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Resolution of Tax Disputes in International Arbitration

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L'arbitrage investisseur-État joue un rôle important dans la protection des droits des investisseurs internationaux et des États hôtes. Cependant, concernant la taxation, la portée des droits et obligations des investisseurs et des États sous les accords internationaux d'investissements (AII) demeure incertaine. Les instruments existants donnent des droits qui varient dans l'arbitrage de disputes de taxes, et l'arbitrage de demandes basées sur la taxation a connu des résultats mixtes. La conséquence est que les demandes basées sur la taxation dans les arbitrages investisseur-État ont des résultats incertains et incohérents, et le système actuel ne laisse souvent aux investisseurs aucun recours effectif contre des comportements abusifs des États.

Compte tenu de l'importance de la taxation pour les États et les investisseurs, il est dans l'intérêt des parties prenantes d'établir un système d'arbitrage investisseur-État pour la résolution des disputes de taxation qui soit cohérent, consistant et stable. L'arbitrage investisseur-État demeure un forum approprié pour les différends concernant la taxation, mais plusieurs changements sont requis. Premièrement, le véto fiscal doit être modernisé afin de permettre plus de neutralité et de transparence. Deuxièmement, les AIIs doivent fournir séparément pour les demandes basées sur la taxation afin de décrire les obligations des États et ce qui constitue une violation d'une obligation concernant les affaires de taxation. Ces étapes permettraient à toutes les parties à mieux comprendre leurs droits et obligations et d'améliorer le régime d'arbitrage investisseur-État pour toutes les parties prenantes.

Investor-state arbitration plays an important role in protecting the rights of both international investors and host states. With regards to taxation however, the scope of their rights and obligations under international investment agreements ('IIAs') is unclear. Existing instruments provide varying rights for arbitrating taxation disputes. The result is that taxation-based claims in investor-state arbitration have highly uncertain and inconsistent outcomes, and the current framework often leaves investors without effective recourse against abusive state behaviour.

Given the importance of taxation to states and foreign investors alike, establishing a coherent, consistent, and stable investor-state arbitration system for resolving taxation disputes is in the interests of both stakeholders. Investor-state arbitration remains an appropriate forum for tax disputes, but several changes are required. First, the tax veto should be modernized to allow for greater transparency and neutrality. Secondly, IIAs need to separately provide for taxation-based claims to delineate states' obligations and what will constitute a breach thereof regarding taxation matters. These steps would allow all parties to better understand their rights and obligations and improve the investor-state arbitration regime for all stakeholders.

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I. OVERVIEW

As the global economy becomes increasingly borderless, companies and states act and react. On one hand, companies strive to find new and innovative ways to reduce their tax burden on a global basis. On the other, tax authorities seek to protect their tax base and retain their fair share of global tax revenues. Indeed, the Organization for Economic Co-operation and Development ('OECD')'s work regarding base erosion and profit shifting ('BEPS') highlights the continuing challenges facing foreign investors and states alike: the ongoing erosion of tax bases, the need for greater transparency from both investors and governments, and the importance of certainty and predictability for effective global markets.[1]

This paper explores the role of investor-state arbitration in achieving these objectives with respect to taxation. First, it will analyze the landscape of foreign investment and taxation, focusing on stakeholders and their interests, to establish the context in which investor-state arbitration of taxation matters must function. Second, it will consider the current lack of consistency and certainty in investor-state arbitration of taxation matters. In so doing, it becomes apparent that the scope of the rights and obligations of both investors and states regarding taxation under international investment agreements ('IIAs') is unclear: first, existing instruments provide varying rights for arbitrating taxation disputes; and, second, arbitration of taxation-based claims has had mixed results.

Against this backdrop, rather than shying away from arbitrating tax matters, a consistent global framework with clearly delineated constraints is required to enable efficient and effective resolution of global tax disputes using investor-state arbitration. The third part of this paper will therefore outline why the IIA regime is the most appropriate one for addressing investor-state taxation disputes. In view of encouraging meaningful and fair investor-state interactions, the needs of all stakeholders are considered.

Finally, this paper will explore a framework for improving the existing system to address the concerns established throughout. First, the tax veto should be modernized by increasing transparency and investor participation. Second, rather than pigeonholing taxation disputes into existing IIA provisions, a new taxation-specific basis centered on objective criteria should be created. Incorporating these recommendations into IIAs with respect to taxation-based claims would satisfy states' central objective of preserving sovereignty all while enhancing investor confidence in the integrity of the dispute resolution process.

II. WHAT IS AT STAKE?

This section explores the interests of key stakeholders, as well as taxation's role in foreign investment and, in doing so, delinates the context within which investor-state arbitration of taxation disputes exists. If IIAs are going to successfully enable taxation-based claims, the stakeholder concerns highlighted must be appropriately considered and addressed.

