TAX MEASURES UNDER INTERNATIONAL INVESTMENT TREATIES: CURRENT REGULATION, ARBITRAL PRACTICE AND PERSPECTIVES

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PREFACE

I would like to express my outright gratitude to the Central European University for giving me a possibility and chance to complete my studies in International Business Law program in one of the most progressive and open-minded universities in the world. The experience and knowledge gained in the university help me in my professional and personally development.

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However, I am the only person responsible for any errors in this thesis.

ABSTRACT

Taxes are valuable for the states to protect the public interests of their citizens and sustainable economic development, to raise necessary funds to finance the state projects, to guarantee the rights of the citizens for the good life conditions. The importance of the state sovereignty in the regulation of the tax policy affect the low level of the foreign investors' protection under the International Investment Agreements. However, the recent investment arbitral practice shows that investment disputes involving the taxation matters became more frequent and suitable for the investors' interests protection.

This thesis analyses the relevance of the tax measures under the investment treaties. The first chapter provides the importance of the Bilateral Investment Treaties (BITs) for the stable planning of the business conditions by investors. It compares two types of the treaties - investment and double taxation treaties and concludes on the necessity of the existence of both of them. The chapter also examines BITs on the issue of the coverage the tax matters by them.

The second chapter overviews the arbitral practice of the investor-state investment disputes on tax matters in the framework of the substantive standards of protection e.g. expropriation, fair and equitable, national and most-favored nation treatment and freedom of transfer of capital.

The last third chapter outlines the great sensitivity of the states to their tax policy and regime. Abusive conduct of the huge multinational companies in tax matters requires some tools to protect the states' interests. Furthermore, last part of the thesis analyses the justifications of the states' behavior to the violations of the investment standards.

The theses focus on the current arbitral decisions and interpretation of the substantive standards in the light of taxation. Some recommendations for the development of the BITs in tax field are provided as well.

LIST OF ABBREVIATIONS

BIT(s)	Bilateral Investment Treaty(-ies)
DTT(s)	Double Taxation Treaty(-ies)
ECT	Energy Charter Treaty
FET	Fair and Equitable Treatment
FTC	Free Transfer of Capital
ICJ	International Court of Justice
ICSID	International Center for Settlement of Investment Disputes
IIA(s)	International Investment Agreement(s)
MAP	Mutual Agreement Procedure
MFN	Most-Favored Nation Treatment
MNE(s)	Multinational Enterprise(s)
NAFTA	North American Free Trade Agreement
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
VAT	Value Added Tax

INTRODUCTION

There are around three thousands concluded BITs around the globe and around two thousands four hundred of them are in force.[1] The same is the number of the Double Taxation Treaties (DTTs) between the countries. The significant amount of the regulatory framework is aimed to attract the foreign investments to the countries' economies and protect the interests of the investors. Some BITs spread their protection e.g. FET, NT, MFN, provisions on expropriation to the tax matters. Some BITs carve out tax issues from the coverage of BITs arguing that all the tax matters are properly regulated by the DTTs. This thesis mostly focuses on the tools of protection of the interests of the investors and states in investments disputes arising from the tax matters available to them under the IIAs.

The rapid globalization of the cross-border commercial transactions and growth of the amount of the foreign investments significantly changed the approaches to the international taxation and investment policies. The taxation relations play a major role in the Host State-foreign investor relationship. Tax issues are twofold. Investors desire to take more tax advantages from a particular jurisdiction, safeguard their assets from the state tax power and changes in the tax regime and policy as well as from any other instability. To compare states are not in a hurry to sacrifice their sovereignty and limit their power to adopt tax legislative acts and regulations by any means. Taxes are the source of filling of the state's budget, a tool of reaction for any economic emergency and economic strategy in total. This thesis outlines the importance of finding the right balance between states' sovereign ambitious and investors' requirement of the predictability and stable conditions of the tax environment of the Host State.

[1] See United Nations UNCTAD, 'International Investment Agreements Navigator' available at: <http://investmentpolicyhub.unctad.org/IIA> accessed 4 April 2017.

In recent years the number of the investor-state investment disputes arising from states' tax measures has increased. Around fifteen disputes involving the claims of breach of the investment substantive standards by the tax measures have resulted in the obligation of the States to pay a huge amount of compensation.[2] More and more investors prefer to choose the formal route to compensate international investment law infringements under the BITs rather than under the DTTs..[3] The recent ICSID proceeding between the Vodafone International Holdings BV against India[4] is a good example of advantages of the BITs for the investors' protection in investment tax disputes in comparison to the DTTs. These are the dispute resolution system which provides for the investor the option to initiate the arbitration proceeding against the states directly, existence of the special ICSID institution for the investor-state dispute resiolution, automatic recognition of the ICSID decisions in every state which is a Contracting Party to the ICSID Convention, wider scope of the protection in comparison to the DTTs.

However, the regulation of the tax matter under the IIA is not absolute. It depends on the different approaches of the States to the recognition of the relevance of the tax measures to the BITs protective standards. Because of the fact that taxation is not properly regulated by the BITs, there is a huge gap and difference in the means of protection available both to the States and investors in the investment tax disputes.

The aim of this thesis is to examine the current regulation and arbitral practice of the investor-state disputes based on tax measures invoked by the Host States as well as trends for development of BITs for higher level of states' and investors' protection. The purpose includes establishing the role

[2] Julien Chaisse, 'Investor-State Arbitration in International Tax Dispute Resolution: A Cut above Dedicated Tax Dispute Resolution' [2016] 35(2) Virginia Tax Review XXX, 149-222.
[3] Jeffrey Owens and Hafiz Choudhury, 'Bilateral Investment Treaties and Bilateral Tax Treaties' [2014] Issues Paper International Tax and Investment Center available at: <http://www.iticnet.org/images/Bilateral%20Investment%20Treaties%20and%20Bilateral%20Tax%20Treaties.pdf> accessed 6 April 2017.
[4] *See*, United Nations UNCTAD, 'Vodafone International Holdings BV v India' (*Investment Policy. Investment Dispute Settlement*, 17 April 2014) available at: <http://investmentpolicyhub.unctad.org/ISDS/Details/ 581> accessed 5 April 2017

of the tax matters in the international investor-state investment disputes framework. This paper surveys the application of the substantive international investment law standards to the tax measures adopted by states and restrictions and justifications to the states' conduct. The hypothesis that this paper attempts to prove is that tax matters should be covered by the IIAs for better guarantees for the investor of the stable legal framework and more sufficient and realistic business planning. Nevertheless, states' power to adopt tax measures is not disputed, but it cannot be absolute. The purpose of this thesis to show that the balance might be between the investors' requirements of stability and states' responsibility to act in relevance to the economic conditions and public interests.

Protection of the investors in tax issues under IIAs leads to the greater attractiveness of the particular jurisdiction and closer cooperation and trust relations between state and investor. Moreover, arbitration dispute resolution mechanism available under BITs takes out the disputes from the field of political battle to purely commercial investment relations. For investors, it also means that they could initiate the investment arbitration proceeding themselves. The developing states will not depend on the decision of developed stronger countries and their influence. Rather they will be equal to the investors' part in the proceeding.

This thesis consists of three chapters. The first chapter of this thesis examines the relevance of the tax matters to IIAs. It discussed the conflict between the sovereignty of the state to adopt tax measures as its historical attribute and development of the international investment law and state's obligations under it. The thesis is going to prove that tax sovereignty to some extent may be limited by the requirements of the international investment law when the state's conduct in tax matters is abusive and contrary to the bona fide principle as well as when the benefits from the tax measures for the public or economy are not sufficient to justify the detriment to the investors. This chapter also provides the opinion on the issue whether the regulation of taxation matters by the DTTs is enough to state that the rights of the investors in tax matters are properly protected. The thesis outlines the difference between regulation of tax matters under DTTs and IIAs. The chapter argues the both types of agreements are relevant to the protection of the investor but the purpose, mechanism and scope of the protection significantly differs. Thus, both types of agreements should exist and regulate taxation in accordance with the principles of the international investment and international taxation laws. In the end the chapter surveys the coverage of the taxation matters under the IIAs, the frequency of clauses which carve out the taxation issues and relation between the carve-out and umbrella clauses.

The second chapter focuses on the relevance of the tax matters to the substantive principles of the international investment law. The chapter examines the recent investment disputes based on the assumption that state's tax measures violate the expropriation, FET, MFN, NT and FTC standards. The chapter clearly examines the scope of the standards and application of their components to the tax relations. It states what measures may breach state's obligations under the international investment law and what are the requirements to constitute the violation.

The last but not the least chapter deals with limitations and justifications to the principles discussed in the previous chapter. The third chapter continues the point expressed in the first chapter that states save their right to adopt the tax measures bona fide when the economic situation requires urgent changes and stabilization. As restrictions and justifications this part of thesis analyses the doctrine of necessity in the light of the economic crisis, public interests and security as well as the participation of the state in the economic and trade unions and counteraction to crimes.

This thesis examines the recent arbitral decisions of the investment disputes related to taxation. The main source materials are the ICSID and UNCITRAL case law. In order to understand the argumentation of the tribunals better the number of the doctrinal and business articles and studies by different authors has been used. Considering that all the investment disputes may arise out the IIAs the provisions of IIAs and BITs are examined by this thesis.

CHAPTER 1. THE RELEVANCE OF TAX MATTERS TO INTERNATIONAL INVESTMENT AGREEMENTS

1.1. Tax Sovereignty of the State in Tax Issues and its Limitations by the Rules of International Investment Law

One of the historical attributes of the sovereign state is the right to adopt tax measures by itself, independently from other states or organizations.[5] The fiscal sovereignty of the state includes a freedom as integral or vital part of the state's sovereign status.[6] Income from taxes forms the state budget and determines the wealth of the state, its position in the global market and power among other states. Thus, the fiscal sovereignty tends to be guarded jealously[7]. The vulnerability of tax system of the state requires the autonomy of the state in its designing, which sometimes deserves greater protection in comparison to the state's autonomy in other areas of regulations[8]. The importance of the taxation for the state is explained by the necessity for the protection of public interests of the citizens in order to provide the efficient economic policy and economic regimes. In order to regulate the activities within the state properly and up to the economic conditions of a particular state as well as the world's economy *"governments must be free to act in the broader public interest through […] new or modified tax regimes".*[9] That means that the state has not only the right to adopt tax legislation but the right to change it to achieve the required and essential economic efficiency. It is of a particular importance for the developing countries with lower- and

[5] Stephan W. Schill, *International investment law and comparative public law* (Oxford University Press, 2010).
[6] Allison Christians, 'Sovereignty, Taxation, and Social Contract' [2009] 18 (1) Minnesota Journal of International Law, 1063 Univ. of Wisconsin Legal Studies Research Paper, 99-153.
[7] Richard E. Krever and John G. Head, *Tax conversations: a guide to the key issues in the tax reform debate: essays in honour of John G Head* (Kluwer Law Intl, 1997).
[8] Rajiv Biswas, 'Introduction: Globalisation, Tax Competition and Economic Development' [2002] International Tax Competition, 1-13.
[9] Marvin Roy Feldman Karpa v. Mexico, ICSID (W.Bank) (ARB(AF)/99/I) Interim Decision on Preliminary Jurisdictional Issues (6 December 2000).

upper-middle-income economies such as Ukraine, Russian Federation, Serbia, Romania and others[10] due to the necessity of stabilizing of the economic processes within those states and developing of macroeconomic programs that increase the attractiveness to foreign investors and business partners.

However, the tax sovereignty of the state is an abstract concept. In the real world, the tax sovereignty is usually limited or shared.[11] Integrated and globalized world's economy, increasing number of cross-border transactions, establishing of multinational enterprises (MNE), international partnership of legal entities, creating of multinational unions, desire of the states to protect the interests of the national legal and natural persons outside its jurisdiction lead to strengthening the collaborative relationship between governments of the countries in tax matters and collective efforts of adopting international rules limiting the states' tax autonomy in some areas and circumstances. Such barrier for the state to change the tax regimes and legislation is the international investment law, violation of which causes harm and negative consequences both to the state and state's investors.

The states around the world face the conflict between the desire to have unlimited and unshared state sovereignty over governmental policymaking including the tax sovereignty and desire of improving the economic conditions and economic efficiency.[12] Generally, the purposes of tax policymaking limitations are (1) opposition to base erosion and profit shifting, abusive actions of MNEs, which use the gaps in national legislations of the countries to reduce tax obligations; (2) regulation the issues of the double taxation between different jurisdictions to guarantee the stable economic conditions for cross-border transactions and business operations; (3) establishing the mechanism of settlement of investor-to-state tax disputes. The State authorities and international organizations as

[10] The World Bank, 'World Bank Country and Lending Groups' (*Working for a World Free of Poverty*) available at: <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups> accessed 23 March 2017.

[11] António Carlos dos Santos and Cidália Mota Lopes, 'Tax Sovereignty, Tax Competition and the Base Erosion and Profit Shifting Concept of Permanent Establishment' [2016] 25(5) EC Tax Review, 296-311.

