direct Taxation

3.1. Introductory remarks

Multilateral investment treaties include free trade agreements (FTAs) and the ECT. These two categories are considered together because, contrary to BITs, they are multilateral international law instruments that confer rights directly upon private (non-state) parties.[19]

3.2. Free trade agreements: Direct taxation matters and the NAFTA

Multilateral free trade agreements are in force in various regions: the North American Free Trade Agreement (NAFTA) (the Agreement),[20] the US-Central America and Dominican Republic Free Trade Area (CAFTA) and the European Free Trade Association (EFTA)[21] are probably the most well known. The NAFTA Chapter 11 dispute resolution mechanism[22] is worthy of special mention, as it allows claims regarding private parties to be brought before an impartial party in a procedure involving mixed arbitration. Chapter 11 establishes a mechanism that ensures the enjoyment of the rights provided for private parties in the Agreement (such as equal treatment) while at the same time guaranteeing due process before an impartial tribunal.[23] A NAFTA investor who has a complaint against a host government

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17. *See*, for example, art. XIII US Model BIT:

    1. No provision of this Treaty shall impose obligations with respect to tax matters, except that:
    (a) Articles III, IX, and X will apply with respect to expropriation; and
    (b) Article IX will apply with respect to an investment agreement or an investment authorization.
    2. A national or company, that asserts in an investment dispute that a tax matter involves an expropriation, may submit that dispute to arbitration pursuant to Article IX(3) only if:
    (a) the national or company concerned has first referred to the competent tax authorities of both Parties the issue of whether the tax matter involves an expropriation; and
    (b) the competent tax authorities have not both determined, within nine months from the time the national or company referred the issue, that the matter does not involve an expropriation […].

18. The UNCTAD paper on taxation, *supra* n. 13, at 36, refers to three reasons why states exclude taxation matters from the scope of application of BITs; these reasons are:

    - many countries prefer to address international taxation issues in separate treaties dealing specifically with such matters in order to maintain maximum fiscal sovereignty;
    - the exception allows countries a certain degree of flexibility in achieving an economic balance with other states, that may not apply in the same way to other countries; and
    - the complexity of tax matters may make such matters unsuitable for inclusion in the kind of standardized provisions that are typical of BITs.

    For a discussion on the fiscal sovereignty concerns related to investor-state disputes, *see* T. Walde & Abba Kolo, *Investor-State Disputes: The Interface between Treaty-Based International Investment Protection and Fiscal Sovereignty*, 35 Intertax 8/9, p. 424 (2007). For a discussion on whether tax disputes are excluded from BIT arbitration from an Indian perspective, *see* A. Kr. Sharma, *International Tax Avoidance Issues: An Analysis of the Indian Law and Policy*, 42 Intertax 12, p. 808 (2014). For the perspective of ASEAN member states on the sovereignty concerns that lead to the adoption of tax carve-outs in BITs, *see* Z. Adam, *Mutual Agreement Procedure Arbitration in Developing Countries – The ASEAN Experience*, 70 Bull. Intl. Taxn. 4 (2016), Journals IBFD.

19. As the aim of WTO agreements is to govern relations between states or regional organizations for economic integration and not to protect individuals, the WTO dispute resolution experience is not relevant for individual tax treaty disputes. For state-to-state disputes, however, covered by art. 25(3) of the *OECD Model*, the WTO experience may offer helpful experience, given the fact that a number of disputes involving direct taxation issues have been dealt with before WTO panels; for a discussion of the WTO rules and the Dispute Settlement Understanding (DSU), *see* K. Perrou, Chapter 4: A Comparative Perspective: Private Parties in International Law Disputes in Taxpayer Participation in Tax Treaty Dispute Resolution (IBFD 2014), Online Books IBFD, in particular Ch. 4.3; for a thorough survey of the WTO tax cases, *see* J.E. Farrell, *The Interface of International Trade Law and Taxation* sec. 3.2. (IBFD 2013); and for a chronological outline of the GATT/WTO case law on direct taxes, *see* J.E. Farrell, id., at sec. 4.3.2.3.