A. The Role and Scope of Double Tax Treaties

Bilateral double taxation treaties ('DTTs') are commonly relied upon to allocate taxation rights

[1]OECD, *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project (2015) at 1–8.

and resolve states' competing claims to the same tax revenue. In seeking to address challenges arising from the allocation of revenues between countries, they are necessarily based on the specific tax systems of, and economic relationship between, the parties. Reciprocal concessions are made to achieve a balanced result wherein each state is satisfied that it is obtaining a fair share of available tax revenues.[2]

IIAs have a different purpose, which protect foreign investments. However, these generate tax revenues that are often within a DTT's scope.[3] Consequently, many IIAs exclude taxation from their purview based on the assumption that DTTs govern or manage these matters.[4] In this way, DTTs create a basic limitation to the scope of investor-state arbitration of tax disputes, and cause certain taxation matters to be excluded from IIAs altogether.

However, DTTs address different problems than IIAs and provide tools distinct from those which the latter contemplates. They seek to prevent double taxation and enable tax authorities to reduce and counter undesirable tax avoidance and abuse through cooperation and exchange of information.[5] They do not address claims relating to host states abusing their taxation powers over foreign investors.[6] Rather, they prescribe a method and forum for states to protect their interests vis-à-vis other states, to resolve interstate conflicts, and to facilitate global taxation enforcement. They do not give investors tools to protect their investments from abusive taxation measures.

Maintaining a separation between these distinct sets of disputes and their conflict resolution processes is desirable. The mechanisms for addressing disputes contained in DTTs are not appropriate for investor-state taxation disputes where allegations of abusive taxation measures are being made. As opposed to understanding and protecting investors' interests, DTTs generally process claims through states' competent authorities and focus on achieving an acceptable allocation of taxation revenues between the two competing states. Further, in an era where governments are increasingly exchanging information to carve up the global tax pie and ensure they get their fair share, investors may require protection from both their own governments and others. Consequently, preserving distinct regimes in DTTs and IIAs in recognition of their differing objectives is a practical goal.

B. States and Taxation

Sovereignty is a core attribute and right of states, and taxation is considered a quintessential element thereof. Consequently, states are reluctant to relinquish control over taxation to international arbitral tribunals. The IIA system represents a compromise: in exchange for voluntarily relinquishing some sovereignty to these adjudicatory bodies, states ostensibly receive higher levels of foreign investment and all of its attendant benefits – income to tax, heightened employment, as well as infrastructure and

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[2] UNCTAD, *Taxation*, UNCTAD Series on Issues in international investment agreements, UNCTAD/ITE/IIT/16 (New York & Geneva: UN, 2000) at 27–30.
[3] *Ibid* at 27.
[4] Matthew Davie, "Taxation-Based Investment Treaty Claims" (2015) 6:1 J Intl Dispute Settlement 202, online: <https://jids.oxfordjournals.org/content/6/1/202.full.pdf+html> at 210–11.
[5] Thomas W Wälde & Abba Kolo, "Coverage of Taxation Under Modern Investment Treaties" in Peter Muchlinski, Federico Ortino, & Christoph Schreuer, eds, *The Oxford Handbook of International Investment Law* (New York: Oxford University Press, 2008) 306 at 311 [Wälde & Kolo].
[6] *Ibid*.

development.[7]

However, despite the evident and accepted compromises made in many areas of national interest, states continue to view taxation as an especially central element of their sovereignty.[8] The right to levy taxes on citizens is a 'special' element of states' sovereign power that has existed in some form since the beginning of settled human civilization.[9] The OECD explains this as follows:

> Tax policy is not only the expression of national sovereignty but it is at the core of this sovereignty ... Tax policy and administration influence many of the drivers of increased productivity, ranging from investment in skills, capital equipment and technical know-how to the amount of resources required to administer and comply with the tax regime.[10]

Clearly, then, taxation is an important feature of states' sovereignty, and their reluctance to relinquish control over taxation disputes to international arbitral tribunals is therefore understandable (but, as discussed in Section IV, misguided).

Taxation's status as a central element of sovereign power derives from its ability both to generate revenues and enable governments to undertake and implement social and economic policies. In 2013, for instance, corporate income tax generated revenues equivalent to around 3 percent of gross domestic product ('GDP') on average across OECD coutries,[11] while total tax revenues comprised approximately 34 percent of GDP in 2014.[12] Further, proceeds from taxation fund not only government expenses and programs, but also alter states' social and economic order. Therefore, taxation has important consequences for the lived reality of a nation's citizens, businesses, and other entities.[13] It is an important policy instrument used, for instance, to discourage consumption of harmful products, to allocate the costs of harmful activities and, more broadly, to ensure economic stability.[14] Consequently, IIA schemes for resolving investor-state tax disputes must preserve governments' rights to effect regulatory changes to their taxation regime, thereby ensuring their ability to carry out essential state functions and policies.

