Reforming International Investment Law to Advance Tax Justice

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1 Introduction

In its current form, the existing framework for international investment law often fails to advance and sometimes actively impedes the advancement of sustainable development objectives. Investment treaties have not been proven to effectively deliver increased investment in host countries,[1] and as a result of their substantive and procedural limitations, they can exacerbate domestic disparities and discourage human rights-informed and environmentally-conscious governance.[2]

Investment treaties typically grant protections and incentives to foreign investors and enable them to seek remedies if they consider these provisions have been breached. Remedies are sought through investor-state dispute settlement (ISDS), a system that foreign investors can use to bring claims to international arbitral tribunals, wherein investors allege that the actions of a host state are in breach of investment treaty provisions.[3] This system grants stronger protections to investors in comparison to other affected parties and makes it possible for the rights and interests of affected third parties, including local communities, indigenous groups, and domestic investors, to be ignored.[4]

ISDS cases can generate excessive legal costs and exorbitant awards if decided in favor of the investor.[5] The average amount awarded to investors by arbitral tribunals is USD 184 million with outliers excluded, and USD 437.5 million with those three particularly large awards included.[6] These awards consume considerable portions of state budgets, diverting resources away from public investments in health, education, infrastructure, and other national priorities.[7] Both the threat and the actual pursuit of such claims impact states' ability to govern as sovereign nations and pursue action in the public interest.

Tax policy is a key dimension of this larger problem. Investors use investment treaty provisions—which notably include national treatment,[8] most-favored nation (MFN) clause,[9] fair and equitable treatment (FET),[10] and expropriation provisions [11]— to initiate ISDS claims, potentially impacting or directly targeting tax policy.[12] These

impacts may chill a state's regulatory agenda, harming efforts to change or establish taxation measures that seek to protect their tax bases or that are otherwise in the public interest. This regulatory chill can have further impacts on states' policy-making regarding actions intended to address climate change,[13] the energy transition,[14] and human rights[15] and environmental protection,[16] among others.

Worldwide, investors have challenged tax-related measures in at least 165 claims, accounting for 15% of the 1,190 publicly-known, treaty-based claims as of the end of 2021.[17] This excludes any consideration of contract-based claims. Of these tax-related cases, states in Eastern Europe, Central Asia, Latin America, and Sub-Saharan Africa comprise a large majority of respondents at approximately 75%.[18] Countries that have notably faced tax-related ISDS cases include Uganda, India, Laos, Algeria, Yemen, Ecuador, Venezuela, Peru, Bolivia, Mexico, and Argentina.[19]

The growing trends of ISDS and a consistently high number of cases in recent years[20] pose an urgent need to strengthen governance and allow host states to preserve their regulatory space. In addition, tax-related issues feature as a component of ISDS proceedings framed around other issues, including cases that challenge measures intended to address money laundering, tax evasion, or bankruptcy.[21]

It is a state's sovereign right under international law to tax.[22] Moreover, effective taxation is fundamental for the proper economic functioning of a state and the achievement of goals in the public interest, including the Sustainable Development Goals (**SDGs**). National governments may choose to amend their tax regimes to increase domestic resources to drive sustainable development objectives, to correct for historical inequities, to close loopholes in tax regimes, or to address national or global crises. Governments may also need to amend or adjust existing tax measures where those measures are no longer consistent with good tax practice or are otherwise out of date.

In this context, the concept of tax justice refers to ideas, policies, and advocacy that seek to achieve equality and social justice through fair and equitable tax structures.[23] If a tax system is to be fair, it should be progressive and redistribute income in an inclusive manner; raise revenues to fund public services; address harmful tax competition and tax incentives that unfairly privilege certain social groups; and curb illicit financial flows such as tax evasion and avoidance.[24] The four goals of tax justice have been articulated this way:

1. Raising revenue to fund human development and address poverty,
2. Redistributing wealth and addressing inequality,
3. Representation, which includes enhancing democratic processes and strengthening the social contract between governments and their citizens, and
4. Repricing social and environmental ills in the public interest, such as discouraging the use of tobacco or reducing carbon emissions.[25]

Tax justice is especially critical for less developed countries, which have a limited tax base[26] and are most dependent on taxation of multinational enterprises (**MNEs**) and wealthy individuals for government revenues.[27] However, these same countries are particularly vulnerable to tax avoidance and evasion by MNEs and wealthy individuals respectively, leading to base erosion and profit shifting (**BEPS**).[28]