20. The parties to the Agreement are the United States, Canada and Mexico; *see* www.nafta-sec-alena.org.

21. The European Free Trade Association was established by the *Convention Establishing the European Free Trade Association* (4 Jan. 1960), which was replaced by the *Convention Establishing the European Free Trade Association* (21 June 2001). The EFTA currently consists of four countries: Iceland, Liechtenstein, Norway and Switzerland; *see* www.efta.int.

22. *See*, for general information on the NAFTA dispute settlement mechanism, L. Trakman, *Dispute settlement under the NAFTA, Manual and Source Book* (Transnational Publishers 1997). Regarding the "tax veto" that applies with regard to claims of investors that implicate taxation measures, *see* W.W. Park, *Arbitration and Tax Measures in North America*, in *Settlement of Disputes in Tax Treaty Law* p. 565 (M. Lang & M. Züger eds., Linde Verlag 2002).

23. Ch. 11 "effects a sharp transfer of competence from domestic courts to international arbitrators" and "has generated a profound crisis of legitimacy among a wide array of critics and an apologetic response among its supporters"; "critics […] fundamentally challenge the right of Chapter 11 international tribunals to scrutinize sensitive domestic legislation on all manner of substantive and procedural topics (for example, gasoline, hazardous waste, punitive damages or statutory immunity"; *see* A. Afilalo, *Towards a common law of international investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis*, Georgetown Intl. Environmental Law Rev. 51, p. 17 (2004-2005). Regarding the legitimacy crisis of NAFTA Ch. 11 Panels, the author refers to the critics of the NAFTA system and notes (id., at 53) that:

    […] they maintain that international law cannot trump the wisdom of domestic policy achieved via domestic processes and that any holding to the contrary would not be legitimate. They further challenge the legitimacy of the international panels not only on jurisdictional grounds but also because their standards and procedures are seen as inadequate. As The New York Times put it:

    > Their meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a small group of international tribunals handle disputes between private parties and foreign governments, has led to national laws being revoked, justice systems questioned and environmental regulations challenged.

    The same concerns also exist in international taxation dispute resolution; one substantial difference, however, is that the tax treaties that form the legal basis for the dispute resolution contain mainly distributive rules (distributing the tax base between the two contracting parties) and rules pursuant to which the states have agreed to limit their taxing powers (for example, a maximum withholding tax rate in the source state on royalties, interest or dividends). The decision of an international adjudicatory body will, therefore, have little effect on the domestic legislation that applies, if indeed it is found that it applies to its full extent. Transparency issues, which are crucial to the democratic control of any dispute resolution system, are to be decided between the two contracting countries that decide to use international tax arbitration. The use of international arbitration does not necessarily mean that the procedure has to be secret and opaque.

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related to the Agreement has two alternatives: he may use the remedies available in the domestic courts of the host state or, alternatively, he may choose to use arbitration.

Direct taxation issues are not, in general, covered by the NAFTA. There is a limited area of intersection, however, in which the NAFTA applies in the context of direct taxation: the key provisions that concern direct taxation and determine whether a matter involving differential tax treatment can be resolved under the NAFTA are the MFN clause and the national treatment obligation (and their exceptions).[24] According to article 2103 of the NAFTA,[25] however, no obligation exists with regard to any tax matter except as specifically provided for in the NAFTA. In particular, according to article 2103(4)(c) of the NAFTA, the MFN clause does not oblige any party to extend to the other parties any advantages it has agreed to under a tax agreement. In general, direct taxation is, for the most part, carved out of the NAFTA[26] and such matters are left to be determined under the dispute resolution mechanism of tax treaties.

3.3. The ECT: Direct taxation matters

The ECT and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects[27] were signed in December 1994 and entered into force in April 1998. To date, the Treaty has 54 members.[28] The Treaty provides for a comprehensive dispute resolution mechanism offering a variety of options; apart from "state-to-state" arbitration regarding the interpretation or application of the Treaty,[29] investors may have recourse to international arbitration against the host state when an alleged breach of the Treaty has taken place.[30] Although the parties do not have an obligation to notify the Secretariat of the Energy Charter of any dispute resolution procedure, the information compiled by the Energy Charter Secretariat, to date, shows that over 80 cases of "investor versus state" arbitration have been brought by investors,[31] as opposed to only one case of "state versus state" dispute known to the Secretariat, for which the dispute resolution mechanism was not used as the dispute was settled through diplomatic channels.

