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Squaring bilateralism with multilateralism: What investment law reformers can learn from the international tax regime[*]

by

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The international tax regime was recently sweepingly reformed. In 2018, the Multilateral Instrument (MLI) entered into force, modifying thousands of bilateral double taxation treaties (DTTs) in substance and procedure. The MLI convention is part of the OECD's tax base erosion and profit shifting (BEPS) agenda and resulted from a concerted, inclusive and multilateral effort initiated by the G20 after the global financial crisis to curb international corporate tax avoidance. By August 2019, 89 countries, including all G20 countries except Brazil and the United States, had signed the MLI. In spite of its scope and ambition, few outside the tax community have taken notice. That is unfortunate, because the MLI can provide valuable lessons for ongoing multilateral efforts to reform international investment law.

The international tax and investment regimes have much in common. As recently as 2011, UNCTAD referred to DTTs and bilateral investment treaties (BITs) jointly as international investment agreements.[1] That makes sense. Whereas BITs protect foreign investment against undue *regulatory* interference by promising compensation for unlawful expropriation or discriminatory treatment, DTTs protect foreign investment more narrowly against undue *fiscal* interference by allocating the right to tax between investors' home and host countries to avoid double taxation. In addition, both regimes share the same decentralized structure. They are based on thousands of bilateral agreements concluded over multiple decades that share similar principles (inspired by earlier OECD Draft Conventions) but differ in their fine print. Finally, both regimes have recently faced significant legitimacy crises that pitted corporate interests against those of taxpayers. BITs have been criticized for prioritizing private profits over public regulatory autonomy, and DTTs have been attacked for enabling fiscal evasion and tax base erosion.

Given these commonalities, developments in one field can inspire action in the other. The MLI represents the international tax regime's response to its legitimacy crisis. It constitutes a sophisticated attempt to achieve an ambitious multilateral reform in a decentralized regime built on bilateral treaties. As such, it offers three useful lessons that can guide investment law reformers.

- The MLI modifies but does not replace bilateral DTTs, leaving the regime's decentralized architecture in place. The MLI is an opt-in agreement similar to the Mauritius Convention on Transparency in investor-state arbitration, but is more ambitious in scope. It introduces changes to DTTs' preambles, adds new substantive provisions and strengthens enforcement, including through a new optional arbitration mechanism. The OECD has set up an online database to resolve the ensuing complexities of having to read DTTs in conjunction with the MLI. For investment lawyers, the mechanics of the MLI constitute an attractive alternative to a multilateral treaty that seeks to replace BITs (like the failed 1998 Multilateral Agreement on Investment). An agreement modeled on the MLI would preserve the bilateral structure of the investment regime, while introducing ambitious, efficient and multilaterally coordinated modifications to all covered BITs.

- The MLI carefully updates thousands of DTTs in substance and procedure to address the regime's legitimacy concerns. While recent DTTs strike an explicit balance between avoiding double taxation whilst ensuring taxation, older DTTs contain imprecise language that facilitates treaty shopping and abuse resulting in double *non*-taxation. The MLI closes these loopholes and aligns past treaties with today's best practices. The investment regime would benefit from a similar modernization, since most BITs were concluded prior to 2000 and failed to balance investment protection with states' regulatory autonomy. An MLI-style reform could thus effectively update the outdated stock of agreements in substance and procedure and align older investment agreements with current best practices.

- The MLI provides a carefully balanced design to combine mandatory minimum standards with the flexibility to accommodate diverging state preferences. On the one hand, the MLI mandates a set of substantive and procedural obligations to achieve the reform's objective of curbing DTT abuse. On the other hand, it provides flexibility on all other matters to contract out or around the MLI. This makes the treaty attractive to signatories whose preferences may diverge on selected issues. For example, the MLI's arbitration mechanism is optional. A similar design choice could facilitate an ambitious investment law reform. Governments could agree on a set of mandatory investment protections (e.g., on expropriation) and exceptions (e.g., on police powers), set out common procedural standards (e.g., on authoritative interpretations) and clarify grey areas (e.g. on valuation of damages). More controversial aspects, such as higher protective standards, investment liberalization or the modalities of investor-state dispute settlement, could take the form of opt-in or opt-out mechanisms.

The MLI constitutes a template for a creative and ambitious investment law reform that goes beyond the narrow procedural fixes thus far contemplated in ongoing UNCITRAL Working Group III talks. The MLI is multilateral in nature, but preserves the regime's bilateral architecture. It addresses legitimacy concerns comprehensively, eschewing a rigid distinction between procedure and substance, but remains tailored in scope. It sets minimum standards, but does not require agreement on all issues. In short, the MLI invites investment lawyers to learn from the international tax regime in considering novel and flexible ways of squaring bilateralism with multilateralism in investment law reform.

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[1] UNCTAD, *World Investment Report* 2011 (Geneva: UNCTAD, 2011), p. 100.

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