[12] Arthur J. Cockfield, 'Tax Integration Under NAFTA: Resolving the Conflict Between Economic and Sovereignty Interests' [1998] (34) Stan J Int'l L 39-73.

OECD made significant efforts to provide the regulations and unify legislations of the countries in above-specified matters in particular through model double-taxation treaties.

However, much less attention is paid by the authorities to the problems arising between the investors and states due to the abuses of the taxation powers by the latter. The limitations of some States' rights find their place in IIAs as North American Free Trade Agreement (NAFTA) and Energy Charter Treaty (ECT), BITs concluded between countries, international rules provided by international organizations such as Organisation for Economic Co-operation and Development (OECD). Some IIAs and BITs provide the definition of tax and cover the tax issues. However, its scope is very limited and is not properly examined yet.

Taxation is not the one criteria in deciding whether to invest in particular industry and state. For instance, investing in oil or mining industry mostly depends on the location of sources and deposits. At the same time textile industry is not in a strong dependence on location. In this example the decision to invest will be more influenced by factors of taxation in particular such taxes as income tax, VAT, payroll tax[13] as well as the factors of the policy of cross-border transfer of capital, currency control etc. Furthermore, the investments are very vulnerable to the changes of the current tax legislation that cause the changes in profit rates and endanger the viability of the investment projects. *"Taxation does have a strong influence on the location of investment and on financing decisions is prima facie evidence that the distortions to competition and resulting efficiency losses caused by taxation could be large".*[14] Thus, the special treatment of foreign investors is designed by the states to promote investments and get the competitive advantages in comparison to other states.[15]

[13] Payroll tax is a tax withheld and paid by employers on behalf of their employees, which is based on employees' wage or salary.
[14] Onno Ruding, *Report of the Committee of Independent Experts on company taxation. Executive summary. [1992]* in: Arthur J. Cockfield, 'Tax Integration Under NAFTA: Resolving the Conflict Between Economic and Sovereignty Interests' (n 12) 43.
[15] Arthur J. Cockfield (n 12) 39.

Capital productivity contributes the state's ability to be a participant of the regional economic integration and compete with other countries.[16]

The other side of the medal that guaranteeing the investors the special regimes, advantages and preferences before the national producers may be contrary to the public interests of the state's citizens and national legal entities. The pursuit of investors and extremely wide range of the incentives attracting the investments may lead to market displacement of local entrepreneurs and monopoly position of the investor on the market. Before the international investment tribunals the states often argue that they "*have the right to adopt regulatory measures and any foreign investor entering the country should assume the risk of being regulated by the Host State*".[17]

IIAs and BITs are supposed to create a win-win situation for both the investor and the state, but at the same time to limit the freedom of the states to act in economic matters.[18] IIAs and BITs prevent the state from adopting new regulatory provisions in relations with investors and applying them to their business operations. Although, such provisions may clash with other competing principles of the international law such as doctrine of necessity, for example.[19]

During the late 1990s and early 2000s Argentina's government in order to address crisis had derogated from some of its obligations vis-à-vis the foreign investors. Following the crisis, around forty cases have been brought against Argentina.[20] In those cases the Argentina argued that the adopted measures were justified under the concepts of State's necessity and national emergency.[21]

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[16] Ibid 40.
[17] Surya P. Subedi, *International investment law: reconciling policy and principle* (Bloomsbury Publishing 2016), 166.
[18] ibid 166.
[19] ibid 167.
[20] Lucy Reed, 'Scorecard of Investment Treaty Cases Against Argentina Since 2001' (Wolters Kluwer. Kluwer Arbitration Blog, 2d March) available at: <http://kluwerarbitrationblog.com/2009/03/02/scorecard-of-investment-treaty-cases-against-argentina-since-2001/> accessed 5 April 2017.
[21] CMS Gas Transmission Company v. The Republic of Argentina, ICSID (ARB/01/8), para 263; LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic, ICSID (ARB/02/1), para 200; Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID (ARB/01/3), para 288; Sempra Energy International v. The Argentine Republic, ICSID (ARB/02/16), para 325.

It is essential for the state to find the right balance between national interests and level of protection for the investors, weigh the pros and cons, economic effect of the balance. The state's authority should make sure that more is to be gained than lost through the implementation of specific norms regulating investor-state relations and no social disruption is caused by its implementation.

1.2. The Regulation of Tax Matters by International Investment Agreements and Double Taxation Treaties

The question that remains disputed whether the tax matters should be regulated under BITs or regulation provided by DTTs is sufficient to prevent all the disagreements that may arise between the investors and States. Such scholars as Reuven S. Avi-Yonah and Oz Halabi argue that provisions of DDTs are obsolete and protect the position of "ceasing of exclusion tax matters from the scope of bilateral investment treaties" providing three reasons: BITs provide the a most MFN standard, much stronger dispute resolution system and possibility for the investor to force arbitration in a neutral panel.[22] Otherwise, at the present time the states are not highly enthusiastic about regulating of tax measures by BITs since BITs have much stronger level of protection in comparison to DTTs. For example, US government presents the position that the tax matters are properly covered by DTTs or should be dealt with them, thus, the tax matters generally are excluded from the BITs which US is party to.[23] Another example of opposition to provide the same standards of protection for investors in tax matters on the same level as other guarantees is OECD Member countries, which are mostly developed and capital exporting.[24] The negotiations on proposed in 1995 Multilateral Agreement on Investment, which was supposed to guarantee the *"high standards*

[22] Reuven S. Avi-Yonah and Oz Halabi, 'Double or Nothing: a Tax Treaty for the 21st Century' [2012] 12(9) University of Michigan Law & Economics Research Paper.
[23] Maira de Melo Vieira, 'The Regulation of Tax Matters in Bilateral Investment Treaties: A Dispute Resolution Perspective' [2014] 8(1) Dispute Resolution International, 63-84.See also, for example, U.S. – Ukraine BIT (signed 4 March 1994; entered into force 16 November 2011)., U.S. – Georgia BIT (signed 7 March 1994, entered into force 10 August 1999), U.S. – Latvia BIT (signed January 13, 1995; entered into force November 26, 1996; amended May 1, 2004).
[24] OECD, 'List of OECD Member countries - Ratification of the Convention on the OECD' available at: <http://www.oecd.org/about/membersandpartners/list-oecd-member-countries.htm> accessed 4 April 2017.

for the liberalization of investment regimes and investment protection and with effective dispute settlement procedures" including tax incentives, were discontinued in 1998.[25] The tax matters should be regulated both by BITs in order to provide the proper level of protection for investor and DTTs as these two types of state-to-state agreements have different purpose, subjects of regulation, spheres of protection and resolution mechanisms.

BITs remain the important tool for the investment protection. The main purpose of BITs is (1) granting the incentives for foreign investments for attracting them with the aim of developing the state's economy; (2) protecting foreign investments in another State, contracting party to the BITs, from unfair or discriminatory treatment, (3) promoting treatment standards of international law and law of the contracting parties, (4) stabilizing the international legal environment.[26] Otherwise the primary purpose of concluding the DTTs (1) to eliminate the double taxation income to facilitate the international flow of capital, services and technologies[27] (2) as well as to guarantee transparency of the tax information and its sharing between tax authorities of the States etc. Now, it can be clearly seen that as the purpose of the regulation is different, thus, the provisions in it also differ.

The other criterion is the subjects of regulation. From the first view it might look that the subjects of these two types of the agreements are similar. Both the BITs and DTTs are concluded between States as Contracting Parties to the agreements and impose the obligations on them. However, there

[25] See also Gildemeister, Arno, 'V. Investment Law and Taxation' in: Marc Bungenberg, Jörn Griebel, Stephan Hobe, August Reinisch, International Investment Law (Nomos Verlagsgesellschaft mbH & Co. KG. 2015). 1726 – 1740. See also OECD, 'Multilateral Agreement on Investment' available at: <http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm> accessed 4 April 2017.

[26] Gudgeon K. Scott, 'United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards' [1986] 4(1) International Tax and Business Law, 105-35.

In United States BITs were created to protect the US investors and their investments from the abusive conduct of the third developing countries. The system of the BITs that was established aimed to provide the principles of treatment of the foreign investments compatible to the US standards. BITs promoted the internalization and globalization of the commercial activity and capital.

[27] Charles R. Irish, 'International Double Taxation Agreements and Income Taxation at Source' [1974] 23 (02) International and Comparative Law Quarterly, 292-316. Dagan Tsilly, 'The Tax Treaties Myth' [2000] 32(4) New York University Journal of International Law and Politics, 939-96.

The point of view exists that DTTs lose their primary purpose to avoid double charge of taxes in different tax jurisdictions. It is argued that the current role of the DTTs is mostly to avoid non-payment of taxes in jurisdictions, that are Contracting Parties to DTTs.

is a difference that does not allow accepting the position that tax measures should be regulated exclusively by BITs or DTTs. The BITs protect "*an investment in [Contracting State's] territory of an investor of the other [Contracting] Party in existence as of the date of entry into force of [Bilateral Investment] Treaty or established, acquired, or expanded thereafter"* made by *"party or state enterprise thereof, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party".*[28] Thus, BITs spread their regulation on the relations between States and foreign investors. DTTs additionally may regulate the relations between the State as a Contracting party to the agreement and its own residents. For example, the Ukraine-Austria DTT[29] states that tax on dividends required to be paid by the company, residence of contracting Country, in this country can't exceed five percent.[30] The subject of regulation in such a case is not only the relations between contracting party and foreign entities, but the relations between country and its own residents.

The second point is the determining and recognizing the legal entities as subjects of protection under analyzed agreements. Under BITs the concept of nationality of contracting party applies in question of determining whether the particular legal person may enjoy the protective provisions of the BIT. The criteria of nationality in dependence on the specific arrangements of BIT are the company's place of incorporation or registered office[31], place of the effective seat of business and or central administration[32], membership of a controlling stake[33].[34] In the same time, for the purposes of

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[28] See U.S. Model Bilateral Investment Treaty (2012), United Kingdom Model Bilateral Investment Treaty (2008). The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (adopted 18 March 1965, entered into force 14 October 1966) 4 I.L.M. 524 (ICSID Convention) art 25.

[29] Convention between Government of Ukraine and Government of Republic of Austria on Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to taxes on income and estate (adopted 16 October 1997, entered into force 20 May 1999) AB 5439 S. 626 (Ukraine-Austria DTT) art 10.

[30] Ukraine – Austria BIT (signed 8 November 1996, entered into force 1 December 1997) art 10.

[31] See Tokios Tokelés v. Ukraine, ICSID (ARB/02/18), Decision on Jurisdiction (29 April 2004); Saluka Investments B.V. v. The Czech Republic, UNCITRAL, Decision on Jurisdiction (7 May 2004).

[32] See Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela, ICSID (ARB/00/5) Decision on Jurisdiction (27 September 2001); Société Ouest Africaine des Bétons Industriels v. Senegal, ICSID (ARB/82/1), Decision on Jurisdiction (1 August 1984).

applying the provisions of DTTs the criteria of domicile, residence, place of management or any other criterion of a similar nature is required.[35]The existing of a fixed base[36] or permanent establishment[37] of legal entity in another contracting country to DTT is required for some groups of taxes.

The next difference of BITs and DTTs is the sphere of the protection. BITs usually contain the basic principles of the protection foreign investors and their investments such as FET, NT, MFN treatment, protection from unlawful expropriation, Full Protection and Security (FPS), non-discrimination. BITs regulate the relations between the Home and Host States on the level of protection and proper attitude to the investors of the Home State in the Host State. BITs provide "reciprocal protection of investment"[38], "stable framework for investment"[39], "effective means of asserting claims and enforcing rights with respect to investment under national law as well as through international arbitration".[40] The DTTs contain absolutely different provisions. Their scope includes only the regulation of the tax relations. For example, UN Model Double Taxation Convention in Chapter 1 "The scope of the Convention" defines that "*Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political*

[33] *See,* Venezuela Holdings, B.V., et al (case formerly known as Mobil Corporation, Venezuela Holdings, B.V., et al.) v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, Decision on Jurisdiction (10 June 2010). Champion Trading Company, Ameritrade International, Inc. v. Arab Republic of Egypt, ICSID (ARB/02/9) Decision on Jurisdiction (23 October 2003).

[34] Rudolf Dolzer and Christoph Schreuer *Principles of international investment law* (2nd edn, Oxford University Press 2012).

[35] Articles of the Model Convention with Respect to Taxes on Income and on Capital (as they read on 28 January 2003).

[36] Fixed Base is defined by OECD and UN model tax treaties in the context of independent personal services and generally means a fixed place of business.

[37] *"The term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on".*

OECD, 'Additional Guidance on the Attribution of Profits to Permanent Establishments' (*BEPS Action Plan: Action 7*, 4 July - 5 September 2016) available at: <https://www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-attribution-of-profits-to-permanent-establishments.pdf> accessed 4 April 2017.