Article 21 of the ECT provides for a general carve-out of taxation issues.[32] Article 13, however, on expropriation, may apply to taxes on income and capital.[33] Whenever an issue arises under article 13 of the ECT, to the extent that it pertains to the question of whether a tax constitutes an expropriation or whether a tax alleged to constitute an expropriation is discriminatory, a special procedure for the resolution of the dispute is set in motion.[34] The drafters of the ECT seem to have considered that issues related to taxes on income or capital

24. *See* the brief presentation of these provisions in www.ucalgary.ca/biztechlaw/node/290, under the title "NAFTA and Taxation".
25. Art. 2103 NAFTA, on "Taxation", provides in general for the priority of tax treaties over the rights and obligations undertaken in the NAFTA. The principle of national treatment and the MFN clause, which are covered in the chapter on investments, do not apply taxation measures on income, capital gains, or taxable capital of corporations. Art. 1110 (Expropriation and Compensation) also applies to taxation measures, except that no investor may invoke that article as the basis for a claim under art. 1116 (Claim by an Investor of a Party on its Own Behalf) or art. 1117 (Claim by an Investor of a Party on Behalf of an Enterprise), where it has been determined that the measure is not an expropriation. The determination of whether a measure constitutes an expropriation or not is carried out by the appropriate competent authorities (set out in annex 2103.6). If the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation within a period of six months of such referral, the investor may submit its claim to arbitration under art. 1120 (Submission of a Claim to Arbitration). For a discussion on these NAFTA provisions *see* Gildemeister, *supra* n. 5, at 159 et seq. and 225 et seq.
26. Tax matters in the context of the provisions that protect cross-border investments have been the subject of the following NAFTA arbitrations (not an exhaustive list): ICSID, 16 Dec. 2002, Case No. ARB(AF)/99/1, *Feldman Karpa v. Mexico*, Award and separate opinion, IIC 157 (2002) (tax on the production and sale of cigarettes and rebates of that tax in case of exports); ICSID, 20 July 2006, *Grand River Enterprises Six Nations Ltd et al. v. United States*, Decision on Objections to Jurisdiction of 20 July 2006, IIC 128 (2006) (tax on cigarettes in the United States); ICSID, 26 Sept. 2007, Case No. ARB(AF)/04/05, *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v. Mexico*, Award and Separate Opinion, IIC 329 (2007) (excise tax on soft drinks and syrups and the same tax on services used to transfer and distribute soft drinks and syrups); and ICSID, 10 Apr. 2001, *Pope & Talbot Inc v. Canada*, Award on the Merits of Phase 2, IIC 193 (2001) (export tax on softwood lumber imposed by Canada).
27. *Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects* (Dec. 1994), available at http://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/.
28. The Treaty has been signed or acceded to by 52 states, the European Community and Euratom.
29. *See* art. 27 ECT; competition and environmental issues are not subject to this form of dispute resolution; instead, they are to be resolved by bilateral (with regard to competition) and multilateral (in respect of environmental protection) non-binding consultation mechanisms.
30. Art. 26 ECT; the options granted to investors are ICSID (an autonomous international institution with close links to the World Bank), a sole arbitrator or an ad hoc arbitration tribunal established under the rules of the United Nations Commission on International Trade Law (UNCITRAL), or an application to the Arbitration Institute of the Stockholm Chamber of Commerce.
31. Information available at http://www.energycharter.org/what-we-do/dispute-settlement/use-of-the-dispute-settlement-mechanisms/. This number is considered by the Energy Charter Secretariat as an operational record. As of 23 Aug. 2016, a list of 99 cases with publicly available information is available at http://www.energycharter.org/what-we-do/dispute-settlement/all-investment-dispute-settlement-cases/.
32. Many issues related to the interpretation of art. 21 ECT and its scope of application in relation to taxation are raised in the line of cases related to the tax reassessments (among other measures taken) against *Yukos* in the Russian Federation following a finding by the Russian tax authorities that the company had implemented an illegal and fraudulent tax evasion scheme designed to misuse special low-tax zones within the Russian federation; according to the investors, these tax reassessments led to the nationalization of their investment; *see* Permanent Court of Arbitration in the Hague (PCA): 30 Nov. 2009, *Yukos Universal Limited (Isle of Man) v. Russian Federation*, Interim Award on Jurisdiction and Admissibility, Case No. AA 227, IIC 416 (2009) in particular paras. 556 et seq.; PCA: 30 Nov. 2009, *Veteran Petroleum Ltd (Cyprus) v. Russian Federation*, Interim Award on Jurisdiction and Admissibility, Case No. AA 228, IIC 417 (2009); PCA: 30 Nov. 2009, *Hulley Enterprises Ltd (Cyprus) v. Russian Federation*, Interim Award on Jurisdiction and Admissibility, Case No. AA 226, IIC 415 (2009); in all three cases, the Tribunal deferred its definitive interpretation of art. 21 and its characterization of the claimant's claims for the purposes of art. 21, to the next phase of the arbitration, when it expected to have a complete record of the nature of the claims themselves and a fuller understanding of the facts (*see*, for example, para. 585 of the *Yukos Universal v. Russian Federation* award) and *infra*, n. 35. For a discussion on arts. 13 and 21(5) of the ECT, *see* Gildemeister, *supra* n. 5, at 164 et seq and 228 et seq.
33. Art. 21(5)(a) ECT: "Article 13 shall apply to taxes".
34. The scope of application and the detailed special procedures are provided in art. 21(5)(b) ECT.

