Analysis

Tax and bilateral investment treaties

SPEED READ **Bilateral investment treaties (BITs), which protect and promote cross-border investments, are one of many areas of law which may be relevant for tax lawyers. BITs may be relevant to tax either because, on the face of it, tax is included in the scope of a treaty, or because only some parts of a tax system are excluded from the remit of a treaty. Substantial tax disputes worth many millions have been dealt with under the procedures under BITs. An interesting feature of disputes under BITs is that they are dealt with under arbitration rather than in litigation. This can be particularly useful for a variety of reasons.**

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Contemporary tax practitioners are well used to assessing tax provisions, by reference to broad provisions of general law. For example, the law of the EU, the provisions of the European Convention on Human Rights, multilateral WTO agreements and bilateral trade agreements all govern the interpretation and application of tax rules. In recent years, a new set of general provisions have acquired a higher profile for tax practitioners, namely the rules governing the promotion and protection of investments which are contained in bilateral investment treaties (BITs).

BITs are not only significant because of their potential impact on substantive tax provisions and procedures. They are significant too because disputes under them may be resolved by arbitration, rather than litigation. That is likely to prove of particular interest to tax practitioners, given the relatively recent introduction into the OECD Model Tax Convention of provision for arbitration in article 25.5.

The growing significance of BITs

Although there is no model OECD bilateral treaty in relation to BITs, as there is in relation to double taxation conventions, the OECD is actively involved in the debates surrounding the growing significance of BITs. The secretary general of the OECD blogged last month about 'The growing pains of investment treaties' (see www.bit.ly/1Dzcu2w). It is unsurprising that BITs attract attention at the moment given, for example, the recent enormous arbitration award of US $50bn in the *Yukos* case (PCA Case No. AA 227) and the current debates over the role of arbitration in any future EU/USA agreement.

The facts surrounding the Yukos saga demonstrate the capacity of a BIT entered into by the UK to affect tax law and procedure. The inappropriate use of tax assessments was held to be an important element contributing to the expropriation of property contrary to the terms of article 5 of the BIT made between the UK and the USSR (see further *Rosinvestco UK Ltd v Russian Federation* SCC Arbitration V (079/2005)).

Not every case will have such extreme facts as *Yukos*. There are a number of other somewhat less dramatic cases in which tax treatment has led to analysis of tax positions by reference to the provisions of BITs. Two examples are the cases of *Vodafone* and *Nokia*. In the first, the BIT between the Netherlands and India is the basis of action by Vodafone, in relation to India's tax treatment of a Dutch Vodafone subsidiary. The BIT between Finland and India is at the heart of a dispute notified by Nokia affecting taxation.

As with tax treaties, the BITs which are relevant to an investment in a particular country need not be limited to the treaty between the investor's home state and the host state. Treaties between intermediate countries may also be relevant and may, not infrequently, have a significant impact on the particular formulation of a given set of commercial arrangements. Treaty shopping in the context of BITs is every bit as significant as it is under double tax treaties.

Given that disputes under BITs may be resolved by arbitration, UK lawyers who practise in that field will know that there is great scope for conducting cases involving the actions or tax system of one of the UK's treaty partners, although there is no need for UK advisers to limit their interest to BITs entered into by the UK. There is, of course, always the possibility that the UK's actions will be scrutinised in a BIT dispute. A recent request under the Freedom of Information Act 2000 sought details of an arbitration that involved the UK. The response by the FCO's South Asia Department appears not to have disclosed significant information at the moment.

BITs: coverage and content

The global coverage of BITs is impressive, with something like 3,000 treaties in existence worldwide. The UK has entered into over a hundred of them. It was particularly active in establishing treaties in the 1980s and 1990s. These treaties are easily available on the web archive of the FCO. They are considerably shorter than double tax treaties. The UK's 2005 Model contained 14 articles in total.

Usually a BIT entered into by the UK contains articles which require that investments be accorded fair and equitable treatment and that national treatment shall be given to the ‘investments or returns’ of nationals and companies from the other contracting state. There is also a most favoured nation clause. Then there is a provision requiring compensation for losses suffered in certain circumstances. One vital provision is a prohibition on expropriation, and there are also guarantees of unrestricted transfer of investments and returns. After this, there may be provisions establishing exceptions and provisions governing or relating to dispute settlement and other formal matters.

The interpretation of BIT articles is, as always, a matter of analysing the specific provisions of a specific treaty. Nevertheless, some general issues of great importance have arisen. One is the precise scope of the most favoured nation (MFN) article. There is debate, for example, over the ability of MFN clauses to introduce into a treaty provisions that the parties deliberately excluded from it. The application of the MFN article to dispute resolution provisions has also attracted attention.

The relevance of many of these articles to taxation will be immediately apparent. The provisions requiring fair and equitable treatment are obviously important. Furthermore, foreign investors frequently wish to ensure that they obtain the tax treatment given to home nationals and that they obtain equivalent reliefs. They also want to avoid expropriatory levels of taxation and fiscal restrictions on the transfer of their investments and returns. All these things can fall within the scope of an appropriately drafted BIT.

Exceptions and taxation

There may be, and usually are, clauses excepting certain matters from the scope of certain of the provisions of a BIT. Exceptions are not, though, always identified. One example of a UK treaty which does not contain exceptions, whether relating to taxation or anything else, is the treaty with Indonesia (1976), which is worth particular attention for those with clients investing there.