BEPS occurs as a result of corporate tax-planning strategies that deliberately exploit mismatches in taxation rules and gaps across jurisdictions.[29] Similarly, wealthy individuals have the ability to move their money across jurisdictions. This international mobility of capital necessitates effective taxation that incorporates both international cooperation and strong domestic institutions. However, most countries face considerable challenges when looking to establish and promote fair tax systems. Developing countries must also grapple with additional capacity challenges and coercive international policies driven by wealthier countries.[30]

Given that taxation is crucial in sustaining public economic architecture and in advancing sustainable development goals, it is critical to understand how and to what extent ISDS can impact states' tax policy-making practices. ISDS can pose a challenge to governments that are seeking to advance tax justice by placing constraints on states' ability to implement new tax measures, rollback subsidies and other tax incentives, and enforce existing tax legislation. This brief outlines an illustrative series of case studies that demonstrate how foreign investors have used ISDS to challenge these tax measures and the impacts said challenges can have on states' efforts to pursue fair and effective tax policies.

2 Investor-State Disputes Challenging Tax Measures

2.1 Cases Involving New Taxes

As the global economy evolves and states continue to adapt to changes in demand for their goods and resources, it is especially important that developing countries have the opportunity to adjust their tax regimes as necessary to realize fiscal benefits. To this aim, states can adopt a series of measures and policies, such as imposing capital gains taxes and windfall profit taxes.

Capital gains taxes are tariffs imposed on profit earned from the sale of property and investments. They apply to capital assets, including exploitation permits, direct and indirect sales of businesses, and transfers of industry assets, including shares, and are distinct from corporate income taxes.[31] Capital gains taxes are particularly important when the sale involves states' natural resources. Foreign investors whose business operations benefit from a state's resources should reasonably expect for a state to exercise its right to tax, especially in circumstances when the investment agreement or contract provides for exceptions to investor protections for tax.[32]

A windfall profits tax is a one-time added tax on large and unexpected earnings caused by economic conditions. It is important to note that unexpected earnings generated by favorable economic conditions rarely have anything to do with direct actions taken by an investor through the course of its business operations. Windfall profits taxes have been used in a number of cases to capture the additional profit on top of an investor's earnings that is generated by these favorable economic conditions, without discouraging future investment or impacting the health of the sector.[33] States may choose to initiate taxes on windfall profit to increase revenue for public infrastructure and development objectives.

Several ISDS cases have centered on states' imposition of new taxes, and windfall taxes in particular.

ConocoPhillips and Perenco v. Viet Nam[34]

In 2012, multinational energy company ConocoPhillips sold its Vietnamese operations via two of its U.K. subsidiaries to a subsidiary of the Anglo-French company Perenco.[35] The sale generated USD 896 million in profit for Conoco who, at the time, was not subject to any Vietnamese tax on the capital gains of the transaction.[36] In 2015, Viet Nam began to make plans to impose a capital gains tax on the transaction of USD 179 million under the terms of the United Kingdom - Vietnam Tax Treaty, which entered into force in 1994,[37] and allegedly communicated this intention to both Perenco and ConocoPhillips.[38] In 2017, the companies filed an arbitration request under the United Kingdom – Viet Nam Bilateral Investment Treaty (BIT), claiming the imposition of the capital gains tax violated the BIT.[39] While both companies held that they should not be subject to any sort of tax in Vietnam, especially considering that the transaction took place between UK companies, Vietnam maintains that it is its right to tax gains that occur as a result of the exploitation of its natural resources.[40] The case has reportedly been settled in principle as of 2020, but the terms of the settlement have not yet been made public.[41]

Perenco v. Ecuador[42]

In 2006, following unexpected spikes in oil prices, Ecuador instituted Law No. 42, followed by Decree No. 662, amending the states' share of a windfall oil profits[43] first to 50% and then to 99%, emphasizing the need for oil revenues to be shared with the public.[44] As a result of this law, Ecuador had a number of ISDS cases brought against it in the ensuing years, including *Murphy v. Ecuador (I)*, *Murphy v. Ecuador (II)*, *Burlington v. Ecuador*, and *Occidental Petroleum v. Ecuador*.