C. The Driving Force of Taxation

Beyond its significance to states, taxation is also critical to global economy and an important driver of investor behaviour. Indeed, the OECD's work on BEPS highlights taxation's materiality and power. It notes that international tax standards have failed to keep pace with changes in global business practices, and that this has enabled multinational enterprises ('MNEs') to undertake various strategies to reduce their global tax bill.[15] The result is that some MNEs pay as little as 5 percent in corporate taxes, while

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[7] Davie, *supra* note 4 at 217–18.
[8] Abba Kolo, "Tax 'Veto' as a Special Jurisdictional and Substantive Issue in Investor-State Arbitration: Need for Reassessment?" (2009) 32:2 Suffolk Transnat'l L Rev 475 at 475 [Kolo].
[9] Insop Pak, "International Finance and State Sovereignty: Global Governance in the International Tax Regime" (2004) 10:1 Ann Surv Intl & Comp L 165; Diane M Ring, "What's at Stake in the Sovereignty Debate: International Tax and the Nation State" (2008) 49:1 Va J Intl L 155 [Ring]; Wälde & Kolo, *supra* note 5 at 314–17.
[10] OECD, *Addressing Base Erosion and Profit Shifting*, (2013) at 28 [OECD, Addressing BEPS].
[11] *Ibid* at 15.
[12] OECD, *Revenue Statistics 2015*, (2015) at 24.
[13] Ring, *supra* note 9 at 167–170.
[14] Davie, *supra* note 4 at 219.
[15] OECD, "Addressing BEPS", *supra* note 10 at 5–7.

smaller businesses pay up to 30 percent[16] – a stark contrast considering that average corporate tax rates for 2013–2014 ranged from 19.68 percent in Europe to 33.25 percent in North America. The average corporate tax rates of Oceania, Latin America, Asia, and Africa also fall within that range.[17] Further, it estimated that annual revenue losses from BEPS reach up to US $100 – 240 billion, or 4 – 10 percent of global corporate income tax revenues.[18]

These figures demonstrate the important cost taxes represent for MNEs and the benefits available in implementing tax reduction strategies. It is thus no surprise that tax regimes, policies, and rates are a driving force for businesses in deciding how to structure their operations. A recent and clear example of taxation's influence on business decisions and strategy was seen in 2016, when Pfizer Inc. terminated its anticipated US$160 billion merger with Allergan Plc – which would have resulted in Pfizer's head offices moving to Ireland – due to changes in U.S. tax rules.[19]

Taxation can also impact investors' substantive and/or property rights. In cases of indirect asset confiscation,[20] states deprive owners of their property by taxing enterprises to such a level that their economic value is severly diminished (i.e. creeping expropriation).[21] Taxation is thus a a central consideration for investors due to the potential direct and indirect impacts it can have on their interests. Fear of unfair state expropriation via taxation or other means may result in a reduction of international economic cooperation and flows of cross-border capital.[22] A comprehensive regime for investor-state arbitration of taxation disputes must therefore enable investors to protect their profits and, more broadly, their property rights.

D. Balancing Competing Objectives

Given the importance of tax to states and foreign investors alike, establishing a coherent, consistent, and stable investor-state arbitration system for resolving taxation disputes is in the interest of both stakeholders. Fiscal stability is important for attracting and retaining foreign investment, as tax regime adjustments can make current investments unprofitable or discourage future investments by reducing opportunities to generate profits and raising concerns about the stability of a state's political regime.[23] Therefore, certainty and predictability in taxation, and the resolution of disputes arising therefrom, facilitate foreign investment. Investors can make more informed investment decisions, while states enjoy a greater tax base than in the absence of foreign investments.

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[16] OECD, "Addressing BEPS", *supra* note 10 at 61–67.
[17] KPMG, "Corporate Tax Rates Table", (2016), online: <https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>.
[18] OECD, "Addressing BEPS", *supra* note 10.
[19] Pfizer, Inc., Press Release, "Pfizer Announces Termination of Proposed Combination with Allergan" (6 April 2016), online: < http://www.pfizer.com/news/press-release/press-release-detail/pfizer_announces_termination_of_proposed_combination_with_allergan >.
[20] William W Park, "Arbitrability and Tax" in L Mistelis & S Brekoulakis, eds, *Arbitrability: International & Comparative Perspectives* (Netherlands: Kluwer Law International, 2009) 179 at 184–86 [Park, "Arbitrability"]; Wälde & Kolo, *supra* note 5 at 306–11.
[21] William W Park, "Arbitration and the Fisc: NAFTA's 'Tax Veto'" (2001) 2:1 Chicago J Intl L 231 at 237 [Park, "The Fisc"].
[22] *Ibid* at 231–32.
[23] Lisa E Sachs et al., "Impacts of Fiscal Reforms on Country Attractiveness: Learning from the Facts" in Karl P Sauvant, ed, *Yearbook on International Investment Law & Policy 2011–2012* (New York: Oxford University Press, 2013) 345 at 347–48.