[38] U.S. Model Bilateral Investment Treaty (2012), Preamble.

[39] ibid.

[40] ibid.

subdivisions or local authorities, irrespective of the manner in which they are levied."[41] The scope of the DTTs in comparison to BITs is limited only to tax administration issues between the countries and can not provide the investors the full protection in the foreign state as BITs do that.

And the last, but not the least distinguishing criterion is the resolution mechanism under BITs and DTTs. Article 25 of the OECD Model Tax Convention provides the Mutual Agreement Procedure for resolving the tax disputes under DTTs. The same provision is included in the article 25 of the UN model Tax Convention. The Mutual Agreement Procedure is aimed to resolve disputes in three main situations: (1) disagreements between the taxpayer and the Contracting States, when the taxpayer contends that administration of taxes in any of the Contracting States is not in accordance with DTT; (2) disagreement between the States on issues of interpretation or application of the provisions of the DTT; (3) cases when the double taxation problem between states is not solved in the DTT (rarely used).[42] There is no consensus among OECD and G20 countries on the adoption of mandatory arbitration as a dispute resolution mechanism under the DTTs.[43] The OECD approach is such that the arbitration procedure should be mandatory for the States after two years of the unsuccessful negotiations, if the taxpayer requests the arbitration.[44] However, the parties to the arbitration procedure would be the States, who act in their own name and exercise their own rights. Thus, the States reserve the right to initiate the arbitration procedure or not. The disadvantage of such mechanism is colossal both for the private company and the state. The investor depends on the political relations and discretion of its home state government[45], who might not initiate the

[41] United Nations Model Double Taxation Convention between Developed and Developing Countries (2001) ST/ESA/PAD/SER.E/21 art 2.
[42] See United Nations Department of Economic and Social Affairs, 'Mutual Agreement Procedure (MAP)' (*Article 25 of the UN Model*,) available at: <http://www.un.org/esa/ffd/tax/2013TMTTAN/A8_Ault.pdf> accessed 4 April 2017.
[43] Jonathan Schwarz, 'International Tax Dispute Resolution and the BEPS Multilateral Convention: A Camel Safari' (Kluwer Arbitration Blog, 16th December) available at: <http://kluwerarbitrationblog.com/2016/12/16/international-tax-dispute-resolution-and-the-beps-multilateral-convention-a-camel-safari/> accessed 4 April 2017
[44] ibid.
[45] *'Settling of the investment disputes'* V. in: Dolzer, Rudolf, and Christoph Schreuer *Principles of international investment law* (2nd edn, Oxford University Press 2012).

arbitration procedure in order not to spoil relations between two countries. For the States such proceedings move from the commercial pool to the field of international political relations. International investment law and BITs significantly avoid the mentioned drawbacks. BITs provide two types of dispute resolution: arbitration and conciliation. Conciliation resembles the Mutual Agreement Procedure (MAP), which is known in DTTs. Like in the MAT and unlike the arbitration procedure, the process requires the active and collaborative work of the parties to the dispute, and agreement of both parties to the specific terms of settlement the dispute.[46] Although, the main attainment of BITs is the procedure of direct investor-state arbitration. The ICSID Convention in article 25 states that *"the jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State […] and a national of another Contracting State […]"*.[47]

To conclude, despite the similarities of the DTTs and BITs they, have absolutely different nature, tasks and purposes. They cannot be used interchangeably. Thus, it is a wrong opinion that the tax matters should not be regulated by the BITs because special agreements (DTTs) exist for this purpose, as well as, that there is no need to conclude DTTs, but to include all the tax matters in the scope of the BITs. Both types of contracts are necessary to regulate the relations between the States. Thus, for the proper protection of the investors the tax issues should be included in BITs to protect tax interests of the investors in the same manner as other interests, such as proper protection and security, regulatory stability and predictability etc.

[46] Jack J. Jr. Coe, 'Toward a Complementary Use of Conciliation in Investor-State Disputes - A Preliminary Sketch' [2005] 12(1) UC Davis Journal of International Law Policy 7-46.
[47] ICSID Convention 4 I.L.M. 524, art 25.

1.3. Approaches to the Coverage of the Tax Matters in Bilateral Investment Treaties

1.3.1. Carve-out clause

IIAs provide different approaches of the provision of the tax matters under the scope of their protection. Some of the treaties contain carve-out clauses, which explicitly exclude the fiscal relations from their coverage in total and apply only to the specific standards. States desire to have a "free hand" to adopt the taxation measures with no risk of any investment claim.[48] For example, article 21 of the U.S. Model BIT provides that "nothing in Section A [Standards of protection] shall impose obligations with respect to taxation measures" except the provisions on expropriation.[49] U.S.–Egypt BIT includes the same provision and states that "all matters relating to the taxation of nationals or companies of the Party [or of covered investment] shall be excluded from the Treaty" except of the expropriatory or transfer measures.[50]

Some BITs do not exclude the tax measures from their scope in total, but rather from the protection of the certain standards. For example, United Kingdom Model BIT outlines that the NT and MFN treatment standards are not applied to any benefits resulting from "any international agreement or arrangement relating wholly or mainly to taxation or any domestic legislation relating wholly or mainly to taxation."[51] The Morocco-Cameron BIT states that "[MFN and NT standards] shall not be construed so as to oblige one Contracting Party to extend to investors of the other Contracting Party treatment which is consequence of any Agreement relating wholly or mainly to double taxation."[52]

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[48] Vivek Kapoor, 'Bitten by the BITs, India looks to constrict its Model BIT' (Wolters Kluwer. Kluwer Arbitration Blog, 14th October) available at: <http://kluwerarbitrationblog.com/2015/10/14/bitten-by-the-bits-india-looks-to-constrict-its-model-bit/> accessed 5 April 2017.
[49] U.S. Model Bilateral Investment Treaty (2012) art 21.
[50] KennethJ Vandevelde, *US international investment agreements* (Oxford University Press 2009). See also U.S. – Egypt BIT (signed 11 March 1986, entered into force 27 June 1992) art. 11
[51] United Kingdom Model Bilateral Investment Treaty (2008), art 7 (1).
[52] Agreement Between the Government of The Kingdom Of Morocco And The Government Of The Dominican Republic On The Promotion And Reciprocal Protection Of Investments (signed 23 May 2002, entered into force 4 April 2007) art 3(2).

Some BITs make a distinction between the types of the taxes covered by the protection of the investment. The examples of such treaties are NAFTA[53] and ECT. These agreements include the carve-out clauses of the direct taxation measures[54] from the NT and MFN substantive protection, but apply them in the case of the indirect taxation[55] measures.[56] The provisions of the ECT prescribe that "the only specific exception to [MFN and NT protection] is in respect of direct taxes".[57]

The reason for exclusion of the taxes for the most of the capital gaining countries[58] is the high importance of the direct taxes for the complience with their budgetary requirements, the achieving their social and political objectives, the support of the sustainable development of the State's national industries and regions and expanding the State welfare. [59]

1.3.2. Umbrella clause

The wording of the umbrella clause in BITs may vary. However, in general the umbrella clause provides that States "shall observe any other obligation"[60] or "ensure the observance of any undertakings"[61]. Umbrella clause guarantees that the conditions of the investor-state contract may

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[53] North American Free Trade Agreement (hereinafter – NAFTA) (signed 8 December 1993, entered into force 1 January 1994) 32 ILM 289, 605 art 2103.

[54] Direct tax is *"a tax that is imposed directly on property that is calculated according to the value of the property" Black's Law Dictionary* 126 (9th ed. 2009). Direct taxes may include: income tax, corporation tax, capital gains tax, national insurance contributions, inheritance tax etc.

[55] Indirect tax is "*a tax that is not levied on the value of property but on another consideration*" *Black's Law Dictionary* 126 (9th ed. 2009). Indirect taxes may include: VAT, customs duty, excise duties, insurance premium tax, environmental taxes.

[56] Walde Thomas, Abba Kolo '*Coverage of Taxation under Modern Investment Treaties II (9)*' in: Peter Muchlinski, Federico Ortino, and Christoph Schreuer *The Oxford handbook of international investment law* (Oxford University Press on Demand 2008).

[57] Energy Charter Treaty (hereinafter – ECT) (signed December 1994, entered into force April 1998) 2080 UNTS 95; 34 ILM 360 art 21. Article 21 of the ECT provides additional specifications on the application of the tax provisions to the substantive standards of investors' protection.

[58] Walde Thomas, Abba Kolo (n. 56).

[59] European Commission *'Tax Policy in the European Union'* (Luxemburg, 2000) in: Peter Muchlinski, Federico Ortino, and Christoph Schreuer *The Oxford handbook of international investment law* (Oxford University Press on Demand 2008).

[60] Katia Yannaca-Small, 'Interpretation of the Umbrella Clause in Investment Agreements' [2006] (3) OECD Working Papers on International Investment available at: <http://dx.doi.org/10.1787/415453814578> accessed 5 April 2017. See also ECT, 2080 UNTS 95; 34 ILM 360 art 10; Germany – Pakistan Bilateral Investment Treaty (signed 25 November 1959, entered into force 28 April 1962) art 7.

[61] Organisation for Economic Co-operation and Development. *Draft convention on the protection of foreign property and resolution of the Council of the OECD on the draft convention*. [1967]

be protected under international investment law in the case of the dispute. Investor should be treated by the State according to substantive investment standards even with respect to contractual obligation of the State under the investor-state individual contract.

Notwithstanding that the umbrella clause is one of the substantial investment standards of protection, the question examined here is whether the investor may claim the violation of the international investment law by the Host State's tax measures if (1) the specific tax conduct is specified in the investor-state investment contract; and (2) the BIT between the Home and the Host States carves out the taxation from its scope, but consists the umbrella clause. Article XII of the US-Argentina BIT reads that the principle of "the observance and enforcement of terms of an investment agreement" between that Party and such national or company is applied to the taxation matters.[62] The U.S.-Ecuador BIT provides the same principle of application the umbrella clause to the taxation matters.[63]

Investor planning to contribute the assets to the business project in the country often concludes the investment agreements with the Host States. Those agreements include the stabilization clauses which aim to guarantee the stability of profits. The tax stabilization clause in the agreement between Duke Energy Company and Peru, for examples, guaranteed that *"(a) laws or regulations that form part of the tax regime [...] will not be amended or modified to the detriment of the investor, (b) a stable interpretation or application [...] will not be changed to the detriment of the investor, and (c) [...] stabilized laws will not be interpreted or applied in a patently unreasonable or arbitrary manner*." [64] Duke Energy initiated the ICSID procedure and claimed the violation of the mentioned

[62] Art XII 2(c) of the US-Argentina BIT with counter0reference to Article VII(l)(a) or (b)
[63] U.S.–Ecuador BIT (signed 27 August 1993; entered into force 11 May 1997) 103-15, art 10.
[64] Duke Energy International Peru Investments Ltd. v. Republic of Peru, ICSID Case (ARB/03/28), Award (18 August 2008), (Duke Energy v. Peru) para 227.

tax stabilization clauses.[65] The tribunal found that stabilization provisions were valid[66] and constituted the breach of the stabilization clause under the umbrella clause.[67]

The case CMS Gas Transmissions v. Argentina[68] provides that State violates the inter-state investment agreements by the violation of the contractual stabilization clauses. *El Paso v. Argentina* involves the conjunction between the umbrella and stabilization clause and reads follows *"…the umbrella clause […] will not extend the [BIT's] protection to breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections contractually agreed by the State as a sovereign –such as a stabilization clause – inserted in an investment agreement.*"[69]

The tax stabilization clauses of the investment treaties between States and foreign investors may be protected under the international investment law and treated as a breach of the umbrella clause as a substantive principle in the case of the violation of the tax stabilization clause. The criteria for such recognition are (1) the stabilizing nature of the tax provisions in the investment contracts and (2) application of the umbrella clause to the tax matters under the inter-State BITs.

[65] ibid

[66] Katja Gehne and Romulo Brillo, 'Stabilization Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment' [2014] 2013(46) NCCR Trade Regulation Working Paper available at: <http://www.nccr-trade.org/fileadmin/user_upload/nccr-trade.ch/wp2/Stab_clauses_final_final.pdf> accessed 5 April 2017.

[67] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan, 'Bilateral Investment Treaties and Their Effect on Taxation Special Report' (12th October 2015) available at: < https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/institute/WU_Global_Tax_Policy_Center/Arbitration/arb_2/TNI_article_BITs_and_DTCs.pdf > accessed 5 April 2017.

[68] CMS v. Argentina, (n 21), para 145, 151.

[69] El Paso Energy International Company v. The Argentine Republic, ICSID (ARB/03/15) in Katja Gehne and Romulo Brillo (n 66).