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would be better dealt with within the familiar context of international double taxation disputes and the competent authority procedures provided therein.[35]

When an issue is related to the non-discriminatory character of a tax that is considered to constitute an expropriation, the ECT explicitly refers to the non-discrimination article of the tax treaty between the two states involved in the dispute, as the only applicable law. If there is no non-discrimination provision in the relevant tax treaty applicable to the tax or no such tax treaty is in force between the contracting parties concerned, then the applicable laws are the non-discrimination principles under the OECD Model (2014).[36] [37]

Apart from the substantive provisions, the ECT also refers explicitly to the organs entrusted with the resolution of a dispute under tax treaties. When a dispute arises that concerns a tax measure, then the investor or the contracting state concerned has to refer the issue to the relevant competent authorities[38] of the two contracting states concerned, as designated in the applicable tax treaty.[39] If the investor or the contracting state fails to do this, then the arbitration tribunals that are called to resolve a dispute under the ECT[40] will have to refer the issue to the relevant competent authorities. The ECT provides for a six-month period in which the competent authorities "shall strive"[41] to resolve the issues referred to them.

The conclusions reached by the competent authorities have different values. The dispute settlement body under the ECT must take into account the conclusion of the competent authorities in respect of any issue regarding the non-discriminatory nature of a tax that allegedly constitutes an expropriation, provided that these conclusions are reached by the competent authorities within the six-month time limit. In contrast, any conclusions regarding (1) the issue of whether a tax constitutes an expropriation or (2) the issue of whether or not a tax that allegedly constitutes an expropriation is discriminatory, that were arrived at by the competent authorities after the expiry of the six-month time limit, are not binding for the dispute settlement body of the ECT; the latter may nevertheless rely on such conclusions in deciding the case brought before it.[42]

The obligation for compatibility of tax assessments imposed on the investor in the host country with the provisions of the ECT was also discussed in *Anatolie and Gabriel Stati, Ascom Group S.A., Terra Raf Trans Traiding Ltd v. Kazakhstan* (2013),[43] where the arbitral tribunal stated that:[44]

> […] there is no doubt that an investor must pay taxes in the host country, as assessed by law. However, there is also no doubt that these tax assessments may be abusively made in breach of the ECT. All of the alleged back tax obligations were created by and during Respondent's conduct after October 2008 which this Tribunal found above to be a string of measures in breach of the ECT. Indeed, the tax assessments were a major part of this string of measures. As the disputed tax assessments were all retro-active assessments for back taxes which had not been assessed during the earlier period before October 2008 when relations between Respondent and the Claimants were still normal, Respondent has the burden of proof that these disputed back tax assessments after October 2008 were not part of this breaching conduct.