Nevertheless, states also require sufficient flexibility to change their tax regimes to ensure they can achieve their policy goals, stay abreast of changes in global markets, and respond to threats and opportunities as they arise. Finding an appropriate balance is difficult: states strive to promote foreign investment by depoliticizing investment disputes while also attempting to retain the regulatory freedom necessary to react to changing circumstances.[24] For reasons of equity, politics, changed circumstances, amongst other factors, fiscal reforms are therefore at the very least understandable, and at most inevitable.[25] States must undoubtedly retain the ability to regulate in the public interest, particularly in the area of taxation.

Consequently, investor-state arbitration of taxation-based claims requires a system that achieves the appropriate balance between certainty and predictability on the one hand, and flexibility on the other. Consistently and coherently accounting for taxation-based disputes in IIAs would achieve these objectives: investors would have an avenue to protect their interests from abusive taxation, while states would retain the ability to regulate their core competency of taxation without fear of unreasonable or unnecessary investor backlash.

III. CURRENT PRACTICE

Having established the need for consistency and coherence in investor-state arbitration regimes for resolving taxation matters, this section explores the current status of taxation dispute resolution in IIAs, and highlights a current lack of uniformity. The ‘tax veto’ as a unique feature of IIAs is also considered.

A. Tax Arbitration in IIAs

As mentioned, most modern IIAs include taxation carve out clauses and do not permit DTT-based claims. Beyond these features, however, there is relatively little consistency in the availability of, as well as the methodology for, investor-state arbitration of taxation matters in IIAs.

After surveying model IIAs of fifteen prominent state actors in the international investment law scene, as well as five regional and multilateral IIAs, Matthew Davie lays out five broad approaches to taxation carve out clauses:[26]

1. IIAs not covering taxation matters (i.e. absolute carve out clauses);
2. IIAs covering taxation matters in a limited manner, namely in allowing expropriation claims;
3. IIAs covering taxation matters with some restrictions – expropriation, national treatment (‘NT’) and most favoured nation (‘MFN’) claims are allowed (with some qualifications), while fair and equitable treatment (‘FET’) claims are not;
4. IIAs broadly covering taxation matters, with some limitations or qualifications to FET, NT, and/or MFN claims; and,
5. IIAs containing no taxation carve out clause aside from an exception to the MFN clause for DTTs.

[24] Lars Markert, “The Crucial Question of Future Investment Treaties: Balancing Investors’ Rights and Regulatory Interests of Host States” in Marc Bungenberg, Jörn Griebel & Steffen Hindeland, eds, *International Investment Law and EU Law* (New York: Springer-Verlag Berlin Heidelberg, 2011) at 145.
[25] Sachs, *supra* note 23 at 348–52.
[26] Davie, *supra* note 4 at 211–17.

While Davie organized the IIAs surveyed into five relatively neat categories, it is also clear that a wide variety of approaches currently exist with respect to enabling or limiting taxation-based claims. This lack of coherency is undesirable for the reasons outlined above in Section II.

B. Investor-State Arbitration of Tax Matters

In addition to problems created by the diversity of approaches to taxation in IIAs, taxation-based claims brought by investors against states have enjoyed little success. The varied responses they have elicited from international arbitral tribunals also highlights an uncertainty in this area of investor-state arbitration. While the lack of consistency in both investors' claims and tribunals' conclusions is not limited to taxation, the challenges created by uncertainty are especially acute in this area. As Section II demonstrated, taxation is central to state sovereignty and drives business strategies and decisions. Therefore, the lack of predictability regarding claims brought and tribunals' holdings in taxation-based investor-state disputes is particularly impactful on foreign investment and investor-state relationships.

i. Expropriation

The failure of investors' taxation-based expropriation claims under IIAs is arguably the most consistent occurance in investor-state arbitration of tax disputes. Indeed, aside from a recent set of cases brought by the shareholders of OAO Yukos Oil Company ('Yukos') under various international treaties, there have been no successful taxation-based expropriation claims.[27]

The Yukos claims and related arbitrations arose from a relatively exceptional factual matrix. In essence, the Russian Federation issued various tax assessments to Yukos which resulted in an amount owed upwards of US $24 billion. It then resisted Yukos' attempts to settle the liability, instead seizing their assets and auctioning them off to a state oil company.[28] Allegations of harassment and persecution of individuals associated with Yukos, including executives, shareholders, lawyers, and accountants, were also levied against the state.[29] Tribunals in both *RosInvestCo* and *Yukos Universal* found that the actions of the Russian Federation did not amount to *bona fide* taxation and were instead intended to bankrupt Yukos, thereby enabling the appropriation of its assets for state purposes. This led them to conclude that expropriation had occurred under the relevant IIAs.[30]