CHAPTER 2. PROTECTION OF THE INVESTOR IN TAX MATTERS UNDER INTERNATIONAL INVESTMENT AGREEMENTS

2.1. Expropriation of the Investment through Taxation

The "expropriation" defines as "the compulsory taking from a person, on compensation made, of his private property for the use of a railroad, canal, or other public work".[70] That is the conventional meaning of the expropriation, which provides the transfer of some capital from private ownership to the state. However, international investment law also distinguishes an indirect expropriation. Indirect expropriation arises when State abuses its superior position and takes actions that don't deprive the investor of the ownership, but "having an effect equivalent to nationalization or expropriation"[71,] "tantamount to nationalization or expropriation".[72] Such measures may differ significantly. In the case Starrett Housing the tribunal argued under the provisions of the Iran v. United States BIT:

> "*it is recognized under international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated".*[73]

In the Interlocutory Award, in this case, the arbitral tribunal concluded that deprivation of the right to manage the company, and as a result, the effective use and control of it is the indirect expropriation of the investment.[74]

Taxation as a tool for the expropriation is actively discussed by the arbitral tribunals in the great variety of cases. The possibility of the indirect expropriation through taxation is currently fully

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[70] *Black's Law Dictionary* 126 (9th ed. 2009).

[71] ECT, 2080 UNTS 95; 34 ILM 360 art 13; U.S. Model Bilateral Investment Treaty (2012) art 6 (1); United Kingdom Model Bilateral Investment Treaty, art 5.

[72] NAFTA, 32 ILM 289, 605 art 1110.

[73] Starrett Housing Corporation, Starrett Systems Inc and Starrett Housing International Inc v. Government of the Islamic Republic of Iran, Bank Omran, Bank Mellat and Bank Markazi (24) Final Award, (314-24-1) 85 ILR 34 (14 August 1987).

[74] ibid, Interlocutory Award (19 December 1983) para 154.

recognized under international investment treaties. However, the arbitral practice is still ambiguous with lots of the problematic issues. As a result, there is no guarantee for the investors in the claims of the expropriation through taxation.

The investment case law provides that in order for indirect expropriation to be recognized by the tribunal some criteria should be met: (1) the investor should be substantially deprived of the value of his investment or the control over it; (2) the expropriation should be durable in time. The same requirements are applied to the claims of the expropriation through taxation. The policy power doctrine is of special importance in the tax claims because of the sensitivity of the States to its sovereign powers in tax matters and value of the taxes for the economic development of the States.

The arbitral tribunal in the in Burlington Resources, Inc. v. Republic of Ecuador case addressed two issues to determine whether the tax measures had an expropriatory effect: (1) what are the circumstances when a tax imposing may cause a 'substantial deprivation' and (2) what other criteria are may decisive for the tribunal to constitute an expropriation e.g. "the intent of the State, the discriminatory nature of the measure or the breach of a tax stabilization guarantee".[75] The arbitral tribunal found the question of "what distinguishes a compensable expropriation from ordinary tax measures" crucial for the expropriation through taxation claims.[76]

Matthew Davie formulates two questions that should be addressed by the tribunal in expropriation through taxation claims: "(1) to what extent has the taxation eroded the underlying value of the

[75] Burlington Resources, Inc. v Republic of Ecuador, ICSID (ARB/08/5), Decision on Liability (14 December 2012) (Gabrielle Kaufmann-Kohler, President; Brigitte Stern; Francisco Orrego Vicun˜ a) and Dissenting Opinion by Francisco Orrego Vicun˜a (14 December 2012) in Arno E. Gildemeister, 'Burlington Resources, Inc. v Republic of Ecuador: How Much is Too Much: When is Taxation Tantamount to Expropriation?' [2014] 29(2) ICSID, 315-20

[76] Arno E. Gildemeister, 'Burlington Resources, Inc. v Republic of Ecuador: How Much is Too Much: When is Taxation Tantamount to Expropriation?' [2014] 29(2) ICSID, 315-20.

investment? (2) does this destruction or transfer of wealth represent legitimate use of the taxing power?”[77]

In the Yukos Universal Limited (Isle of Man) v. The Russian Federation case the court formulated the issues: (1) whether the actions of the Russian authority and their effect on the claimant constituted an expropriation within the ECT; (2) whether the respondent met the requirements for the lawful expropriation e.g. public interest purpose, non-discriminatory character, due process of law, payment of prompt, adequate and effective compensation.[78]

The first issue to analyze is what the substantial deprivation of the value in the tax claims and when states’ tax regulatory measures violate the expropriation requirements under international investment law.[79] The most common reason of the investors’ failure to win the tax claims on expropriation is the difficulty of proof by the investors that they were substantially deprived of the value of the investments.[80]

In the Telenor v. Hungary case the ICSID tribunal ruled that “exercise by government of regulatory powers that create impediments to business or entail the payment of taxes or other levies does not of itself constitute expropriation”.[81]

In EnCanada v. Ecuador case, the company claimed the violation of the Canada-Ecuador BIT and stated that the rejection of the VAT credits and refunds of the 10% of the transaction value to the claimant amounted to indirect expropriation. The UNCITRAL tribunal found that those tax measures did not deprive the investor of the normal range of the profits or render the value of the

[77] Matthew Davie, 'Taxation-Based Investment Treaty Claims' [2015] 6(1) Journal of International Dispute Settlement, 202-227.
[78] Yukos Universal Limited (Isle of Man) v. The Russian Federation, UNCITRAL, PCA (AA 227) Award (18 July 2014) para 1575-1593. See also ECT, 2080 UNTS 95; 34 ILM 360 art 13.
[79] In the case of the tax measures it is reasonable to analyse the deprivation of the value, rather the deprivation of the control. Because the any change of the tax regime that harms the investor provides the increase of the tax burden for it and losing of some amount of profits.
[80] Matthew Davie (n 77).
[81] Telenor Mobile Communications A.S. v. The Republic of Hungary, ICSID (ARB/04/15) Award (13 September 2016), para 64.

investment "so marginal or unprofitable as to effectively deprive them of their character as investments'.[82]

In Tokio Tokeles v. Ukraine case the arbitral tribunal noted that the existing jurisprudence does not clarify the "substantiality" of the deprivation and stated that "one can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient." [83]

In Perenco v. Ecuador case the Perenco was obligated to pay the "extraordinary revenue" to 99% of the income from all sales of oil above the applicable reference price.[84] The arbitral tribunal rejected the claim of the expropriation because of the fact that even after the increase of the tax burden the company did not cease to operate.[85]

Thus, every arbitral tribunal in its decision tries to define some threshold of the tax burden which may be treated as an expropriatory measure. However, currently, there is no hope that such threshold may be clear in the international investment cases in the nearest future. This can be explained by the fact that all the countries have different tax rates and standards. For example, the total tax rate of Austria is 52 %, France – 66,6 %, Argentina – 137,3 %.[86] In Burlington Resources, Inc. v Ecuador case Kohler and Brigette Stern argued that 90 % of the windfall tax was not tantamount to an expropriation as the company remained profitable.[87] While Professor Orrego-Vicun˜a decided in a

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[82] Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador), ICSID (ARB/08/6), para 674 in Tanzi, Attila, et al., eds. *International Investment Law in Latin America/Derecho Internacional de las Inversiones en América Latina: Problems and Prospects/Problemas y Perspectivas* (Brill 2016). See also EnCana Corporation v. Republic of Ecuador, LCIA (UN3481) UNCITRAL This decision was proved by the another arbitral tribunal in Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID (ARB/06/11), Award (5 October 2012).
[83] Tokios Tokelés v. Ukraine, ICSID (ARB/02/18) Award (26 July 2017), para 120.
[84] Perenco v. Ecuador ARB/08/6 (n 82) para 120.
[85] ibid para 429-430.
[86] Martin Will, 'Here are the 27 countries with the highest levels of tax' (Business Insider, 18th February) available at: <http://uk.businessinsider.com/wef-27-countries-with-the-highest-tax-rates-in-the-world-2016-2/#25-ivory-coast-519--one-of-eight-african-countries-in-our-ranking-ivory-coast-charges-a-basic-25-corporate-profits-tax-but-bumps-that-to-30-for-those-in-the-telecommunication-it-and-communication-sectors-3> accessed 5 April 2017
[87] Perenco v. Ecuador, ARB/08/6, (n 82), paras 429-430.

contrary way and stated that tax diminished the market value of the assets and deprived the claimant of a 'fair' reward for its employees.[88]

The other criterion of the expropriation analyzed by the arbitral tribunals relates to the requirement of the good faith. This includes the public purpose justification, the discriminatory nature of the measures, the intent of the state, previous behavior of the state and legitimate expectations of the investor.

In Saluka v. Czech Republic case the arbitral tribunal stated that the international law shall to draw "a bright and easy distinguishable line" between the "permissible" and "commonly accepted" regulatory powers of the state and, thus, uncompensated regulations and those that deprive the investor from the enjoyment of his investment.[89] There is no unanimous approach to the public purpose doctrine but States always use the protection of the policy power doctrine in tax-related disputes, because of the heighten importance of the taxes for the financing of the state needs.

As the common practice of the investment disputes between the investors and states, tribunals don't usually pay attention to the expropriatory intent of the State when the indirect expropriation takes place. However, in the tax investment disputes, the expropriatory intent of the State may be a persuasive argument in favor of the investor. Fiscal expropriations may be characterized by the "destructive" intent or discriminatory treatment of the state.[90] In Jukos v. The Russian Federation case the arbitral tribunal analyzed the tax measures of the Russian Federation against Yukos Empire and held that the primary intent of the State was not to collect taxes in a prompt and effective way,

[88] Matthew Davie (n 77).
[89] Saluka Investments B.V. v. The Czech Republic, UNCITRAL, Partial Award (17 March 2006), para 263. Andrea K. Bjorklund, August Reinisch (eds) *International investment law and soft law* (Edward Elgar Publishing 2012).
[90] Arno E. Gildemeister (n 76). See also RosInvestCo UK Ltd. v. The Russian Federation, SCC (V079/2005) Award (12 September 2010) paras 449–54, 556, 621; Marvin Roy Feldman Karpa v. United Mexican States, ICSID (ARB(AF)/99/1) (Feldman v. Mexico), Award (16 December 2002) paras 105 , 113; EnCana v Ecuador, (n 82), para 173; Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova, UNCITRAL , Award (18 April 2002) paras 69–71.

but to bankrupt the company and all the valuable assets of it.[91] Holding that the expropriation was not for the public purpose of the state, in violation of a due process and without payment of prompt and adequate compensation the tribunal recognized the Russian Federation liable for the violation of the article 13 of the ECT.[92]

The other issue that can be taken into account by the tribunal is the legitimate expectations of the investor and character of the pre-dispute relations between the investor and the State. In the Link-Trading v. Moldova case the tribunal held that "tax measures may also become expropriatory without necessarily being arbitrary or discriminatory, when their application violates a specific obligation that the state has previously undertaken in favor of a particular person or class of persons, such as an investor protected under a treaty."[93] In the Ecuador v. Perenco case the arbitral tribunal ruled that changes to the previously concluded contract between the state and the investor "cannot distort the contract's very objective", should have "reasonable justification", and "if the exercise of jus variandi negatively affects the economic rights of the contractor, the entity must compensate the contractor, in such a way that the stipulated price does not change."[94]

The importance of the legitimate expectations argument of the investor on the tax regime is described in *EnCana v. Ecuador case*. In this case, the arbitral tribunal held that investors cannot expect that the States tax regime or tax policy will not be changed without any special commitments. Moreover, the investor cannot be deprived of the enjoyment of the investment by the only mean of the tax increase.[95]

In the claims of the expropriation through the series of the tax measures, the reasonable arguments should be presented by the investor and the state on the issues of "substantiality" of the deprivation,

[91] Yukos v. The Russian Federation PCA AA 227 (n 78).
[92] ECT, 2080 UNTS 95; 34 ILM 360 art 13.
[93] Link-Trading v. Moldova (n 90) para 73.
[94] Perenco v. Ecuador ARB/08/6 (Decision on Remaining Issues of Jurisdiction and on Liability) (n 82) para 404.
[95] En Cana v. Ecuador (n 82).

the duration of it, public purpose justification of the tax measures, *bona fide* regulatory intent of the state, pre-dispute relations and agreements between the parties.

On the basis of the analyzed cases, it can be reasonably concluded that the "substantiality" of the deprivation should depend not on the amount of the tax itself, but on the amount of the increase of the tax burden. Entering the market, the investors analyze the business conditions, prospect profits, conclude the contracts with employers with the specific amount of the salary, take bank loans and issue debt to raise the finances for the project. Notwithstanding that all those expenses are deductible for the profit before taxation, the substantial increase of the particular tax leads to substantial increase of the total tax burden that could make the investor's entity totally unprofitable and with short of money for the reinvestment and development of the project on the time of its duration.