In addition to the direct taxation issues specifically covered or not covered by the ECT, as referred to herein, it appears that other articles of the ECT may also be used in order to attack procedural tax issues, such as actions or measures taken by the tax authorities for the collection of taxes against an investor. This was, for example, the situation in *AMTO v. Ukraine* (2008).[45] The investor, AMTO LLC,

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35. *See*, however, the relevant discussion in the final award on the *Yukos* case that was given on 18 July 2014. The arbitration panel discusses in depth the scope of application of the carve-out of art. 21 ECT and its relationship to articles 10 and 13; the panel concludes 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 taxation carve-out in Article 21(1). As a consequence, the Tribunal finds that it does indeed have "direct" jurisdiction over claims under Article 13 (as well as Article 10) in the extraordinary circumstances of this case" (***see*** paras. 1402 et seq. and, in particular, para. 1407 of the Final Award, available at http://www.energycharter.org/fileadmin/DocumentsMedia/Disputes/ISDSC-006a.pdf). Even though both the *Yukos Universal Limited (Isle of Man) v. Russian Federation*, Interim Award on Jurisdiction and Admissibility (30 Nov. 2009) and the Final Award (18 July 2014) were quashed by NL: The Hague District Court, 20 Apr. 2016, Joined Cases C/09/477160 / HA ZA 15-1, C/09/477162 / HA ZA 15-2 and C/09/481619 / HA ZA 15-112**,** available at http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBDHA:2016:4230, the value of the analysis has not diminished; the Hague District Court reversed the awards of the international arbitrators on the grounds that they lacked jurisdiction to arbitrate cases concerning international investment arbitrations based on the ECT, since the Russian Federation had signed the ECT, but never ratified it.
36. *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD.
37. Art. 21(5)(b)(ii) ECT.
38. Compare the findings of the Tribunal in ICSID, 27 Aug. 2008, Case No. ARB/03/24, *Plama Consortium (Cyprus) v. Bulgaria*, IIC 338 (2008), at para. 266, discussed further below.
39. According to the definition provided in art. 21(7)(c) ECT:
    > A "Competent Tax Authority" means the competent authority pursuant to a double taxation agreement in force between the Contracting Parties or, when no such agreement is in force, the minister or ministry responsible for taxes or their authorized representatives.
40. These dispute settlement bodies (institutionalized international arbitration or ad hoc arbitral tribunals) are constituted according to the provisions of art. 26(2)(c) or art. 27(2) ECT.
41. *See* art. 21(5)(b)(ii) ECT; compare the similar wording used in tax treaties, where the competent authorities "shall endeavour" to resolve the case under the MAP (art. 25(2) *OECD Model*).
42. Compare the use of the phrase "shall take into account" as opposed to the phrase "may take into account" in art. 21(5)(b)(iii) ECT.
43. Arbitration Institute of the Stockholm Chamber of Commerce, 19 Dec. 2013, Case No. 116/2010, available at http://www.energycharter.org/fileadmin/DocumentsMedia/Disputes/ISDSC-028a.pdf.
44. Id., at para. 1799.
45. Arbitration Institute of the Stockholm Chamber of Commerce, 26 Mar. 2008, Arbitration No. 080/2005, *AMTO LLC (Latvia) v. Ukraine*.