Elswhere, however, expropriation claims involving taxation measures have largely failed. Tribunals have frequently held that impugned taxation measures did not rise to the level of expropriation.[31] For example, in both *EnCana Corporation v the Republic of Ecuador* and *Occidental Exploration and*

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[27] Davie, *supra* note 4 at 204–05. For sake of simplicity, this paper considers only two of cases arising therefrom; namely, *RosInvestCo UK Ltd v The Russian Federation* (2010), V079/2005 (Rules of the Arbitration Institute of the SCC) [*RosInvestCo*] and *Yukos Universal Limited (Isle of Man) v The Russian Federation*, Award (18 July 2014), UNCITRAL, Case No AA 227 [*Yukos Universal*].
[28] *RosInvestCo, supra* note 27 at paras 61–86.; *Yukos Universal, supra* note 27 at paras 88–105.
[29] *RosInvestCo, supra* note 27 at paras 88–90; *Yukos Universal*, *supra* note 27 at paras 81–87.
[30] *RosInvestCo supra* note 27 at paras 620–621; *Yukos Universal*, *supra* note 27 at paras 756, 1404, 1579–80.
[31] *EnCana Corporation v The Republic of Ecuador*, Award (3 February 2006) at paras 177–78, 194–98, Canada-Ecuador Bilateral Investment Treaty & UNCITRAL, LCIA Case No UN3481 [*EnCana*]; *Occidental Exploration and Petroleum Company v The Republic of Ecuador*, Award (1 July 2004) at paras 91–92, UNCITRAL, Case No UN3467 [*Occidental*].

Petroleum Company v the Republic of Ecuador, the Ecuadorean tax authorities' refusal to grant VAT refunds was not found to deprive the investors of their rights so as to constitute expropriation. Both tribunals showed a clear deference towards the state and its right to levy taxes. The *EnCana* tribunal noted the special nature of taxation and emphasized that only if a tax law is "extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect appropriation be raised."[32] The *Occidental* tribunal simply dismissed the expropriation claim based on admissibility, despite acknowledging that such claims would normally be considered in the context of the merits of the case.[33]

A final example of investor failure in taxation-based expropriation claims is *Burlington Resources Inc. v the Republic of Ecuador*. There, the tribunal refused to find that expropriation occurred in the passing of Law 42, which had imposed taxes of 50 percent and 99 percent in two consecutive years. The tribunal found that Ecuador passed the law for several reasons: first, with the intention of pressuring oil companies to negotiate with it; second, to force the abdication rights under certain agreements entered into between Burlington and the Ecuadorean government (namely, the Production Sharing Contracts ('PSC')); and third, that this was done without the intention of complying with some of its clauses. Nonetheless, the tribunal held that Law 42 did not amount to expropriation because it did not substantially deprive Burlington of the value of its investment.[34] It reached this conclusion by surveying the impact on Burlington's profitability in light of the tax rates under Law 42 and determining that, despite a potential reducution in profitability upwards of 60%, the investment remained economically viable and did not lose the ability to generate future commercial returns.[35]

Takeaways from these cases, echoed by many,[36] are threefold. First, while the test for expropriation is quite consistent in that tribunals steadfastly look for discriminatory taxation measures resulting in a substantial deprivation of rights, what behaviour actually meets this requirement is unclear. For instance, in light of the tribunal's analysis in *Burlington*, how much would a taxation measure have to reduce an investment's profitability to be considered a 'substantial deprivation' of the investment's value amounting to expropriation? Further, would the analysis have been different had there not been an underlying concern that the allocation of oil revenues under the PSC was unfair to Ecuador?[37] Investors and, to a lesser extent, states, are therefore faced with significant uncertainty when bringing taxation-based expropriation claims.

Second, tribunals seem to show significant deference towards states with respect to expropriation claims, particularly in the realm of taxation. They repeatedly acknowledge taxation's importance to states, as well as the need to ensure that their ability to levy taxes is respected.[38] Additionally, as mentioned, there have been virtually no successful taxation-based expropriation claims,[39] and *Burlington* demonstrates that the deference given to states in expropriation claims is particularly pronounced. Indeed, Ecuador *admitted*

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[32] *EnCana*, *supra* note 31 at para 177.
[33] *Occidental*, *supra* note 31 at para 80.
[34] *Burlington Resources Inc. v The Republic of Ecuador*, Award (14 December 2012), ICSID, Case No ARB/08/5 (ICSID) at paras 455–57 [*Burlington*].
[35] *Ibid* at paras 424–30, 446–50.
[36] See e.g. *Link-Trading Joint Stock Company v Department of Customs Control of the Republic of Moldova,* Award (18 April 2002), UNCITRAL, Case No UN-0014-002 (UNCITRAL). Further, the cases discussed in the following section with respect to NT and FET claims generally also had unsuccessful expropriation claims.
[37] *Burlington*, *supra* note 34 at paras 454–45.
[38] See e.g. *EnCana*, *supra* note 31 at para 177; *Burlington*, *supra* note 34 at paras 391 – 392; *RosInvestCo*, *supra* note 27 at para 496.
[39] Davie, *supra* note 4 at 3–4.