In regards to the public purpose and intent of the parties, it is essential in each case to analyze the discriminatory intent and premises for the tax decision. However, the investor is responsible for the proof of such intent.[96] The public purpose of the tax increase is much easier to argue than discriminatory effect. For example, in the case Tokio Tokeles v. Ukraine the tribunal rejected the arguments of the claimant on the expropriation because "*the Claimant has simply failed to satisfy [the] burden [of proof].*"[97]

Any arrangements between the investor and the State play a major role in the expropriation disputes. The arbitral tribunal in EnCana v. Ecuador case perfectly ruled the investor cannot expect that no tax conditions will change in the long perspective without the proper arrangements between himself and the State.[98] Otherwise, those changes should be treated as a normal business risk of the investor and his investments.[99]

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96 Probandi actori incubit principle means that the burden of proof is on the plaintiff.
97 Tokio Tokeles v. Ukraine (ARB/02/18) (n 83) para 122.
98 EnCana v. Ecuador (n 82).
99 Normal business risk connected to the nature of the business activity which is from its very beginning risky. The investors should assume the loses and unpredictable conditions.

2.2. The Application of the Fair and Equitable Treatment Standard to the Tax Matters

The application of FETvstandard to the protection of the investor from the regulatory power of the State in the tax issue depend on the provisions of the particular BIT. FET's application to the taxes is excluded by the general exclusion of the tax matters from the BIT's protection.[100] However, if tax matters are not carved out the coverage of the investment treaty, FET is also applied to the tax matters "*by virtue of both the restrictive and effective rules of interpretation of treaties*".[101] Some BITs explicitly provide the application of the FET standard to the tax policies. The U.S. – Latvia BIT generally excludes the tax matters from the protection of the BIT, but in article 10 states that the BIT "*exhorts both countries to provide fair and equitable treatment to investors with respect to tax policies*".[102] Japan-Vietnam BIT includes the similar provision of exclusion of the tax measures from the BIT coverage but requires the application of FET, MFN and NT standards to taxes.[103]

The arbitral practice distinguishes the main components of the FET standard. The arbitral tribunal in the often cited *Waste Management v. Mexico* case ruled that the State is in breach of the FET if its conduct is "*arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety*".[104] Tribunal in Ostergetel and Laurentius v. Sovak Republic case was more laconic in the definition of FET compounded and focused on the analysis of the reasonable expectations, bad faith, and denial of justice concepts.[105]

[100] Walde, Thomas, and Abba Kolo. 'Investor-state disputes: the interface between treaty-based international investment protection and fiscal sovereignty.' [2007] 35 Intertax. Kluwer Law International 424.
[101] ibid
[102] US – Latvia BIT art 10
[103] Japan – Vietnam BIT (signed 14 November 2003, entered into force 19 December 2004) art 3,9,19; U..S-Latvia BIT n (102) art 10; U..S-Poland BIT (signed 21 March 1990, entered into force 6 August 1994) art 6; U..S Kazakhstan BIT (signed 19 May 1992, entered into force 12 January 1994) art 11; US-Armenia BIT (signed 23 September 1992, entered into force 29 March 1996) art 11

[104] Waste Management, Inc. v. United Mexican States, ICSID (ARB(AF)/00/3) Award (20 April 2004) para 98.
[105] Jan Oostergetel and Theodora Laurentius v. The Slovak Republic, UNCITRAL, Final Award (23 April 2012)

2.2.1. Stability, Respect to the Legitimate Investor's Expectations and Proportionality Test of the Host State's Tax Regulations

Stability of the legal framework for the current and prospect investors is the cornerstone of the investment disputes on violation of the FET standard. Making the decision to invest in the particular state, investor assesses the business and legal environment at the time of the investment as well as expects the State's conduct to be fair and equitable.[106] The same requirement for ensuring the "stability of the legal and business framework in the State Party"[107] is found in the LG&E v. the Argentina Republic and Bayindir v. Islamic Republic of Pakistan[108] cases. The famous Occidental Exploration v. Ecuador case outlines the importance of the stable business and legal framework. The dispute arose because OEPC who was not entitled to VAT refunds on their exports contrary to the established practice, in the future and was obligated to refund the taxes already paid retroactively.[109] The tribunal in the case lined that "*the relevant legal question under international law was not whether there was an obligation to refund VAT…but whether the legal and business framework met requirements of stability and predictability*"[110]. The tribunal found the violation of the FET, because even if the VAT refunds are not required to be made to investors under international investment law, the State failed to ensure stable legal and business environment as part of FET standard.[111]

However, the obligation to save the stable legal and business conditions in the time of the investment is not absolute. Otherwise, the FET may lead to "virtual freezing"[112] of the regulatory power and level of the state economic development in contradiction to the "evolutionary character of

[106] Saluka Investments BV v. The Czech Republic, Partial Award, (17 March 2006,) para 301.
[107] LG&E v. Argentina Republic (n 21) paras 121-131.
[108] FET comprises "the obligation to refrain…from frustrating the investor's reasonable expectations with respect to the legal framework affecting the investment" in: Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID (ARB/03/29) Award (27 August 2009).
[109] Occidental Exploration and Production Company v. The Republic of Ecuador (n 82) para 170.
[110] ibid para 191.
[111] Julien Chaisse (n 2).
[112] EDF (Services) Limited v. Romania, ICSID (ARB/05/13) Award (8 October 2009), para 217.

economic life".[113] In Saluka v. Czeck Republic case the tribunal held that '*a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other."*[114] In order to comply with the proportionality test the state should strongly argue the public purpose and the expected effect of the tax measures. For example, in OPEC v. Ecuador case, the tribunal held that the tax measures of the state were not justified by any public purpose or any interest of public welfare. In comparison, in the Sergei Paushok v. Mongolia and Perenco v. Ecuador case,[115] the tribunal decided that investors due to their economic and business knowledge might consider that rapid growth of the price of the commodities, the government could change its tax policy in relation to those goods.[116] Thus, the threshold for the constitution of the fair and equitable treatment breach remains high.

2.2.2. Good Faith in Exercising of the Host State's Regulatory Power in Tax Measures

Good faith is a general principle recognized under Article 38 of the ECJ Statute.[117] Goof Faith is a very broad concept and may include or overlap with the obligation of the consistency of the state with its previous arrangements, non-discrimination to other foreign and domestic investors and other requirements. However, sometimes the tribunal may limit the scope of the good faith only to the intent of the State in adopting of the regulatory measure. In Occidental Exploration v. Ecuador case, the tribunal stated that FET does not depend on a good or bad faith of the state.[118] By this approach, the tribunal analyses the actual effect of the measure on the investor but not purely the subjective

[113] ibid para 217.
[114] Saluka v. Czeck Republic case, para 306.
[115] Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. The Government of Mongolia, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011) and Perenco v. Ecuador case (n 82).
[116] Matthew Davie (n 77).
[117] Rudolf Dolzer,'*Fair and equitable treatment: Today's contours*' [2013] 12(7) Santa Clara J. Int'l L. 7-35. See also Vienna Convention on the Law of Treaties (signed at Vienna 23 May 1969, entry into force: 27 January 1980) 1155 U.N.T.S. 331 art 31.
[118] Occidental Exploration v. Ecuador UN3467 (n 109) in Julien Chaisse, 'Investor-State Arbitration in International Tax Dispute Resolution: A Cut above Dedicated Tax Dispute Resolution' (n 2).

intentions of the state, which are difficult to prove. Thus, the tribunal gives the investor more chances to win the dispute.

2.2.3. Transparency and Due Process of the Tax Regulations in IIA

Transparency and due process requirements apply in the same way to the tax disputes as to the other investment disputes. In Tecmed S.A. v. United Mexican States the tribunal ruled on the transparency issue that "*the foreign investor expects the host State to act […] totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations*."[119] In the OECP v. Ecuador case, the tribunal stated that the tax law must be changed with the obligation of the State to provide clarity about its meaning and extent of changes.[120]

In Marvin Feldman v. Mexico case, the United Mexican States rejected to grant benefits of the certain tax refunds that should be granted to the investors. Mexico also refused to rebate the taxes exercised to cigarettes exported by the investor as well as to prospective cigarette exports. The tribunal held that Mexico in such way violated the non-discrimination requirement of the FET. However, it can be stated that due process was also not granted to the investor because the investor did not have any chance to debate the application of the tax requirements as well for the protection of their rights by the other mean than the arbitration.

2.2.4. The Non-Discrimination Requirements to the Tax Regulations

Non-discrimination principle requires the Host State's conduct to avoid any kind of the discrimination on any ground in relation to the foreign investors.[121] The IIAs and DTTs in general distinguish two kinds of non-discrimination requirements in the tax matters. Those are the

[119] Rudolf Dolzer (n 117).
[120] OECP v. Ecuador, para 707.
[121] Julien Chaisse (n 2).

discrimination of the foreign investors in relation to the nationals of the Host State – National Treatment (NT), and the non-discrimination towards the investor in comparison to the other foreign investors of the third countries – Most-Favoured Nation Treatment (MFN).[122] Discriminatory treatment may take the form of applying of the specific legislation to the investors or execution of common legislation by e.g. prosecution or targeted auditing.[123]

Both the BIT (IIA) and DDT types of contracts include the provisions on the protection from the discrimination of the investor. However, they have completely different approach to the standard's definition.[124] The scope of the non-discrimination under the mentioned types of treaties is not equal. In the DTT the non-discrimination is more a rule than a general principle as under the BITs.[125]

2.3. National Treatment and MFN Requirement to the Tax Matters under BITs and DTTs

Under the BITs the one of the requirements of the non-discrimination is the nationality of the investor. The nationality of the legal persons is determined on the basis of the place of incorporation or registered office[126], place of the effective seat of business and or central administration, membership of a controlling stake.

NT standard is designed to protect the foreign investors against the policy of protectionism of the State towards the national producers and service suppliers. In order to analyze the violation of the NT principle the arbitral tribunal should constitute the presence of the specific criteria: (1) the investor and the comparator were accorded the relevant treatment; (2) the investor and comparator had similar conditions of the business activity: "in the same circumstances", "carrying on the same

[122] Wenhua Shan, ed. *The legal protection of foreign investment: a comparative study* (Hart, 2012).
[123] Matthew Davie (n 77). See also Tokio Tokeles v. Ukraine (ARB/02/18) (n 83), Yukos v. The Russian Federation (n 78).
[124] Catalina Hoyos, 'Non-discrimination and fair tax treatment in Bilateral Investment Treaties (BIT's) and Foreign Trade Agreements (FTA's)' (Wolters Kluwer Kluwer International Tax Blog, 28th July) available at: <http://kluwertaxblog.com/2015 /07/28/non-discrimination-and-fair-tax-treatment-in-bilateral-investment-treaties-bits-and-foreign-trade-agreements-ft as/> accessed 5 April 2017
[125] ibid.
[126] See Tokio Tokeles v. Ukraine (n 83); Saluka v. Czeck Republic (n 89).

activities", "similar enterprises"[127]; (3) the treatment of the investor-claimant was not equal or worth than the national comparator.[128]

In Feldman v. Mexico case, the tribunal stated the *de facto* discrimination took place.[129] Mexico rejected to rebate exercised taxes applied to the cigarette exports.[130] Despite the fact that the option to rebate the tax regime was not granted to anyone by the national law, the local exporters had been granted to those benefits.[131]

In the same case, the tribunal ruled that NAFTA does not protect the investors from the *de jure* discrimination, but from the *de facto* discrimination as well.[132] In the determination of the "similar circumstances", the tribunal interpreted the criterion as the similar business, – exporting of the cigarettes.[133] In OEPC v. Ecuador case, the claimant argued that Ecuador breached the national treatment obligation because the exporters of other goods were entailed to the tax refunds. The arbitral tribunal rejected the argument on the statement that the state's treatment should be able to compare the market players of the same economic activity and "directly competitive or substitutable products".[134]

The same approach had the tribunal in the Archer Daniels Midland Co. & Tate & Lyle Ingredients Americas, Inc. v. Mexico case. The claimant, in this case, was a producer of HFCS.[135] Mexico authorities enacted legal acts that imposed twenty percent tax on the transfer and distribution on

[127] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan (n 67).
[128] Matthew Davie (n 77).
[129] Feldman v. Mexico1 (n 90) paras 128, 157, 177, 169.
[130] ibid.
131 Catalina Hoyos (n 125)
[132] ibid.
[133] ICSID, OECD AND UNCTAD ,'Making the Most of International Investment Agreements: A Common Agenda' (Symposium OECD Headquarters Paris, 12th December) <https://www.oecd.org/investment/internationalinvestmentagreements/35805957.pdf> accessed 5 April 2017
[134] OECP v. Ecuador (n 82) paras 173-176.
[135] High-fructose corn syrup (HFCS) is a sweetener made from corn starch that has been processed by glucose isomerase to convert some of its glucose into fructose.

sweet beverages containing HCFS and exempted can sugar from certain types of taxes.[136] The arbitral tribunal applied the three-step test for determination of the National treatment violation: (1) identifying subjects for comparison, (2) analyzing the applied treatment (3) and considering any justifiable factors.[137] The arbitral tribunal paid much attention to the criterion of the "like circumstances" and constitute that "both are part of the same sector, and competing for face-to-face in supplying sweeteners to the soft drink and processed food market".[138] The tribunal stated the breach of the NT "notwithstanding the fact the fructose and cane sugar producers are not identical comparators […] but overall circumstances of the case suggest that they are in like circumstances."[139]

DTTs include the other approach to the non-discrimination. Article 24 of the OECD Tax Model Convention consist the non-discrimination requirements.[140] In comparison to the BITs provisions, DTTs prohibit the discrimination both on the nationality and residence criteria. BITs do not cover the discrimination on the basis of residence e.g. in the case of imposing of the withholding taxes on dividends of the nonresident corporate shareholders.[141]

On the other hand, article 24 of the OECD Tax Model Convention considers the discrimination only in five specific accurate cases[142] and thus, limits the scope of the non-discrimination principle.