A considerable number of treaties contain exceptions from the national treatment and MFN provisions only. The UK’s treaties with Argentina, India and Ukraine, which entered into force in the 1990s, are examples of such treaties. They provide that a contracting state is not to be compelled to extend the benefit of any treatment, preference or privilege resulting from any international agreement or arrangement, or any domestic legislation, relating wholly or mainly to taxation. The exception also deals with duties. A similar provision is found in later treaties, for example, the one between the UK and Vietnam. The UK’s treaty with Mexico (2006) contains, in addition, a provision that any inconsistency between a BIT and an international treaty relating wholly or mainly to taxation shall be resolved by the latter prevailing.

These exceptions may seem very broad at first sight, but they leave considerable areas of tax within the scope of a UK BIT. There may well be many situations where the treatment, preference or privilege in question may be said to result not from an international agreement or domestic legislation but from an exercise of discretion, or in some cases a ruling or agreement. The treatment arising from an exercise of discretion, a ruling or an agreement may fall, for example, within the scope of treaty provisions relating to national treatment. The absence of any exclusion relating to tax rulings ought to be borne in mind, particularly at a time when the exercise of discretion by revenue authorities and their rulings and agreements are in the spotlight for reasons related to state aid. The ability of an enterprise to seek judicial review of the treatment of its competitors in appropriate circumstances may also prove important in this context (see *R v AG ex p ICI Plc* (1984) 60 TC 1).

The current increase in work related to BITs generally is bound to be reflected in increased work for tax experts

The broader context

It is worth contrasting the exceptions from BITs with the articles dealing with taxation in WTO and EU agreements. The General Agreement on Trade in Services allows for inconsistency with national treatment provisions, where it results from a double tax treaty or provisions on the avoidance of double taxation in other binding international agreements or arrangements. An inconsistency with the MFN requirement depends on the existence of equitable or effective provisions relating to the taxation of suppliers (see article XIV(d) and (e)).

In EU agreements, which may more easily feature in commercial dispute resolution, there may also be a tax exclusion defined, for example, by reference to equitable or effective collection or imposition of direct tax. The exclusion may, nevertheless, exclude arbitrary or unjustifiable discrimination or certain disguised restrictions and may apply only to a defined ‘tax measure’.

Recent EU agreements with important tax-related provisions include the agreement with South Korea (see article 7.50(f)) and the newly negotiated Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, which contains extensive provisions for the protection of investments (see Chapter 10 and Chapter 32, article X.06). The exclusions in these agreements are by no means as broad as they may seem at first. The need for an exclusion is an implicit admission that tax is within the ambit of the agreement. It is excluded, therefore, only to the precise extent required by the relevant provision which, in consequence, must be closely examined.

The provisions of CETA are strongly influenced by the fact that foreign direct investment is now one of the areas of exclusive EU competence (see the Treaty on the Functioning of the EU, article 207.1).

An investor may consider that there are a number of advantages to arbitration as compared with litigation

As a result, Regulation (EU) No. 1219/2012 has been passed. This establishes transitional arrangements for member states' existing bilateral investment agreements with third countries and sets out the regime to which member states are now subject. More recently, Regulation (EU) No. 912/2014 has been passed, creating a framework for managing financial responsibility in relation to investor/state disputes under agreements to which the EU is a party.

Arbitration

One of the features of bilateral investment treaties and of CETA is that disputes may be settled by arbitration. Not all countries are comfortable with arbitration being used in relation to tax disputes. Nevertheless, to the extent that disputes under BITs concern taxation, arbitration may take place. An investor may consider that there are a number of advantages to arbitration as compared with litigation.

A good many arbitrations involving tax matters have already taken place. Usefully, the BITs set out the mechanics of any dispute resolution procedure in much more detail than are to be found, for example, in article 25.5 of the OECD's Model Double Tax Convention. Article 9 of the BIT between India and the UK, to take but one example, makes provision for the submission of the dispute to the International Centre for the Settlement of Investment Disputes or arbitration under UNCITRAL rules. The article specifies that, in an UNCITRAL arbitration, each party is to select one arbitrator and the two chosen arbitrators then select an arbitrator from a third country.

Conclusion

The current increase in work related to BITs generally is bound to be reflected in increased work for tax experts. The input of tax specialists into existing arbitrations may well be vital. In addition, if they do not do so already, they should be looking to see to what extent tax disputes in which they are instructed can be resolved under BIT arbitration. For some disputes, it will be the most efficient resolution mechanism available. ■

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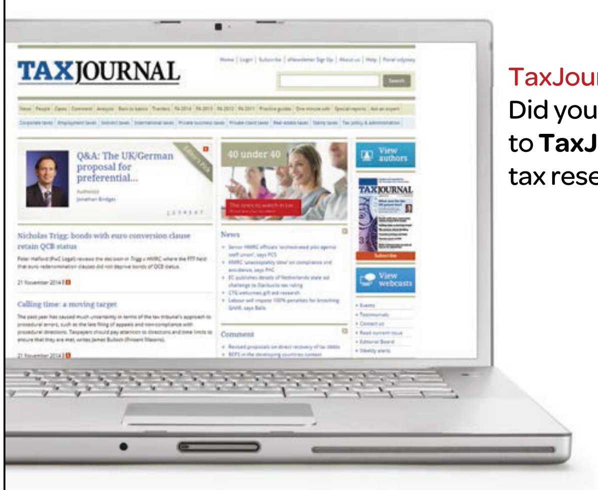

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