its intention in passing Law 42 was to pressure Burlington and appropriate a portion of its profits.[40] While the nature of the relationship between state sovereignty and taxation has driven this deferential approach,[41] investors' ability to recover under alternative bases, such as NT and FET, may also be a contributing factor. Due to the requirement of loss of investment value, and not merely profitability, for expropriation to be found, tribunals may find taxation-based claims are more appropriately decided on other bases. Nonetheless, in addressing expropriation claims, tribunals in investor-state arbitration have leaned towards ensuring states retain a wide latitude with respect to their ability to enact taxation measures, and towards protecting their ability to use these to effect policies at the expense of foreign investors.

Finally, where applicable IIAs limit taxation-based claims exclusively to expropriation, the lack of investor success, high uncertainty, and tendency of tribunals to show deference to states may leave investors without recourse even when faced with clearly abusive taxation measures. While frivolous arbitrations challenging legitimate taxation measures must certainly be limited to ensure states can achieve their policy goals, investors must also be protected to ensure global capital flows persist and resources are allocated efficiently. Consequently, the current state of taxation-based expropriation claims in international arbitration is undesirable, and a more reasonable balance between the competing interests must be sought. As discussed below in Section V, expropriation is ultimately not appropriate for taxation-based claims, and should therefore be unavailable as a basis for them.

ii. National Treatment, Most Favoured Nation, & Fair and Equitable Treatment Claims

Investors have enjoyed a greater level of success in making taxation-based claims founded on NT, MFN, and FET guarantees contained in IIAs. The *Occidental* tribunal, for example, found that Ecuador's refusal to issue VAT refunds violated the NT and FET requirements of the US-Ecuador BIT despite also rejecting a concamitant expropriation claim.[42] Similarly, in both *Archer Daniels Midland Company v the United Mexican States* and *Marvin Roy Feldman Karpa v the United Mexican States*, which respectively dealt with taxes imposed on, and the denial of rebates for, investors' products, the investors' expropriation claims were also refused; however, claims based on breaches of the United Mexican States' NT obligations under *NAFTA* succeeded.[43] In both cases, the finding of discriminatory treatment violating the state's obligation to provide NT to the claimants was based on disparate taxation measures towards the claimants compared to domestic entities acting in like circumstances, something that was done in an effort to promote and favour domestic industries and participants.[44]

Conversely, in *Sergei Paushok v the Government of Mongolia*, the investor was unsuccessful in its expropriation, MFN, and FET claims.[45] At issue was the *Law On Imposition of Price Increase (Windfall) Taxes on Some Commodities* (the 'WPT'), passed by the Government of Mongolia, which created a 68

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[40] *Burlington*, *supra* note 34 at paras 454–55.

[41] Matthieu Gregoire, "Taxation and Expropriation Under Bilateral Investment Treaties: Setting the Standard" (2015) 30:10 Butterworths J Intl Banking & Financial L 629 at 629.

[42] *Occidental*, *supra* note 31 at paras 173–79, 186–87.

[43] *Archer Daniels Midland Company v The United Mexican States*, Award (21 November 2007), ICSID, Case No ARB(AF)/04/05at paras 213, 247–52 [*ADM*]; *Marvin Roy Feldman Karpa v United Mexican States,* Award (16 December 2002), ICSID, Case No ARB(AF)/99/1 at paras 108–09, 111, 153, 187–88 [*Feldman*].

[44] *ADM*, *supra* note 43 at para 208; *Feldman*, *supra* note 43 at paras 136, 173–84.

[45] *Sergei Paushok v The Government of Mongolia*, Award (28 April 2011), Case No UN-0023-02)Arbitration Rules of the United Nations Commission on International Trade) at paras 309 – 21, 330 – 37 [*Paushok*].

percent tax on excess gold sales prices above US$500 per ounce.[46] In dismissing Paushok's FET claim, the tribunal emphasized that foreign investors bear the risk of taxation-level modifications, particularly in countries in early stages of their economic and institutional development, and held that even such a significant change in the tax rate would not be considered 'unpredictable' so as to constitute a violation of Mongolia's FET obligation.[47] Thus, the recurring theme of state deference was clearly present in the dismissal.