In 2008, Perenco, a French energy company based out of the Bahamas, brought Ecuador to arbitration alleging the new windfall profit tax constituted an expropriation of its investment under the Ecuador - France BIT and two concession contracts.[45] Three years later, Ecuador lodged its own complaint against Perenco, alongside a similar claim against American company Burlington,[46] alleging both companies had caused environmental damage in the Amazon, failing to notify Ecuador of a number of oil spills that had taken place between 2002 and 2009, which was a breach of both environmental law in Ecuador as well as the concession contracts with the state.[47] The counterclaim against Perenco sought approximately USD 2.5 billion in compensation and was substantiated by both Ecuador's 2008 Constitution which codified strict liability for environmental damages as well as Ecuadorian courts who had been confirming the approach since 2002.[48]

The tribunal found that environmental counterclaim had merit and that Perenco bore some responsibility for the contamination, requiring Perenco to pay approximately USD 54 million.[49] On the larger ISDS proceeding, the tribunal decided in favor of the investor in 2019 and awarded USD 416.5 million USD to Perenco.[50]

ConocoPhillips v. Venezuela[51]

In 2007, Venezuela sought to restructure three projects in the Orinoco Oil Belt —the Hamaca, Petrozuata, and Corocoro fields—in which a number of U.S. oil multinational ConocoPhillips's Netherland subsidiaries had invested.[52] This restructuring was meant to grant 60% ownership to Petróleos de Venezuela, S.A. (PVDSA), Venezuela's state-owned oil company and align ConocoPhillips's investment with the legal and fiscal requirements that had been applied to all other companies with business operations in oil in Venezuela.[53] PVDSA proceeded to nationalize the projects after ConocoPhillips ultimately rejected the restructuring terms and exited the Venezuelan market.[54] In April of 2008, Venezuela enacted a windfall profits tax that "applied to export or transportation of liquid hydrocarbons abroad when, in respect of any month, the average price of Brent crude exceeds USD 70 per barrel…" to be paid to the National Development Fund.[55] Amendments to the payment structure of this tax were made in 2011 and again in 2013.[56]

When ConocoPhillips initiated arbitration in 2007 under the Netherlands-Venezuela BIT, it claimed that (1) the revenue generated by the windfall profits tax should be included in the valuation of reasonable expected profits that occurred after the expropriation of the investment projects and (2) that the windfall profits tax was considered a "discriminatory action" under the Petrozuata Association Agreement for the projects' original contracts.[57] Venezuela was found liable in 2019 for unlawful expropriation. Notably, however, the tribunal determined the windfall profits tax should not be included in the valuation, but that it did constitute discriminatory action.[58] The tribunal awarded ConocoPhillips USD 8.4 billion for the expropriation under the BIT and USD 286 million for "discriminatory actions" that violated the Petrozuata Association Agreement, however annulment proceedings are currently pending.[59]

2.2 Rollbacks of Subsidies or Other Incentives

When states are seeking to encourage foreign investment, they may offer various investment incentives, some of which may particularly focus on a state's tax landscape, such as subsidies and tax exemptions. Alongside other

investment incentives, tax-specific incentives can be offered with the goal of achieving public interest or economic objectives.

Subsidies are direct or indirect grants or tax breaks given to companies to attract foreign direct investment or incentivize the development of a specific sector within a state's economy. They may support research and development and innovation, subsidize job training or workers' wages, or provide financing options that can mitigate start-up costs or balance an investor's operations.[60]

Alternatively, tax exemptions are mechanisms employed to reduce the cost of a company's economic activity in a particular area through the reduction or removal of tax that would otherwise be imposed on the company's business activities. These can include exemptions from customs taxes, value-add taxes, as well as certificates of free zone.[61] For instance, in the early to mid-2000s, some EU countries used feed-in tariffs as their main policy mechanism to induce investment in the renewable energy sector.[62]

There may be occasions where a state is forced or chooses to withdraw subsidies or tax exemptions as a result of external factors, such as diplomatic obligations, changes in international tax norms, or pressures or shifts in the global economy. In the context of the financial crisis of 2008 and the consequent global reduction of electricity consumption, incentives policies became financially unsustainable for many EU governments as they accumulated massive tariff deficits in the electricity system.[63] As a result, governments rolled back or revoked renewable energy incentives policies to stop the tariff deficit from increasing. In response, foreign investors claimed that regulatory changes violated the protection of legitimate expectations under the Energy Charter Treaty (**ECT**). Investors have challenged similar types of withdrawals of incentives and subsidies through provisions outlined in other investment treaties.