MFN standard provides a comparison to be made between foreign investors and investors of a third State, which are in the same circumstances.[143]Article 24 of the OECD Model Tax Convention excludes the taxation issues from the MFN protection. The commentary to the Model Tax

[136] The protective nature of legal acts of the local cane sugar producers was confirmed by the supreme court of Mexico.
[137] Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. The United Mexican States, ICSID (ARB (AF)/04/5) Award, (21 November 2007) para 196.
[138] ibid para 201.
[139] ibid paras 201-202.
[140] Model Tax Convention on Income and Capital, OECD (2015) art 24.
[141] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan (n 67).
[142] Catalina Hoyos (n 125).
[143] Jeffrey Owens, Laura Turcan, Jasmin Kollmann, Alicja Majdanska and Sudin Sabnis *'What Can the Tax Community Learn from Dispute Resolution Procedures in Non-Tax Agreements*?' [Oct. 2015] Bulletin for International Taxation 577-589.

Convention states that its provisions cannot be interpreted as an application of MFN treatment to investor-state relations.[144] MFN treatment protection cannot be applied to the tax matters if the State has bilateral or multilateral agreements on the tax benefits, which are based on the principle of reciprocity.[145]

BITs have different approaches to application of the MFN principle to the tax measures. Some BITs do not provide the application of the MFN principle to the tax measures,[146] other BITs either apply MFN to the tax measures in general meaning or provide the specific exceptions to them. The latter type of the BITs is the most frequent. The limitations and restrictions specified in the BITs and their scope are discussed in the third chapter in detail.

2.4. The Right of the Investor to the Freedom of Transfer of Capital and Tax Regulations

The main purpose of the foreign investor to invest money is to generate profit.[147] The transfer of funds principle is provided by lots of BITs, which define its scope and types of funds or assets that are covered by it and entitle the investors freely transfer cash flow outside the Host State. BITs may provide certain types of transfers "related to investment" or "in connection with an investment", as well as detailed illustrative or exhaustive list of funds covered by the principle protection.[148] There are also different regimes of transfer prescribed in the BITs as (1) free transfer, (2) transfer in accordance with Host State' laws and regulations, (3) free transfer regime with exemptions for balance of payments difficulties, (4) free transfer in accordance with IMF and/or WTO Agreements.

The main issue here is whether any types of taxes may be contrary to the free transfer of capital principle under the BITs. Investing in the Host State, investors prefer the free regimes of the transfer

[144] Commentaries on the Articles of the Model Tax Convention, OECD (2010), Commentary On Article 24 Concerning Non-Discrimination available at: < http://www.oecd.org/berlin/publikationen/43324465.pdf > accessed 5 April 2017.
[145] ibid.
[146] U.S. Model Bilateral Investment Treaty (2012) art 21, UK Model Bilateral Investment Treaty (2008).
[147] Kern, Carsten, *'VI. Transfer of Funds'* in: Marc Bungenberg, Jörn Griebel, Stephan Hobe, August Reinisch (Hrsg.) *International Investment Law* (Nomos Verlagsgesellschaft mbH & Co. KG. 2015), 919 – 935.
[148] ibid.

of capital in the forms of profits, royalties, dividends, assets, interests etc. He wants to have guarantees from the Host state that he will be able to transfer any kinds of assets to the home State or to the third state in order to comply with his obligations.[149] The State contrary is interested in saving money within the country borders. From the State's point of view transfer of capital can lead to the economic instability e.g. currency fluctuations, exchange control etc.[150] Developing countries could have a strong intention and interest the investors to reinvest money in local projects and to contribute more to the Host State Development.[151]

2.4.1. Free transfer of capital and withholding taxes

International investment does not provide the scope of the free transfer of capital principle.[152] The Contracting Parties are free to define its scope in the BIT. The ECT in Article 21 provides that *"for the avoidance of doubt [Freedom of transfer of capital] shall not limit the right of a Contracting Party to impose or collect a tax by withholding or other means"*.[153] The US-Ukraine BIT states that "*notwithstanding [freedom of transfer of capital related to investment provisions], either Party may maintain laws and regulations […] imposing income taxes by such means as a withholding tax applicable to dividends or other transfers*."[154] "Withholding means" and "other transfers" may include dividends, royalties, interest payments etc.

Withholding taxes are imposed to balance the interests of the investor and the State. By general approach withholding taxes are not covered by the transfer capital principle. Imposing of the taxes belongs to the regulatory authority of the state. Moreover, funds required to pay taxes belong (owed)

[149] Peter T. Muchlinski, *Multinational Enterprises and the Law* (Oxford, Oxford University Press, 2nd edn, 2007) 690–691

[150] Cristopher J. Neely, *'An Introduction to Capital Controls'* [1999] 81(6) Federal Reserve Bank of St. Louis Review 13-30.

[151] Walde Thomas, Abba Kolo '*Coverage of Taxation under Modern Investment Treaties II (9)*' in (n 56).

[152] Rudolf Dolzer and Christoph Schreuer. *Principles of international investment law (*Oxford University Press, 2012).

[153] ECT, 2080 UNTS 95; 34 ILM 360 art. 21 with counter reference to article 14 [Freedom of transfer of capital].

[154] United States-Ukraine Bilateral Investment Treaty (signed 4 March 1994; entered into force 16 November 2011) art. 4(3)

to the state and not the investor.[155] Thus, they cannot be freely transferred. On the other hand, the withholding taxes may be covered by the protection of FTC principle, if they are implemented to discourage or prohibit the transfer of funds and have the same nature and effect as a capital exchange control.[156] The State by imposing of the withholding taxes may create such conditions when its amount makes it impossible of financially unattractive to transfer the profits.[157] One can argue that such actions may be tantamount to the expropriation.[158] However, in the case of the expropriation, it would be difficult for the investor to prove that high withholding taxes could substantially deprive him of the enjoyment of his investment. Still, the individual facts should be analyzed in the every particular dispute. In the same time, the violation of the FTC standard could be claimed by the investor. In such circumstances International investment law may take into account not a legal form used to diminish the value of the investment, but "economic reality" and effect of the tax measure on the freedom of capital transfer.[159]

2.4.2. Free Transfer of Capital and Exit Taxes

The nature of exit taxes is that the investor should pay the specific amount of tax from the amount of "unrealized capital gains, hidden reserves and value increases of the assets" of a natural or legal person that leaves the jurisdiction of the Host State.[160] Moreover, the leaving of the jurisdiction means the transfer of tax residence for the purpose if the exit tax.[161] The triggering events for the imposing of taxes are a transfer of the registered office and/or place of effective management, ceasing the tax resident status under Host State law or DTT provisions.[162] For the taxpayer, the levying of the exit taxes gives some problems: cash-flow, double taxation, and tax base

[155] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan (67)
[156] ibid
[157] Walde Thomas, Abba Kolo (n 56).
[158] ibid.
[159] ibid.
[160] Daria Zernova, '*Exit Taxes on Companies in the Context of the EU Internal Market', [2011] 39(10)* Kluwer LAW International BV, 471.
[161] ibid.
[162] ibid.

disadvantages.[163] In the National Grid Indus decision the ICJ concluded that the exit tax is not, of itself, contrary to EU law.[164] In the Daily Mail and Cartesio cases[165] ECJ proved its position that it does not interfere with the national authority power on the regulation of the right of a company to exit the state without dissolution.[166] The exit taxes do not fall within the protection of the free transfer of capital under the BITs. The change in the residence status is not equal to the transfer of assets because the initial investments remain in the Host State.[167]

Exit taxes are not provided under the BITs as an exception to the freedom of transfer, but they may be defined as "other means" as it stated in ECT.[168] However, the "material" test may be applied in the case of exit taxes in the same way as to the withholding taxes discussed in the previous part. If the exit taxes make the transfer of capital financially unattractive and the whole investment unprofitable with the aim not to allow the investor to change the tax residence, it might be possible for the investor to argue the violation of FCT standard.

[163] Cash-flow disadvantage arises when the tax charged on the emigration date and not the realization date of capital gains .Double taxation disadvantages are a result of the lack of the uniform approach to the international taxation worldwide. Moving the capital to second country will automatically increase the tax base in that country. Tax base disadvantage are connected with possible fluctuations of the valuation of assets, which may increase or decrease a tax base as well as with undesirable regulations of the second country.
See Shane Murphy, Shane Wallace, 'Exit Taxes: Where to Now? After ECJ Decision in National Grid Indus BV' [2012] 2 (Delloite) 80-84 available at <https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/2012_exit_taxes_delo itte_ireland.pdf> accessed 6 April 2017. See also Andreea Farcas-lohan, 'Company migration-A study on the European corporate exit taxation' [2013] (Master thesis) Faculty of Law, Lund University.

[164] Eversheds Sutherland (International) LLP, 'Exit taxes and Europe - where are we now?' (Lexology, 17th September) available at: <http://www.lexology.com/library/detail.aspx?g=964fa36c-71eb-468f-adcb-7852dcd768b5> accessed 6 April 2017. See also National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam [2011] C-371/10 (ECR) (Grand Chamber).

[165] The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc [1988] C-81/87 (ECR 05483) and Cartesio Oktató és Szolgáltató bt [2008] C-210/06 (ECR I-09641).

[166] Andreea Farcas-lohan, 'Company migration-A study on the European corporate exit taxation' (n 163).

[167] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan (n 67).

[168] ECT, 2080 UNTS 95; 34 ILM 360 art. 21.

CHAPTER 3. PROTECTION OF THE HOST-STATE INTERESTS IN THE INVESTOR-STATE INVESTMENT TAX DISPUTES

3.1. The Necessity of the Protection of the Host State's Interests in the Investor-State Tax Relations

Bilateral investment treaties are defined as "*international agreements establishing the terms and conditions for private investment by nationals and companies of one state in another state.*"[169] The main purpose of their concluding between the states is to protect the interests of the investors of the Contracting Parties against abusive actions of the state's authorities and grant the fair and prompt treatment. But no BIT has relative provisions to protect the State from the abusive conduct of the foreign investors. In relation to the tax issues, such protection is of the heighten value. Multinational enterprises (MNE) use their territorial prevalence to avoid taxation of the Host State. In such a way the companies abuse their protection and guarantees, use the State's resources e.g. labor, financial sources, raw materials, but do not pay the proper amount of taxes causing the detrimental effect to the Host State economy.

3.1.1. Abuses of the Tax Regulations by the Foreign Investors

The most of the attention of the world community in tax problems has been devoted to the tax erosion and profit shifting (BEPS) of the MNE in the recent years. The fact is that the major MNE exploit the "flaws and loopholes in existing tax rules"[170] to take the benefits of the law tax jurisdictions. Non-compliance of the MNE with the tax regulations of the Host States and "aggressive" tax planning are motivated simply "by rational calculation of costs and

[169] Cornell University Law School, 'Bilateral investment treaty' (Legal Information Institute) available at: <https://www.law.cornell.edu/wex/bilateral_investment_treaty> accessed 6 April 2017.
[170] Clemens Fuest, Christoph Spengel, Katharina Finke, Jost H. Heckemeyer, and Hannah Nusser 'Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform'13-078 Discussion Paper Centre for European Economic Research available at: <http://ftp.zew.de/pub/zew-docs/dp/dp13078.pdf> accessed 6 April 2017

opportunities".[171] The taxation rules for the MNE require to be reformed in order to prevent seeking of the drawbacks and gaps by the investor in the tax system of the Host State.

Shifting profits to law tax jurisdictions allows Apple, Google and other highly profitable multinationals significantly reduce their tax burden on the income from 1 % to 3%.[172]

The current and most famous case is the dispute between the EU tax authorities and Apple, Inc. Apple, Inc. used the imperfect provisions of the double taxation treaties and national legislation in such a way that its Irish entities were not residents for the tax purposes anywhere.[173] Irish subsidiaries earned about 90 % of the profits gained by Apple, Inc. outside the US.[174] The amount of taxes paid was around 4 % from hundreds of billions of dollars earned by Apple, Inc. for the last 10 years.[175] The dispute caused the major political contradictions between the United States and the European Union.[176]

The pattern of Google, Inc.'s tax avoidance is known as become known as "Double Irish Dutch Sandwich".[177] As in the case of Apple, Inc., Google Inc. avoided the paying of taxes due to the "de facto waiver of the residential taxation"[178] and presenting "no or little source taxation"[179].