The tribunal's dismissal of Paushok's MFN claim that Mongolia had violated its obligations given that it discriminated between gold and copper[48] also deserves note. Article 3(2) of the Russia-Mongolia bilateral investment treaty ('BIT') simply refers to treatment of foreign investors as being no less favourable than the treatment afforded to domestic and other third-state investors.[49] Despite acknowledging differences between the wording in this article and that of the WTO treaty, the tribunal still evaluated the existence of discriminatory treatment by borrowing the WTO's language of 'competitive and substitutable products'. On that basis, the tribunal concluded the WPT was not discriminatory, either on the basis of a cross-industry or gold-copper comparison.[50] This contrasted with the use of language in other IIAs, such as "in like situations" – contemplated in *Occidental* –[51] as well as "in like circumstances" – considered in *ADM* and *Feldman*.[52] Nonetheless, different standards clearly emerged: based on the wording of the applicable IIA, discrimination and breaches of NT obligations may occur as a result of disparate treatment of entities in different industries, or, conversely, states' rights to tax economic sectors differently may justify why disparate taxation of various industries does not amount to discrimination.[53] Further, based on these cases, it is thus unclear when a particular treaty will be read to support one approach versus another.

The takeaways from these cases are twofold. Firstly, this short survey of the treatment of taxation-based NT, MFN, and FET claims in investor-state arbitration once again highlights the uncertainty surrounding taxation matters within the IIA regime. The findings in *ADM*, *Feldman*, and *Occidental* vis-à-vis *Paushok* highlight the fact that minor differences in the language in IIAs can lead to substantially different conclusions. Consequently, investors cannot anticipate the availability of relief from allegedly abusive taxation measures based on similar provisions across IIAs. Further, the success of taxation-based NT, MFN, and FET claims contrasts starkly with the failure in expropriation claims, suggesting a lower level of deference given to states by tribunals than that implied by the expropriation cases surveyed. It suffices to say then that, clearly, taxation-based claims in investor-state arbitration have highly unpredicatable and inconsistent outcomes. This lack of predictability in investor-state dispute resolution may generally be the result of the highly fact-dependent nature of these disputes. However, avoiding it is also particularly necessary in the realm of taxation because of its centrality to states, as well as its importance to investors in deciding whether and where to invest, as discussed above in Section II.

Secondly, these cases highlight the necessity for investors to have better tools at their disposal to protect their rights and investments against abusive state behaviour. As exemplified by *Feldman* and *ADM*,

[46] *Paushok, supra* note 45 at paras 103–04.
[47] *Ibid* at paras 302, 305, 327.
[48] *Ibid* at para 309.
[49] *Ibid* at para 562.
[50] *Ibid* at para 315.
[51] *Ibid* at para 313.
[52] *ADM*, *supra* note 43 at para 196; *Feldman*, *supra* note 43 at para 171.
[53] Davie, *supra* note 4 at 209.

host states may abuse their taxation power to discriminate against foreign investors. Or, as in *Yukos* and *RosInvestCo*, they may use it to punish their political opponents, push their agendas, and even to collude to destroy the economic value of an investment under the guise of legitimate state action.[54] Foreign investors knowingly accept risks associated with investing in foreign states – including possible tax changes – which may negatively impact their eventual returns. Nonetheless, states should not be permitted to do so arbitrarily and discriminatorily, particularly subsequent to the investment being made when the investor is in a more vulnerable position vis-à-vis the state.

iii. The Effectiveness of Taxation Carve Out

A final consideration arising from *Yukos* and *Occidental* relates to the effectiveness of the existing taxation carve-out clauses contained in IIAs. In *Yukos*, the tribunal found that the taxation carve out in Article 21(1) of the Energy Charter Treaty only applied to *bona fide* taxation actions, namely those intended to increase state revenue.[55] In *Occidental*, the tribunal read the opening words of Article X, paragraph 1 of the US-Ecuador BIT, which referred to the necessity for the state to "strive to accord fairness and equity" in taxation matters, as imposing the FET obligation in Article II on the host state.[56] This finding was used to read down the carve-out for taxation matters found in Article X, paragraph 2, which excluded taxation from the treaty except in three specific areas (not including FET).[57]

The willingness and ability of tribunals to interpret taxation carve-out clauses in a manner that enables taxation-based claims, even where the IIA seeks to explicitly exclude them, demonstrates the limited usefulness of the carve outs. Thus, such clauses are not achieving their primary objective of maintaining state sovereignty in taxation matters in the manner states desire. This begs the question of why such carve out clauses are included at all. If tribunals are readily able or willing to avoid their application, they simply increase inconsistency and incoherence regarding the rights and obligations of states and investors with respect to taxation-based claims.