The 80+ publicly-known renewable energy ISDS cases brought under investment treaties—the majority of which have been brought under the ECT[64]—are a prime example of barriers that the ISDS system can present for sustainable investment and for achieving SDG-aligned goals, such as climate mitigation. ISDS tribunals have expanded the scope of investor protections and privileges beyond equivalent protections found in domestic legal frameworks. This limits the critical policy and fiscal space governments need to regulate areas such as the energy transition and increases the costs to states and their citizens from consequential policy issues such as the climate crisis.

A stark example is Spain who has been subject to at least 51 known ISDS cases pertaining to the rollback in its renewable energy sector incentives policies. So far, Spain owes more than EUR 1.2 billion in compensation to investors whose claims have been successful, which is "equal to the country's entire spending commitment to fight the climate crisis or five times what it spent to alleviate energy poverty in 2021."[65] Spain also owes EUR 101 million in associated legal and arbitration fees.

The proliferation of claims and threatened claims challenging changes to incentives policies substantially increase the cost to states of implementing regulatory tools that require flexibility. Flexibility which is necessary due to complex and evolving technologies, financial factors, and assumptions about costs and markets, among other changing circumstances.[66] Indeed, the regulatory chill that is emerging in light of increasingly costly investor–state disputes may ultimately undermine the very tools that may be effective at promoting investments.[67]

Charanne and Construction Investments v. Spain[68]

In the early 2000s, many companies benefited from the Spanish government's special regulatory framework for the photovoltaic sector.[69] Established in 2007, Grupo T-Solar Global S.A. (**T-Solar**), whose shareholders included Dutch company Charanne and Luxembourg company Construction Investments in 2009, was one of these companies.[70] In 2010, the Spanish government rolled out a number of amendments to this regulatory framework, leading to the

elimination of incentive payments–also known as the revocation of feed-in tariffs–and urgent measures passed to correct rising tariff deficits.[71] Additionally, these decrees created 30-year limits on tariffs, imposed an annual cap on the amount of electricity photovoltaic companies could sell above the market rate, and, ultimately, became focal points for a number of ISDS claims in Spain brought under the ECT.[72]

Charanne and Construction Investments brought a claim in 2012 on behalf of T-Solar, claiming that these revisions to the regulatory framework breached the FET and expropriation provisions of the ECT.[73] The shareholders claimed that the 2010 laws retroactively changed the terms of their investment in a solar generation plant and impacted their ECT protections.[74] Among other analyses, the tribunal asserted that, since there were no signed contracts with Spain, investors, like Charanne and Construction Investments, did not have legitimate expectations that Spain's regulatory environment would remain unchanged during the lifetime of these investment projects.[75] The case was decided on the merits in favor of the state in 2016 with the tribunal rejecting Charanne and Construction Investments' claims in their entirety.[76]

CEF Energia v. Italy[77]

Between 2005 and 2012, Italy enacted an incentive framework to encourage green energy production, particularly production within the photovoltaic sector.[78] The framework manifested through Legislative Decree 387 which was followed by a series ministerial decrees, numbered one through five, called "Conto" or "Conto Energia" that outlined the various rules and requirements for tariff premiums.[79] Decree 387 also outlined that state-owned energy company GSE (Gestore dei Servizi Energetici) was responsible for paying out incentives and was the entity with which companies would enter into contract.[80]

Dutch energy company CEF Energia acquired three photovoltaic companies: Megasol S.r.l. (in January 2010), Phenix S.r.l. (in December 2010), and Enersol S.r.l. (in March 2012).[81] Between 2011 and 2012, each of these three companies entered into contracts with GSE to benefit from the incentive tariffs.[82]

In 2014, within the context of similar reforms across the European continent, Italy began to reform this model by both decreasing and ultimately stopping new incentives as well as altering existing incentives in a process known as *Spalma Incentivi*. Under *Spalma Incentivi*, Megasol, Phenix, and Enersol's tariffs enjoyed under the incentives program were cut by six to eight percent.[83] CEF Energia subsequently initiated ISDS proceedings in November 2015, claiming breaches of the FET standard and the umbrella clause as well as arbitrary, unreasonable, and discriminatory measures.[84]