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[171] Kristina Murphy 'Aggressive tax planning: Differentiating those playing the game from those who don't' [2004] 25(3) Journal of Economic Psychology 307-329. See also Robert A. Kagan and John T. Scholz, 'The "criminology of the corporation" and regulatory enforcement strategies' [1980] Organisation und Recht. VS Verlag für Sozialwissenschaften 352-377. See also Erich Kirchler and Boris Maciejovsky, 'Tax compliance within the context of gain and loss situations, expected and current asset position, and profession' [2001] 22(2) Journal of Economic Psychology 173-194

[172] Clemens Fuest, Christoph Spengel, Katharina Finke, Jost H. Heckemeyer, and Hannah Nusser (n 170).

[173] Vanessa Houlder, Alex Barker and Arthur Beesley, 'Apple's EU tax dispute explained' (Financial Times, 30th August) <https://www.ft.com/content/3e0172a0-6e1b-11e6-9ac1-1055824ca907> accessed 6 April 2017.

[174] ibid.

[175] ibid.

[176] Shortly, Apple abused the wide residency definition in Ireland and the US as well as transfer pricing rules and CFC rules.

[177] See Clemens Fuest, Christoph Spengel, Katharina Finke, Jost H. Heckemeyer, and Hannah Nusser (n 170) on "Double Irish sandwich" explanation.

[178] ibid.

[179] ibid.

These and other major tax disputes[180] on the avoidance of the taxation in Europe by the MNE and increase of the amount of the cross-border transactions captured the attention of the G20-countries, who developed the BEPS project. It "refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations."[181]

3.1.2. BIT as a tool for the protection of the Host State Interests

BITs may play a great role in attraction of the investments for the economic growth of the Host State's economy. Mahmoud Khalid Almsafi in his Foreign Direct Investment and Economic Growth Literature Review from 1994 to 2012 proves mostly positive and even significant effect of FDI on the host country's economic growth. He examines around 30 researches on this issue and only in four of them the authors contend null and just in two – negative influence of FDI on the economic growth.[182] The positive or negative result may depend on various factors: the country's level of development in general and the technological development, the quality and quantity of labor and material resources, nature of FDI either short-term or long-term.

The one of the most important regional factor to attract investments is the tax policy, tax regimes and tax administration of the country. Guarantee of the stability of the tax regime and tax relations of the State in BITs may be an additional advantage of the Host State's investment policy. States compete against each other for the investors' money and assets. They use the tax advantages to influence the company's relocation, establishing, expansion, protecting them from the failure and

[180] See James Kanter and Mark Scott, 'Amazon's Tax Deal With Luxembourg May Break Rules, EU Regulator Says' (The New York Times, 16th January) available at: <https://www.nytimes.com/2015/01/17/business/amazon-luxembourg-european-commission.html?_r=0> accessed 6 April 2017. See also James Kanter, 'EU Orders 2 Nations to Recover Taxes From Starbucks and Fiat' (The New York Times, 21th October) <https://www.nytimes.com /2015/10/22/business/international/starbucks-fiat-eu-tax-netherlands-luxembourg.html> accessed 6 April 2017

[181] See Organisation for Economic Co-operation and Development, 'Base erosion and profit shifting' (*Better Policies for Better Life*) available at: <http://www.oecd.org/tax/beps/> accessed 6 April 2017.

[182] Almfraji, Mohammad Amin, and Mahmoud Khalid Almsafir. *'Foreign Direct Investment and Economic Growth Literature Review from 1994 to 2012.'* [2014] 129 Procedia-Social and Behavioral Sciences, 206-213.

against a competition.[183] In that competition, the States may forget that the competition is healthy up to a certain level. Over extensive tax incentives of the State may outweigh the benefits of the competition and cancel out the positive effects of the tax breaks. [184]

Reasonable Host State's tax policy is required to balance the interests of the foreign investments attraction and public interests to gain the maximum benefits from the proposed benefits. If the BITs of the Host-State grant the protection for the investors in relations with the tax authorities, the reasonable restrictions and justifications should be applicable to the standards of protection.

3.2. The Justifications to the State Conduct and Exceptions to the Standards of the Investor's Protection in Tax Matters

Three types of exceptions and justifications may be distinguished under the BITs[185]: (1) general exceptions based on public purposes and national securities;[186] (2) special taxation benefits granted by DTTs, trade agreements, participating in custom and economic unions etc;[187] (3) country-specific exceptions e.g., different policy regulations to the enterprises.[188]

3.2.1. Exceptions and Justifications to the Expropriation Standards

General taxation cannot be treated as expropriation. The State cannot be responsible for the legitimate and bona fide exercise of its right to regulate the interstate relations. The State is not

[183] Terry F. Buss, 'The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature' [2001] 151(1) Economic Development Quarterly.
[184] Peter D. Enrich 'Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business.' [1996] 110(2) *Harvard Law Review* 377-468.
[185] Alexia Kardachaki , 'IFA Research Paper: Tax Aspects of International Non-Tax Agreements' (International Fiscal Association,) available at: <https://www.ifa.nl/Document/Research%20Papers/IFA%20Research%20paper%20-%20Tax%20Aspects%20of%20Int%20non-tax%20agreements.pdf> accessed 6 April 2017
[186] GATS: General Agreement on Trade in Services (signed 15 April 1994, entered into force 1 January 1995) Marrakesh Agreement Establishing the World Trade Organization, Annex 1b, The Legal Texts: The Results Of The Uruguay Round Of Multilateral Trade Negotiations 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167 arts 14, 14 bis of the GATS; ECT, 2080 34 ILM 360 art 21; NAFTA 32 ILM 289 art 2102
[187] Netherlands Model BIT (1997) art 4.
[188] NAFTA 32 ILM 289 art 1108 (5); ECT, 2080 34 ILM 360 art 10 (10).

considered as responsible for any economic losses resulted by the "bona fide general taxation"[189] or for "uncompensated taking of an alien property or a deprivation of the use or enjoyment of property of an alien which results from the execution of tax laws […] incidental to the normal operation of the laws".[190]

There is no the concrete approach of the arbitral tribunals in the International Investment law on the issue what is the legitimate and bona fide exercise of state police powers […] [with no] corresponding obligation to pay [prompt] compensation".[191] States use different strategies to argue the application of the public purpose doctrine and legitimacy of the expropriation measures. The examples of the public purposes may be the necessity of the human rights protection, stabilizing measures in the economic crisis, changes in the market conditions, protection of the welfare of Host State's citizens in the developing countries.

It is mandatory the tax measure of the Host State to be complied with the proportionality test. Proportionality analysis provides a way for the judging in conflict or the collision situations between the state and investor's interests.[192] In Tecmed v. Mexico the arbitral tribunal analyzed the proportionality test in details and outlined: "…in order to determine if the [State's measures] to be characterized as expropriatory, [the arbitral tribunal should examine] whether [they] are proportional to the public interest presumably […] and to the protection legally granted to investments, taking into account that the significance of such impact has a key role in deciding the proportionality […] whether such measures are reasonable with respect to their goals […]"[193]

[189] Restatemenr 3d of the Foreign Relations Law of the U.S., § 101 (1987) § 712(g)
[190] Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Published to Oxford Scholarship Online 2015)
[191] Richard R. Baxter and Louis B. Sohn, 'Responsibility of States for Injuries to the Economic Interests of Aliens', [1961] 55 American Journal of International Law 545–84, 554.
[192] Benedict Kingsbury , Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest—the Concept of Proportionality in: StephanW Schill (ed), *International Investment Law and Comparative Public Law* (Published to Oxford Scholarship 2011).
[193] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID (ARB (AF)/00/2) Award (29 May 2003) para 122.

Because the economic is generally characterized by its cycle periods of the economic processes, all the States from time to time fight with the economic crisis. Regulation of tax policy in accordance with the state's economic conditions may be one of the most important tools among the anti-crisis measures. The question is whether the stabilization of the economic conditions as a consequence of the economic crisis may be a proper justification in investor-state investment tax disputes. In the 2000s Argentina went through various economic and financial crises.[194] CMS v. Argentina, Sempra v. Argentina, Suez v. Argentina cases arose out of a series of regulatory measures including the increase of the tax burden invoked by the Argentine government in the wake of the Argentine economic crisis.[195] In all of the mentioned cases, the tribunal held that Argentina's regulatory anti-crisis measure "did not constitute a permanent and substantial deprivation" of the investments.[196]

Thus, even though Argentina used the doctrine of necessity as argument against the expropriation claim, the tribunal paid more attention to the "substantiality of the deprivation" test and not the fact of the economic crisis as a justification.

The human rights claims based on the constitutional guarantees of the Host State to its citizens were rejected in the CMS Gas Transmission Co v. Argentina case.[197] Argentina representatives argued that the tax policy used by the State was justified by the priority to the protection of the human right to education, welfare, and healthcare, internal and external security. However, the arbitral tribunal rejected State's position on the grounds that the property is also protected by the Constitution of Argentina and the rights that were claimed as a defense to the State's regulatory power did not

[194] *Suez, Sociedad General de Aguas de Barcelona SA, and Vivendi Universal SA v. Argentine Republic*, ICSID (ARB/03/19) para 28, and *AWG Group v. Argentine Republic*, UNCITRAL Arbitration, Decision on Liability (30 July 2010) para. 28 in: Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Published to Oxford Scholarship Online 2015)

[195] Mark W. Friedman, Dietmar W. Prager and Ina C. Popova, 'The Guide to Energy Arbitrations: Expropriation and Nationalisation' (Global Arbitration Review, 2d October) available at: <http://globalarbitrationreview.com/chapter/1036073/expropriation-and-nationalisation> accessed 6 April 2017

[196] UNCTAD *Expropriation.UNCTAD Series on Issues in International Investment Agreements II (*United Nations , New York and Geneva, 2012*)*

[197] CMS v. Argentina ARB/01/8 (n 21) para 121.

belong to the fundamental human rights.[198] In order to protect the interest of the State by the application of the human rights justification, it is reasonable to take into account the fundamental human rights recognized in the world and proportionality test between the effect on the human rights and investor's interests. The arbitral tribunals should encourage the States to protect the human rights and respect their defense in international investor-state dispute settlement, as the States are required to comply with their various international obligations simultaneously.[199]

Developing countries are especially sensitive to their regulatory power and investor-state relations. The reason is that they do not have enough financial resources to compensate the foreign investor the indirect expropriation.[200] And the second reason is that they more often suffer from the financial instabilities than the developed countries and require more intensive steps and amendments to the economic policy to cope with the financial crisis.[201] Broad interpretation of the "indirect expropriation" would have an effect that the developing state cannot amend its legislation at all. In those circumstances the tribunal should be attentive to the proportionality of the measures, not discriminatory and bona fide intention of the state to adopt regulatory measures.

3.2.2. Exceptions and Justifications to the NT and MFN Principles under the BITs

Taxation cooperation is the important tool of the inter-State economic relations. The State may grant reciprocity the tax benefits for the foreign companies in consideration for tax or other kinds of preferences. The legitimate exception to treat the investors in a different way based on the public

[198] ibid para 121.

[199] Jasper Krommendijk and John Morijn, 18 'Proportional' by What Measure(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration. in Stephan W. Schill (ed), *International Investment Law and Comparative Public Law* (Published to Oxford Scholarship Online2011) 422-452

[200] Suzy H. Nikièma, 'Best Practices: Indirect Expropriation' [2012] The International Institute for Sustainable Development available at: <http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf> accessed 6 April 2017

[201] ibid.

interests and public security might be fighting tax evasion and profit shifting by the resident and non-resident taxpayers.[202]

The examples of the BITs providing the exception to the MFN and NT standards and special tax benefits to economic allies are Czech Republic-Paraguay BIT, Egypt-Germany BIT and others, which provide the exception to the tax treatment under NT and MFN[203] on the basis of "participation to a free trade zone, customs union, similar international agreements to such unions or institutions, common market, monetary unions or other forms of regional agreements […] double taxation or other agreements relating to the tax matters"[204] or specifically "with respect to taxes on income and capital".[205]

The protection of the Energy Charter Treaty, in general, does not cover the taxation measures except under the NT and MFN treatment.[206] NT and MFN standards apply only to the taxes other than capital gains and income taxes. Furthermore, ECT also exempts from the BIT protection tax benefits granted under "regional economic integration and income tax treaties.[207]

Canada Model BIT makes an exception to the application of the NT and MFN principles in relation to taxation to specific "sectors, subsectors or activities" or "financial services".[208]

Such provisions have the economic value. States should concern to include restriction of application NT and MFN standards to the tax measures in their BITs. States vary by their level of development, country-specific sectors of the economy, the structure of consumption, standards of life, since the

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[202] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan, (n 67).
[203] UNCTAD *Most-Favored Nation Treatment.UNCTAD Series on Issues in International Investment Agreements II (*United Nations , New York and Geneva, 2010*)*
[204] Czech Republic-Paraguay BIT (signed 21/10/1998, entered into force 24/03/2000) art.4.
[205] Egypt-Germany BIT (signed 16/06/2005, entered into force 22/11/2009) art 3(4).
[206] ECT, 2080 34 ILM 360
[207] William W. Park, '*Arbitrability and* Tax' in Loukas A. Mistelis and Stavros l. Brekoulakis (eds), 'Arbitrability: International & Comparative Perspectives' (Kluwer Law International 2009) 179-205. See alsoECT, 2080 34 ILM 360 art 21(3)(a).
37 See ECT, 2080 34 ILM 360 art 21(3)(a), with its cross reference to art 21(7)(a)(ii).
[208] Canada Model BIT (2004) art 9.

equalization of the tax burdens for the foreign and national investors may lead to economic collapses, declines of national industries, the disintegration of the economic unions and international cooperation etc.