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complained about the allegedly "aggressive" conduct of the Ukrainian tax authorities. In particular, the investor alleged that the actions of the tax authorities constituted a breach of article 10(1) of the ECT on the promotion, protection and treatment of investments,[46] as the host state, according to the investor, failed to provide treatment that was not unreasonable or discriminatory, and fair and equitable. In addition, the claimant stated that the implementation of an aggressive tax inspection against its subsidiary, including the freezing of its assets, was unreasonable and disproportionate, as well as arbitrary and in breach of the claimant's legitimate expectations.[47] The tribunal, however, found that the claimant had not demonstrated any discriminatory or unfair treatment, or any other breach of article 10(1) arising from the actions of the tax authority. Consequently, the tribunal concluded that:[48]

> […] there is no evidence arising from the tax inspection and related bankruptcy proceedings of any unreasonable, disproportionate, arbitrary, or discriminatory conduct, or any breach of its legitimate expectations. There was no unfair or inequitable treatment, or any other breach of Article 10(1) ECT.

The obligations under article 10(1) of the ECT were also invoked in *Plama Consortium Ltd v. Bulgaria* (2008).[49] In this case, the investor complained that Bulgarian tax law unfairly gave rise to a "paper profit" in respect of which the investor was liable to pay company income tax in Bulgaria, which ran contrary to the obligations imposed on it by virtue of article 10(1), on the one hand, and constituted a hidden expropriation, on the other.[50] The Arbitral Tribunal did not find that any action of Bulgaria gave rise to a breach of the obligations created by the ECT. In particular, the Tribunal pointed out that the investor was informed of the tax legislation of Bulgaria, which was not considered to be discriminatory, unfair, or as leading to expropriation with regard to the paper profit issues raised by the investor.[51]

The above analysis shows that direct taxation issues, both those related to substantive provisions, as well as procedural aspects, may be the core of a "state-investor" dispute under the ECT, within the limits of the Treaty as far as direct taxation issues are concerned. The example of the ECT offers useful experience regarding disputes between a sovereign state and a private party that involve direct taxation issues.

4. Taxpayer Participation in Investment Treaty Arbitration: Some Practical Aspects

In the previous sections, three different systems were presented in respect of which private parties have direct access to international arbitration in order to resolve disputes that arise in the context of bilateral or multilateral investment treaties such as BITs, the NAFTA (1993) and the ECT.[52] As far as the procedure is concerned, it must be noted that this is governed by the arbitration rules that the parties agree upon when the arbitration is set up. What is clear is that the parties, who enjoy the same rights irrespective of the fact that one of them is a private party and the other is a sovereign state, are in control of the proceedings at all times.

First, the parties have the right to nominate an equal number of arbitrators each; subsequently, they have to agree or give their consent to the appointment of the president of the arbitration tribunal. Special rules apply in order to remove a deadlock in the event no agreement is reached within a certain time limit. The parties also agree on the person who is appointed as secretary to the tribunal and on the rules of arbitration, especially on the procedure that is to be followed, as well as the timetable of the arbitration.

Each party can be represented by counsel, usually law firms. It is not rare, however, for states to be represented in the proceedings by their ministry officials rather than by law firms. The number of counsel that each party may use is not limited. Counsel is present or is involved in all stages of the case. The parties may communicate freely and directly with each other (by letters, telephone communication, email, telephone conferences) and with the members of the tribunal.

Each party is entitled to file reports, memorials, counter-memorials and any other documentation it deems relevant to the case; it may submit observations and comments on points of the procedure, as well as issues of substance. The parties may also produce expert opinions and witness reports that are relevant to the case. At oral hearings, the witnesses and experts are examined by the counsel of the parties; after direct examination and cross-examination of witnesses take place, a second direct examination and cross-examination usually follow, on issues raised during the first examination or cross-examination. Interpreters are present to help with the witnesses where necessary. The parties have access to all the records (such as written transcripts of the oral proceedings, translations, minutes of meetings, etc.).

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46. Art. 10(1) ECT creates an obligation for the host state to "encourage and create stable, equitable, favourable and transparent conditions for Investors", including a commitment to accord at all times to investments "fair and equitable treatment". In addition, the states undertake the obligation "not to impair in any way by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal" of the investment. Last but not least, it provides that "in no case shall such investments be accorded treatment less favourable than that required by international law, including treaty obligations".
47. *AMTO LLC (Latvia) v. Ukraine* (2008), para. 96.
48. Id., at para. 99.
49. *Plama Consortium Ltd (Cyprus) v. Bulgaria* (2008).
50. Id., at para. 259.
51. Id., at paras. 265-273.
52. For an overview of several non-tax treaties' dispute resolution mechanisms and their possible use for tax treaty disputes, *see* J.P. Owens et al., *What Can the Tax Community Learn from Dispute Resolution Procedures in Non-Tax Agreements?*, 69 Bull. Intl. Taxn. 10 (2015), Journals IBFD.