Italy argued that some of the reforms undertaken were tax measures, so they were legal under the ECT's tax carve out clause and out of the tribunal's jurisdiction.[85] The tribunal agreed on this front. Because of this, the only CEF Energia claim subject to the tribunal's analysis and decision was whether the *Spalma Incentivi* reforms constituted a breach of the FET standard.[86] Since both Megasol and Phenix were not beneficiaries of the GSE incentive scheme when CEF Energia acquired them, only Enersol had an FET claim.[87] The tribunal agreed with Italy's claim that the reform measures were not unreasonable, had origins in a legitimate goal, and were made with the goal of maintaining the sustainability of the incentive system.[88] However, the tribunal stated that this did not outweigh CEF Energia's expectations regarding the nature of its investment. Thus, the tribunal found that Italy had partially breached the FET standard with respect to Enersol, awarding EUR 9.6 million (USD 11 million).[89]

Goetz v. Burundi (I)[90]

Affinage des Métaux (AFFIMET) is a Burundian-based company whose business operations primarily concern producing and marketing precious metals across local, regional, and international markets and is primarily owned by Antoine Goetz, along with five other Belgian shareholders.[91] In 1993, Burundi granted AFFIMET a "certificate of

free zone" that conferred upon it certain tax and customs exemptions as part of a 1992 Burundian law creating a free zone regime.[92] Burundi withdrew AFFIMET's certificate in 1995 on the grounds that companies who extracted and sold ore were no longer able to benefit from the free zone regime, causing Goetz and the other shareholders to sustain losses.[93] Shortly thereafter, AFFIMET gave notice to the Burundian government that, unless a settlement was reached, it would initiate arbitration under the Belgium-Luxembourg Economic Union - Burundi BIT and sought diplomatic support from the Belgian government.[94] Goetz and AFFIMET's other shareholders subsequently filed their request for arbitration just a few months later.[95]

While proceedings took place, AFFIMET and the Burundian government entered into settlement negotiations, so the tribunal elected to render a decision on liability rather than an award.[96] The tribunal's decision in 1998 found that Burundi had acted in the public interest, without discrimination, and in compliance with required legal procedures, but that Burundi had not provided the appropriate compensation, required under the BIT, to AFFIMET for the withdrawal of its certificate.[97] Following the decision on liability found by the tribunal, the parties ultimately agreed in 1998 that Burundi would pay AFFIMET approximately USD 3 million.[98]

Micula v. Romania (I)[99]

In 1998, Romania enacted an ordinance (EGO 24) that granted a number of tax incentives[100] to investors who met certain requirements to invest in disfavored regions of the country.[101] These incentives included exemptions from the payment of customs duties and value-added tax (VAT) for certain types of machinery, refunds on customs duties on raw materials, exemption from the payment of both a profit tax as well as a tax collected for the removal from agricultural use of land, and a number of subsidies that were meant to encourage exports and finance investment projects, among other aims.[102]

Two Swedish brothers, Ioan and Viorel Micula, who owned a series of Romanian food processing and manufacturing companies, notably European Food S.A, Starmill S.R.L., and Multipack S.R.L., benefitted from these incentives, receiving customs duties exemptions[103] as well as exemptions from VATs and taxes on profits, which they expected to be maintained for ten years.[104] In 2005, Romania and Bulgaria signed a Treaty of Accession to the European Union.[105] In preparation for its 2007 accession to the EU, Romania repealed a number of the tax incentives under this ordinance, with the exception of the profit tax incentive, in order to be in compliance with EU state aid obligations.[106] The allegedly premature repeal of these tax incentives caused the Swedish investors and their three companies to initiate an ISDS claim in 2005 under the Romania - Sweden BIT.[107]

The Miculas claimed, among other breaches, that Romania's repeal of the various tax incentives demonstrated a failure to "...provide a stable and predictable legal and business environment…", diminished the investors' "...legitimate expectations with respect to the regulatory framework…", was not undertaken transparently, and constituted a bad faith action. [108] Romania, however, argued that political and economic motivations to join the EU had not only been in place for a number of years, but that there was a certain amount of confidentiality that had to be maintained during their talks with the EU.[109]

In its decision, the tribunal found that Romania breached the FET standard and: (1) violated the Micula brothers' legitimate expectations, (2) acted unreasonably by maintaining duties and obligations under the incentive program while repealing essentially all benefits, and (3) failed to inform Romania in a timely manner of the forthcoming repeal.[110] The tribunal additionally asserted that Romania's contention that it was required to retain confidentiality during negotiations with the EU was unjustified.[111] Notably, however, the tribunal determined that Romania's conduct as it pertained to the elimination of the incentives scheme was reasonable, noting that Romania fought to grandfather the existing incentives for as long as possible, that "…the repeal of the EGO 24 incentives was reasonably related to a rational policy objective…, and there was an appropriate correlation between that objective and the measure adopted to achieve it..."[112]