3.2.3. Limitations to the Freedom of Transfer of Capital in tax matters

The inter-State transfer of capital sometimes has a detrimental effect on the State's economy. Large infusions of the assets affect the level of prices in the country and may lead to inflation, devaluation of country's currency and undesirable volatility of it exchange rates, reduction of the monetary reserves and impairment of the macroeconomic indicators in total.[209] Economic consequences may be even worth if the Host State is a developing country. Thus, many states include the restrictions to their BITs to the freedom of transfer of capital. Such restrictions are necessary as well to prevent specific types of crimes. However, any restrictions are not exempted from the requirements of good faith, non-discrimination, and due process.

UK Model BIT specifies:

> *"Where, in exceptional circumstances, payments and capital movements between the Contracting Parties cause or threaten to cause serious difficulties for the operation of monetary policy or exchange rate policy in either Contracting Party, the Contracting Party concerned may take safeguard measures with regard to capital movements between the Contracting Parties for a period not exceeding six months if such measures are strictly necessary."*[210]

[209] Jeswald W. Salacuse, *The law of investment treaties*. (OUP Oxford, 2015).
[210] U.K. Model BIT (2009) art 7(2).

US-Ukraine BIT allows the Contracting to *"maintain laws and regulations (a) requiring reports of currency transfer; and (b) imposing income taxes by such means as a withholding tax applicable to dividends or other transfers".*[211]

Some IIAs include the exceptions stating that Contracting Parties are entitled to take necessary measures to protect security interests of the States. Thus, except the withholding taxes and exit taxes discussed in the previous chapter. Investors may face with some limitations to the freedom of transfer of capital connected with the transparency of transactions requirement and public security, financial or another kind of economic crises or unstable economic situation, the obligation of payment of all the taxes in Host State, participating in the State in the trade or economic unions.

Transparency may not only be a requirement of the FET standard in relation to investors, but also a requirement of the State to the investor's conduct. Transparency, in this case, means the power of the State authorities to ask for the reports of capital and currency transfers or financial statements of the companies. The recent developments of the OECD of the BEPS actions made the requirements of transparency much stricter.[212] The restrictions on the freedom of transfer of capital in the case of failure of an investor to comply with transparency and reporting requirements may be argued as a breach of the international investment law if BIT does not provide to the contrary. However, States may defend themselves using the "safeguards for government measures" such as public purpose and security.[213] Failure to submit necessary documents may be interpreted as a reasonable ground to suspect that transactions involve some illegal operations and thus freedom of transfer may be restricted for certain time.

[211] US-Ukraine BIT (n 159) art 4(3).
[212] PWC, 'Multinationals receive OECD recommendations on BEPS proposals for G20 and wider take-up' (Tax Policy Bulletin, 5th October) available at: <https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-provides-beps-recommendations-for-multinational-companies.pdf> accessed 6 April 2017
[213] Nathalie Bravo, Rita Julien, Jasmin Kollmann, Alicja Majdanska, and Laura Turcan (n 67).

The other question is whether States are allowed to impose limitations on the freedom of transfer of capital in the time of the financial crisis. Measures taken as a reaction to the economic crisis can serve as a Treaty exception or customary defense.[214] The issue that remains open is what a threshold of circumstance that qualifies as a justification.[215] There is no requirement of the total collapse of the economy in the State to use the situation as a defense in the investment dispute.[216] However, tax measures to cope with the economic crisis should comply with the proportionality test. The measures should be necessary and with least possible detrimental effect to the foreign investors.[217]

Some BITs include the obligation of the State of the good governance.[218] Choosing from the great amount of the national markets to invest money the investor might consider the professional quality of the public governance. *"The challenge is that to accomplish their roles, governments must mobilize co-operation within the administration, between the national government and others levels, and between the public sector and others actors, principally in the private sector and civil society."*[219] All the measures of the governments in all the circumstances should be reliable and consider the effects on the all the market players.

Economic unions can also be a limitation to the freedom of transfer of capital as well as to the NT and MFN standards. ICJ ruled on the three disputes between the European Commission and Austria, Sweden and Finland. The Commission claimed the failure of the states to include the restrictions on the transfer of capital to their BITs with third countries violates article 307 of the ECT. ICJ ruled

[214] Jeswald W. Salacuse (n 215); August Reinisch, 'Necessity in International Investment Arbitration-An Unnecessary Split of Opinions in Recent ICSID Cases-Comments on CMS v. Argentina and LG&E v. Argentina.' [2007] 8 J. World Investment & Trade 191; CMS v. Argentina para. 319, 355; LG&E v. Argentina para. 253 in: Manu Sanan and Ramon della Torre. 'The consistency of capital flow regulation under the US Model BIT, 2012 vis à vis the IMF and the WTO.'
[215] ibid
[216] Continental Casualty Company v. The Argentine Republic, ICSID (ARB/03/9) Award (5 September 2008) para. 180
[217] El Paso Energy International Company v.The Argentine Republic ICSID (ARB/03/15) Award (31 October 2011) para. 656; National Grid v. Argentina UNCITRAL (3 November 2008) para.262.
[218] U.S.-Uruguay Bilateral Investment Treaty (signed 4 November 2005, entered into force 1 November 2006), Canada-Peru Bilateral Investment Treaty (signed 14 November 2006, entered into force 20 June 2007).
[219] Janos Bertok, Elodie Beth, Josef Konvitz, Delia Rodrigo and Christian Vergez 'Public Governace' [2006] *Policy Framework for Investment: A Review of Good Practices* available at: <https://www.oecd.org/daf/inv/investment-policy/40287484.pdf> accessed 6 April 2017

that exclusion of the restrictions on the freedom of transfer of capital by the Member States between them and third countries is incompatible with the rule of the EU existence. In this way, the European Union protects their industries in all the Member States from the foreign competitors. These actions are against the free market and competition principles but in accordance with the States' and Union's interest.

The States should not freeze their taxation power by any mean. The most important role of the State is to regulate and support the economic and market stability and development. Taxation is a tool that facilitates the state authorities in this purpose. International investment law gives the essential freedom for the states with only limitations of the bona fide and proportionality requirements.

CONCLUSION

Power to adopt tax measures is an expression of the sovereignty of the state as well as power and obligation to react to the economic changes and fluctuations, reform the legislation and market mechanisms. In the modern globalized world, tax sovereignty remains rather an idealistic concept than world's reality. States' tax sovereignty is limited by the rules of international taxation law and international investment law from relatively recent time. States more frequently include rules on tax protection for the foreign investors in their BIT's provisions in order to attract funds. The rationale of the limitation of the tax sovereignty by such inclusion is that States can gain more benefits from business-projects of foreign investors operating and developing the Host country rather than loses from granting tax benefits – "sweeteners".

Nevertheless, not all the States are in a hurry to grant the extensive protection from the state's tax measures under BITs. Some States apply only some investment protective standards to tax matters. Others exclude taxation from the scope of BIT totally. The only option for the foreign investors would be to conclude with the States the investment contracts and include the tax stabilization clauses in them. Depending on whether or not the relevant BIT between the investor and Host State includes the umbrella clause and applies it to the tax matters, the investor may use international investment or purely contractual remedies in the case of the violation of the tax stabilization clauses.

States, which exclude the taxation from the BITs, often argue that all the necessary tools for protection and healthy cooperation are included in DTTs. However, these two types of agreements differ significantly. The purpose of the BIT is to guarantee the investors the stable framework for the business operation, effective remedies and dispute resolution system. In contrary DTTs are aimed to avoid the double taxation of the companies and non-payment of taxes in two jurisdictions. Both the agreements should regulate tax measures, but the aim and scope of regulation are different.

Moreover, the arbitral practice shows that investment disputes under IIAs involving tax issues are not consistent. Investors more often choose the investor-State arbitration for the resolution of the disputes on the state's tax measures. Most of those known cases were heard by the ICSID or UNCITRAL tribunals. The investors are attracted by the stronger and wider protection under the BITs in comparison to DTTs and faster and more effective dispute resolution mechanism rather that proposed by DTTs.

Investors in the arbitration claim that tax measures allegedly violate the FET, NT, MFN and FTC standards as well as claim compensation in the case of the unlawful expropriation. Almost all BITs recognize that tax measures may lead to the indirect expropriation of the investment by charging over extensive taxes, providing frequent tax inspections or by means of the politically motivated prosecution on tax evasion. The main challenge that the investor and tribunal face in the disputes is the difficulty in proving the substantiality of the deprivation of the enjoyment of the investment and state's lack of legitimate power to act in the mentioned way. Unfortunately, the arbitral practice is largely ambiguous in their approaches to examining the criteria for indirect expropriation by the tax measures. Accepting the amicable opinion regarding the threshold of taxes enough to constitute the breach of the investment treaty and scope of legitimate power in taxation may be the next steps in development investment arbitral practice.

The claims of the unlawful expropriation are followed by the claims on violation of the FET. The major concern of the FET requirements in the investment tax disputes relates to the legitimate investors' expectations. Every planning of business involves the calculation of profits including tax calculations for the several following years after initial investment. Currently, the arbitral practice reasonably concludes that investor cannot expect that nothing in the future will change in tax policy. However, the violation by the state of investment contract with tax stabilization clauses is contrary to the requirement of the legitimate expectations of the investor and FET standard. Thus, the investor may seek remedy under BIT, even if it does not include an umbrella clause.

Free transfer of capital standard is not often raised by the investors in their investment claims related to tax measures, but commonly discussed by scholars and practitioners. The reason is that foreign investors are concerned about the ability and guarantees to transfer the profits and other assets from the Host countries to their Home and third countries. The transferability is an essential attribute of the decision of the investor to invest. A barrier to the transferability may be charging of the extensive withholding and exit taxes that can make the transfer undesirable and detrimental. As a result, the investors might fail to meet their obligations to shareholders or debt obligations, for example.

Although, there is no threshold of withholding and exit taxes to constitute the breach of the Freedom of Transfer of Capital as in the expropriation disputes. It is suggested the arbitral practice determine at least criteria and calculative methods to deal with disputes on violation FTC by the tax measures. States in their turn are strongly advised to balance the tax purposes and economic reality. Because the sum of compensation in the investment disputes may level all the benefits gained due to the charging taxes and cause the harm to the state's reputation.

National Treatment and Most-Favored Nation Treatment standards have very specific features in the disputes involving taxation. Both the DTTs and BITs include the rules on the application of these standards to taxation. While the NT requirement is provided by almost all the treaties, MFN is generally excluded for the tax purposes. The economic background of such regulation is that tax is one of the components of various economic and trade cooperation. Application of the MFN standard to tax measures may ruin the essence of the economic cooperation or create the situation of the absence of taxation for all foreign investors. To conclude on this issue, there is no economically or legally reasoned need to make any changes to current regulation.

One of the purposes of this thesis was to discuss the balance of interests between states and investors. Taxation is sensitive to limitations and restrictions due to the frequent tax abuses by the big multinational companies. The limitations on the substantive investment standards and justifications to the State's conduct in specific circumstances under the concept of necessity is a duty of the State to stabilize the economic conditions or deal with the economic crisis, participating of the states in the trade and economic unions as well as protection of public interest and security, for example, for preventing economic crimes.

However, any State or tribunal should not consider limitations as absolute, but to apply the test of the proportionality to the conditions of the particular case. Economic crises and economic fluctuations may serve as justification for the State's tax measures when they are detrimental to the investors' business operation and violate expropriation or FTC standards. There is no requirement of the total collapse of the Host State economy. Nevertheless, any tax measure of the State should involve reasonable evaluation of the economic conditions and problems to fix. It should be based on the proper analyses of the effect of the tax measure for the economy and balance the benefits for the economy against the detrimental effect to the private investors. Protection of public interests and guarantee of the security as a justification for the States involve the protection of the human rights, economic interests of the state, protection the interests of creditors as well as tax authorities, prevention economic crimes such as tax evasion as well as prevention of non-payment of taxes and shifting the profits to low tax jurisdictions.

The tax interests of the foreign investors should be protected under IIA and states have the possibility and grounds to include the respective provisions in BITs. However, the most important task for the States is to find balance and proportionality, not to sacrifice their interests but to create favorable conditions for the foreign investor's business operations within concurrent States' policy development.

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