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During the meetings or oral hearings, the parties are present, either in person (when the claimant is an individual) or through legal representatives (with regard to corporations), such as the chief executive officer, chief financial officers, chief legal officers, etc., along with their counsel. The parties may agree on whether the witnesses and experts are present at the oral hearing during the examination of other witnesses or experts. The claimants themselves or their legal representatives may be heard as witnesses. Witnesses and experts may also appear by videoconference if the parties agree to it.

The costs related to international arbitration are high and include the legal fees, costs and expenses of each party, as well as the costs of the arbitration (arbitrators' fees, costs of the hosting institution, etc.). As a more or less standard rule, each party bears its own legal costs and expenses, whereas the costs of the arbitration are shared equally by the parties (one half each). The arbitration tribunal may, however, decide on a different partition of the costs. For example, in the case of *PSEG Global Inc and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Širketi v. Turkey* (2007),[53] the Tribunal found that the respondent state, having breached its obligation to accord the investor the fair and equitable treatment guaranteed in article II(3) of the US-Turkey BIT (1985), were to bear 65% of the total costs of the arbitration, which, including legal costs and fees, was set at USD 20,851,636.62.[54] In another example, the Tribunal, having found that the claimant was not entitled to any of the substantive protections afforded by the ECT, ordered the claimant to pay all fees and expenses of the Arbitral Tribunal, ICSID's administrative charges, being USD 919,985, as well as USD 7 million on account of the respondent's legal fees and other costs (the respondent state had submitted a claim for legal and other costs of USD 13,243,357).[55]

5. Conclusions

The analysis in the previous sections offers insight into the experience that arbitration bodies have gained in dealing with international direct taxation disputes on the basis of legal instruments other than tax treaties. In those cases, taxpayers had direct access to public international law institutions to defend their case. The access so granted to private parties is aimed at facilitating the pursuit of their rights; such rights may be founded on domestic law or on international law. In these cases, private parties do not act in the international sphere as substitutes for their national states; instead, they act in their own name, asserting their own rights against the foreign (host) state.

Of course, the criticism and negative nuances that accompany an investment treaty arbitration, especially in respect of developing countries, should not be ignored. The aim of this analysis, however, is not to support or promote this institution but rather to offer some practical guidance to states wishing to use arbitration for international tax disputes and wishing to offer an enhanced level of taxpayer rights in the dispute resolution procedure.

Tax matters are only the subject of international investment treaties to a limited extent and, consequently, only a small number of cases that involve taxation issues have been dealt with by international tribunals. Nevertheless, these cases show that the "taxpayer versus state" dispute resolution model may, in practice, work and useful practical conclusions may be drawn from the experience gained through the arbitration of tax disputes under the international investment law regime. The small-scale sample of tax cases dealt with by international arbitration tribunals (in the context of various investment instruments) offers a useful preview of how a similar system would work on a large scale, in the context of tax treaties.

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53. ICSID, 19 Jan. 2007, Case No. ARB/02/5, *PSEG Global Inc and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Širketi v. Turkey*, Award and Annex, IIC 198 (2007). For a discussion of this case *see* Gildemeister, *supra* n. 5, at 302 et seq.
54. According to the award (id.):

> The Respondent shall pay 65% of the costs of the arbitration and legal costs and fees (US$13,553,563.80), of which it has already advanced US$8,950,832.10. The Claimants shall pay 35% of the costs of the arbitration and legal costs and fees (US$7,298,072.81), having paid US$11,900,804.52. Therefore, the Respondent shall pay to PSEG Global US$4,602,731.70 in respect of such costs.

55. *Plama Consortium Ltd v. Bulgaria* (2008).

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