In 2013, the tribunal decided in favor of the investor and awarded the Micula brothers approximately USD 116.2 million with interest.[113] In 2014, Romania filed an application to annul the award.[114] This application included the contention that the ICSID tribunal manifestly exceeded its powers and was supported in part by the European Commission's decision in 2015 that determined the partial payments paid by Romania constituted a violation of EU law.[115] The ad hoc ICSID committee rejected Romania's application and the decision was upheld in 2016.[116] This case draws attention to the question of jurisdiction as well as the protection of states' sovereign tax powers, especially those governed by rules associated with larger regional coalitions.

2.3 Robust Enforcement of Existing Tax Laws

States should be able to enforce their fiscal regimes, and this can mean reexamining past transactions and payments and retroactively assessing tax payments and penalties in cases where the correct tax was initially not collected due to error, underreporting, or fraud.

Tax audits or investigations are in-depth investigative procedures implemented by a government's tax authority on a routine basis, or at times, when a government considers that a company may have been under-taxed. If a discrepancy in actual and potential taxes paid to a national government is found, the tax authority may have the power to issue a tax assessment to the entity in question, outlining the total amount of money owed.

On the occasion of the initiation of this type of investigation over investors, foreign investors have used ISDS to confront the legality of the retroactive imposition of additional tax obligations, even in circumstances where existing domestic law permitted the tax assessments.

Cairn v. India[117]

In January of 2014, Cairn UK Holdings Limited (CUHL), a subsidiary of Cairn Energy PLC, was contacted by the Indian Income Tax Department (ITD) concerning a demand for payment of back tax plus interest and penalties relating to the 2006/2007 tax year.[118] During that tax year, the company was planning to float its Indian subsidiary, CIL, on the Mumbai stock exchange and needed to reorganize in order to go public through an initial public offering (IPO).[119] The tax arrears sought by the Indian government pertained to transactions that occurred in order for CIL to acquire CUHL's Indian assets.[120] In 2010, the ITD determined that there was no grounds for taxing this transaction, contrasting to the capital gains taxes that were imposed on CUHL's gradual sale of CIL shares in the following years.[121] However, in 2016, the ITD assessed Cairn's prior transactions. This was done as a result of the 2012 Finance Act's revisions to the 1961 Indian Income Tax, ultimately seeking roughly USD 4.4 billion in tax liability, including interest.[122]

By 2017, Cairn had not only started its arbitral proceedings, but India had also assessed an additional 1.6 billion in penalties in 2017.[123] Cairn argued that the new tax law was contrary to a number of provisions in the India - United Kingdom BIT, notably the FET standard, due to the retroactive determination of tax liability that was taking place. Meanwhile, India argued both that the 2012 amendment was not retroactive taxation and that these taxes were permitted according to Indian law.[124]

Through the course of the proceedings, India notably contended that the case should have been brought before India's constitutional court due to its subject matters and that the provisional measures imposed by the tribunal impeded its sovereign right to tax. The first contention concerning jurisdiction was rejected by the tribunal, effectively demonstrating a case in which a foreign investor was able to successfully circumvent domestic judicial bodies.[125] This rejection was compounded by the tribunal's determination that the UNICTRAL rules and Dutch arbitration law concerning a tribunal's power to grant provisional measures did not include a carve out for tax matters.[126] This is especially poignant as the tribunal's determination represented a direct impediment to the

sovereign tax powers of the Indian government. The tribunal in this case decided in favor of Cairn, ordering India to pay approximately USD 1.2 billion in compensation as a result of breaches of the BIT.[127]

Oyu Tolgoi v. Mongolia[128]

In 2009, the government of Mongolia embarked on a joint venture with Canadian mining company Turquoise Hill Resources known as Oyu Tolgoi LLC contracted under the Oyu Tolgoi Investment Agreement, which granted the Mongolian government 34% shares and 66% shares to Turquoise Hill.[129] Turquoise Hill is majority owned by Rio Tinto, a British-Australian multinational mining corporation.[130]

