The Treatment of (National) Taxes in Tax and Non-Tax (International) Agreements

Purpose: Information
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The Treatment of (National) Taxes in Tax and Non-Tax (International) Agreements

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In a nutshell

Can tax disputes be shifted to investor-state arbitration?

Facts: trend in investor-state arbitration
Why? No systematic tax exception in investment treaties

Prospects and policy lessons: tax an “old new-issue”

Does the ongoing international tax reform increase the risk of triggering more tax disputes in the context of investment treaties?
Tax disputes under IIAs are not accidents

Since 1999, at least 32 tax-related cases have been brought to international investment arbitration.

Foreign investors considered using investment treaties to complain against a number of countries and tax measures.

Typology of the tax disputes shows the diversity of tax measures reviewed by ISA.

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Tax Disputes Lost by the Host States

Out of the 32 disputes dealing with tax matters, 15 have been lost by the host states.

- These disputes are the most interesting because they show what can go wrong in terms of designing tax policy in accord with investment treaties.

The majority of cases (exactly nine awards) concluded with a finding of expropriation.

- However, two claims were consolidated into a single case for Rent a 4 and Quasar de Valores v. Russia.
- Also, as part of the Yukos case, three separate lawsuits by former Yukos shareholders were filed by Hulley Enterprises Limited (Cyprus), Yukos Universal Limited (Isle of Man) and Veteran Petroleum Limited (Cyprus).
- As a result, there are only six truly different tax disputes that resulted in a finding of expropriation.

However 6 other cases resulted in a breach of FET or NT

Typology

Great diversity of tax measures that are at the origin of the dispute:

- windfall profits tax,
- tax investigations,
- value-added tax,
- taxation of income trusts,
- import taxes,
- corporate income tax,
- tax stamps on cigarettes,
- duty-free regime, etc.

Unsurprisingly, the broad scope of application of investment treaties allows tribunals to look at a wide variety of tax measures.
Complex regime of Taxation Exclusion from IIAs

If taxation isn’t excluded, taxation is covered by investment treaties. Exceptions regime is (very) complex:

- Host States’ conduct to address tax erosion by investors can be restricted by substantive obligations derived from IIAs.
- Exceptions regime is (very) complex

They can be categorized into 7 main types:

- General exclusion (1),
- Limited exclusion (2)(3)(4),
- Tax veto to expropriation case (5),
- Priority of taxation treaties over IIAs (6).
- Sometimes types of exclusion and/or exceptions can be complexly combined in one investment treaty (7).

Example (1): Limited exclusion in relation to NT and MFN standards

Some BITs exclude the application of NT and MFN from treatments resulting from ‘any matter’ related to taxation.

For example, Article 3(3) of Austria/India BIT (1999) states as follows:

- (3) The provisions of paragraph (1) [i.e. NT and MFN] shall not be construed as to oblige one Contracting Party to extend to the investors of the other Contracting Party and their investments the present or future benefit of any treatment, preference or privilege resulting from [...] any matter, including international agreements, pertaining wholly or mainly to taxation.
Example (2) Priority of taxation treaties over IIAs

Some BITs insert no express provision on exclusion of taxation from its coverage, but provide priority of taxation treaties over the investment treaty, which can be qualified as ‘explicit conflict clauses.’

For example, Article 20 of Japan/Iraq BIT (2012) stipulates:

- Nothing in this Agreement shall affect the rights and obligations of either Contracting Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.
- This type of BITs still applies to taxation, but to the extent that is covered by taxation treaties, the latter shall prevail.

Tax and investment do not co-exist in clinical isolation

- Several IIAs exclude taxation issues from their scope of regulation, though the extent of exclusion may vary from one treaty to another.
- Some investment treaties still cover taxation.
- Issue: Host states’ sovereign power to taxation can be subjected to the scrutiny of investment arbitration.
International Taxation rapid evolution

Significant losses of national tax revenues
Sophisticated tax planning by MNES aimed at shifting profits in ways that erode the taxable base.
Most tax planning schemes legal: ‘outdated’ international taxation system.

Reaction is ‘BEPS’
OECD originated the Action Plan on tax base erosion and profit shifting

Main instrument: Mutual Agreement Procedures (MAPs).
Few constraints in terms of timeliness of MAP,
Little involvement on the part of taxpayers...

International Taxation

• Tax among last bastions of Westphalian sovereignty.
  Little progress had been made towards a multilateral tax regime, until recently.
  International tax law is centered on a network of more than 3,800 bilateral tax treaties.
  Panama papers HSBC, LuxLeaks...

New Deal for the International Tax Regime
The OECD’s Package on Base Erosion and Profit Shifting (BEPS) (October 2015).
15 “actions”: countering harmful tax practices, treaty shopping, transfer pricing, interest deductibility, and transparency to exploring the tax implications of the digital economy
Implementation has begun (OECD report to G20, Shanghai, 26-27 February 2016).
Is BEPS tax transfer pricing relevant to invest treaties?

Look at size of intra-group flows...

Climate of tax uncertainty

These disputes may be fuelled by tax authorities having unprecedented access to information on the global operations of MNEs

- Country-by-Country Reporting; Transfer Pricing Master and Local Files.
- This global access to information should, in the long term, lead to fewer disputes,

However, BEPS on short term could lead some tax authorities to adopt a more aggressive approach

- Some may be tempted to use this information to move towards a more global formula apportionment approach to transfer pricing.
- Investors will react by increasingly relying on ISA (Back-door)
G20 big push on tax is going to affect a lot of powerful people, so there will be pushback...

- In the meantime, re-thinking the complementarity tax-investment (and trade) treaties
  - Distinguish the two systems (consistency in the use of tax exceptions)
  - Establishment of dedicated tax tribunals is urgent but tax calls for greater reduction of regulatory autonomy

Growing number of international disputes that involve a tax issue.
- Investment and trade treaties do provide for compulsory adjudication (albeit with limited tax carveouts) but are not the most appropriate for to interpret and develop the meaning of complex tax rules.
- Tax, trade, and investment spheres are increasingly overlapping.
- Sovereign tax regulatory autonomy affected by the backdoor.