In 2015, Oyu Tolgoi concluded a development and financing plan for an underground mine for gold and copper in Southern Mongolia known as the "Oyu Tolgoi Underground Mine Development and Financing Plan."[131] In 2018, the Mongolian Tax Authority rendered a tax assessment that ordered Oyu Tolgoi to pay approximately USD 155 million that related to an audit on taxes during the period between 2013 and 2015.[132]

Oyu Tolgoi paid approximately USD 4.8 million in order to settle unpaid taxes, finances, and penalties and was of the opinion that it had paid all that was required under the investment agreement and financing plan as well as under Mongolian law.[133] Oyu Tolgoi first attempted to negotiate with the Mongolian government and, when negotiations were unsuccessful, ultimately initiated formal arbitration proceedings under the United Nations Commission on International Trade Law's (UNCITRAL) rules in accordance with the dispute resolution chapters in both the investment agreement and financing plan.[134]

Though public details of the proceeding have been relatively limited, in January of 2021, Oyu Tolgoi applied to include an additional tax assessment of USD 228 million that was issued by the Mongolian Tax Authority for the 2016 to 2018 period to its initial claim, which the tribunal granted.[135] By March 2021, Oyu Tolgoi had paid the amounts due under both assessments in accordance with the applicable Mongolian tax law, despite continuing to dispute the amounts through the formal arbitration process.[136] In February 2022, the tribunal issued a partial award, which has not been made public, and the case was suspended while the parties attempted to resolve the dispute on their own.[137]

Société des Mines de Loulo S.A. (Somilo) v. Mali[138]

In 1993, the government of Mali entered into an establishment agreement governing a gold mining venture in Loulo, a remote area located in southeastern Mali, with Société des Mines de Loulo S.A. (Somilo), a joint venture between Canadian firm Randgold and the government of Mali.[139] The establishment agreement featured a stabilization clause that guaranteed a specific fiscal regime and obligated Mali not to alter said regime. The stabilization clause states:

> "The State hereby undertakes to guarantee to Somilo that all economic and financial benefits and tax and customs conditions laid down in the present Convention shall be maintained. No modification made in the future to any Mali law or regulation, and in particular the Mining Code, shall apply to Somilo without its prior written consent. Any more favorable provision that is enacted after the date of the present Convention, within the framework of generally applied legislation, shall be extended automatically to Somilo."[140]

In 2008, Mali's tax authorities determined that not only had Somilo's fiscal dues been previously underestimated but also that Somilo's tax bill should be "adjusted."[141] In 2013, Somilo filed a case with ICSID in response to the tax adjustments, asserting that Mali's actions had violated the stabilization clause of the establishment agreement.

Due to the terms of the stabilization clause, both Somilo and Mali agreed that the establishment agreement was governed by Malian law as it stood in 1993. Given that it has evolved since 1993, however, general Malian law had a subsidiary and complementary role. In other words, the stabilization clause impedes Mali from adopting any regulation that might change the conditions offered to the investors or exonerates the investor from such measures. This is the case even if the adoption of a regulation is in the public's interest or if regulation is as a necessary result of inevitably changing economic or political circumstances. This necessity is usually the case over contract periods of 20 to 30 years in the extractives industries. The tribunal decided in favor of Somilo, awarding approximately USD 29 million, primarily citing penalties on VAT collection and the wrongful collection of the tax on industrial and commercial profits.[142]

3 Conclusions and Recommendations

The paper underscores the impact of ISDS mechanisms on tax justice objectives and the fiscal and regulatory autonomy of host states. Policymakers face a crucial task as they look to restructure investment governance frameworks to align with the pursuit of tax justice and broader sustainable development goals. To facilitate this restructuring and alignment, policymakers have a range of options that they can implement in order to prioritize the regulatory space of host states and allow for adjustments to tax regimes that align with development needs.

1. International investment agreements, including investment treaties and contracts, should be designed to both strengthen and advance rather than undermine tax justice objectives.
2. Investment agreements should preserve the regulatory space of host states to allow them to adjust their respective tax regimes to advance development needs.
3. Investment governance frameworks should encourage and facilitate cooperation between states to collaborate on efforts to reform tax regimes at national, regional, and international levels.

Investment agreements should be restructured as tools that allow states to regulate investments in the interest of their communities and realize their development goals. If done in tandem with the creation of progressive tax policies, this could be a particularly effective strategy for countries to strengthen tax justice across the globe. However, the implementation of effective tax systems is currently hindered by ISDS clauses and the possibility of arbitration that accompanies them. It is vital that capacity building for investment policy actors be carried out to sensitize them to the tax implications of investment treaties. Moreover, review of existing investment agreements is critical to highlighting potentially problematic areas within the agreements with a view to renegotiating or providing further guidance.

Existing Investment Treaties

Among the broader impacts that investment agreements and ISDS have on public policy-making and regulatory approaches,[143] states should limit and remove the possibility for foreign investors to rely on such powerful instruments to challenge states' right to tax.

One of the most desirable solutions would be to terminate investment treaties[144] that generally impinge on states' sovereign powers and prerogatives as well as to remove ISDS from national investment laws, when relevant.[145]

Where termination is not possible, states should look to unilaterally withdraw advanced consent to arbitration through ISDS.[146] At times, however, unilateral withdrawal may prove to be ineffective as a result of sunset clauses in these agreements that would maintain the ISDS provision until a certain date.[147]

A third option could be the removal of access to ISDS from investment treaties by amending the treaty and removing the ISDS provision altogether. A partial solution would be to amend treaties to exclude at least taxation-based claims from treaties' or investment laws' ISDS coverage.[148]

Furthermore, where a government is a contracting party to an investment contract, it should renegotiate existing contracts to eliminate ISDS clauses and stabilization provisions that curtail its ability to change the legal framework regulating the investment, including its fiscal regime.

Drafting New Treaties

When drafting new treaties, states should avoid including provisions, including arbitration mechanisms, that might impact their judicial sovereignty over tax matters; to the contrary, all forms of international governance should protect states' sovereign right to enforce, alter, and make additions to their tax systems, promote investments that align with sustainable development objectives, and strengthen domestic governance.

The 2020 Brazil-India Co-operation and Facilitation Investment Agreement (CFIA) is a notable example of governments' effort to draft new treaty language that effectively promotes investment cooperation and mutually reinforces the judicial sovereignty of the host state.

The Brazil-India CFIA[149]

The Brazil-India CFIA adopts an approach that focuses on effective cooperation and on preserving the host state's right to regulate. As opposed to traditional BITs, the treatment afforded to foreign investors is applicable to nationals. This is mirrored by domestic legislation. And, the treaty does not provide for ISDS.[150] The text also avoids notoriously open-worded standards, such as protection against direct and indirect expropriation or FET that investors typically use to challenge state measures as exemplified by a number of the case studies above.

Further, the CFIA includes a series of provisions that specifically aim to protect the parties' sovereign right to tax. First, it includes an overarching tax carve-out, which establishes that "[t]his treaty shall not apply to […] b) any law or measure regarding taxation, including measures taken to enforce taxation obligations."[151] Article 20 further clarifies the scope and application of the exemption of tax measures from the application of the treaty. Moreover, the treaty explicitly states that investors and their investments shall comply with tax law and their tax liabilities, when defining the meaning and scope of compliance with laws for foreign investors.[152] Finally, provisions regulating specific areas such as corporate social responsibility[153] and exchange of information[154] include tax clauses.

Thus, even though no award has yet been rendered based on this agreement, the CFIA demonstrates a thorough effort by the treaty parties to preserve their fiscal and regulatory space.

Regional Investment Cooperation

At the regional level, investment treaties and FTAs can potentially guide cooperation, economic integration, and interactions between both member states and non-party states. With regard to tax matters, regional investment treaties should:

1. Curb harmful tax competition,
2. Harmonize governance over tax incentives,
3. Create regional-level taxation agreements,
4. And, provide guidance on the formulation of investment treaties with third parties.

Under Article 4 of the South African Development Community (SADC) Protocol on Finance and Investment,[155] member states to the SADC are not only required to harmonize their taxes but also ensure transparency in their governance of tax incentives. Tax incentives may only be provided through legislation and must be outlined in the

SADC tax database. Further, the SADC instrument uniquely contains an express provision that member states should prevent harmful tax competition and accounts for instances which could be characterized as such.

Given the obstructions ISDS presents to tax policy, states must first take steps to reform their investment governance frameworks to create and maintain policy-making space, through one or any of the aforementioned pathways. Once and as they do so, it is vital to ensure that that policy-making space is effectively utilized to guarantee fiscal benefits and government action bolster sustainable development objectives. This second step can and should be meaningfully guided by the principles of tax justice.

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