C. The Tax Veto

The tax veto is a unique feature with respect to taxation matters. For instance, Article 2103(6) of the *North American Free Trade Agreement* states that an investor can only make a taxation-based claim of expropriation under article 1110 after referring it to the competent authorities of the host and home states for determination of whether the measure constitutes expropriation.[58] Consequently, if the states' competent authorities agree the taxation measure does not constitute expropriation, no expropriation claim can be brought under *NAFTA* (although article 2103(4) *NAFTA* enables taxation-based claims under NT or MFN provisions). If, however, no agreement is reached between the two states within six months of

[54] Kolo, *supra* note 8; Wälde & Kolo, *supra* note 5 at 342.
[55] *Yukos Universal*, *supra* note 27 at paras 1407, 1430–47.
[56] *Occidental*, *supra* note 31 at paras 70, 75.
[57] Davie, *supra* note 4 at 211; Wälde & Kolo, *supra* note 5 at 339–40; *The Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment*, United States and Ecuador, 27 August 1993, Senate Treaty Doc. 103-15 art X (entered into force 11 May 1997).
[58] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2 art 2103(6) (entered into force 1 January 1994) [*NAFTA*]. For the sake of simplicity, this paper only considers the *NAFTA* tax veto. However, other IIAs do include similar or slightly modified versions of it. The discussion is equally applicable to them.

a claim's submission, the investor is granted the ability to bring the expropriation claim under *NAFTA*.[59]

The tax veto attempts to enable states to retain a level of control over investor-state arbitration of taxation matters. Nevertheless, the extent to which it is effective in achieving this objective is questionable: taxation-based claims may still be brought under the NT or MFN guarantees, and most of the success achieved by investors to date in taxation matters has been under NT and MFN provisions where the tax veto is generally inapplicable, rather than on expropriation grounds. Additionally, while it is generally understood to be advantageous to states, the tax veto may also be beneficial to investors. It aims to protect states' taxation powers and to prevent or minimize possible abuses of the investor-state arbitration forum from frivolous taxation-based expropriation claims.[60] In so doing, it performs a gatekeeping function by enabling both the host and home states to evaluate the claim's validity. As noted, the language of *NAFTA* article 2103(6) requires states reach an agreement that the measure is not an expropriation for an investor's claim to be prevented. The home state's competent authority would likely be cautious about reaching such a conclusion where a measure was clearly abusive despite being clothed as legitimate regulation. It is thus granted a protective role vis-à-vis its investors.[61]

Thus, if exercised objectively and conscientiously by states, the tax veto function serves to protect the integrity and fairness of the IIA regime. It thereby encourages states to continue making investor-state arbitration available, as well as enoucraging for investors to rely on it as a means of legitimately safeguarding their foreign investments. However, there are nonetheless justified criticisms levied again the tax veto. In particular, it has two important weaknesses as currently formulated in IIAs that require attention. First, it is questionable whether states' competent authorities could ever undertake such an analysis without political considerations seeping in. Authorities are not impartial; particularly for the host state, there is an important self-interest in ensuring that the taxation matter not be found to be an expropriation.[62] This sense of self-protection is heightened in the context of expropriation claims where a taxation measure's very legitimacy is in question.[63] Politicizing the evaluation of whether a taxation matter constitutes expropriation creates a real risk that meritorious claims may not reach the impartial sphere of investor-state arbitration.[64] Secondly, because there is no obligation for states to involve the investor in the evaluation of whether its claim has merits, there is a lack of transparency in the process. States' decisions are typically made through an exchange of letters, rather than in a forum or other manner accessible to the investor.[65] Investors are thus not only excluded from the process but may also fail to receive an explanation as to why their claims were found not to constitute expropriation once a decision is reached. Further, if investors are invited to participate in the process, they may be hesitant to disclose information and evidence for fear that it will then be used to their detriment in the event of a future arbitration (either if the expropriation claim is allowed or for claims made on other bases).[66]

For these reasons, the tax veto is somewhat at odds with core goals of the IIA regime, like the provision of fair and impartial dispute resolution. Its weaknesses, however, are not inherent to the tax

[59] *NAFTA, supra* note 58.
[60] Park, "The Fisc", *supra* note 21 at 237, 241; Kolo, *supra* note 8.
[61] Park, "The Fisc", *supra* note 21 at 236.
[62] Kolo, *supra* note 8 at 481.
[63] Park, "Arbitrability", *supra* note 20 at 183.
[64] Kolo, *supra* note 8.
[65] *Ibid*.
[66] *Ibid*.

veto itself, and are instead a product of its current design. If properly conceived, the benefits it offers will outweigh its flaws, and it can be a useful tool to balance states' desires to retain sovereignty over taxation measures while providing a measure of protection to investors. Section V.A below considers how to correct the tax veto's existing failings.

IV. WHY INVESTOR-STATE ARBITRATION IS BEST-SUITED FOR ADDRESSING TAXATION–BASED DISPUTES

This section addresses key concerns regarding investor-state arbitration of taxation matters, and argues that it is the most appropriate forum for resolving tax disputes. As discussed in Section II.A, DTTs are an inadequte device for protecting investors against abusive taxation measures given their state-centric objectives and the state-based nature of the tools they provide. The IIA regime is better suited for resolving such disputes because it already incorporates a general and tested framework for investor-state claims.

A. Prioritizing Neutrality

As explored above in Section II.B, taxation is a sensitive and core aspect of state sovereignty that is guarded fiercely. Consequently, the necessity for neutrality in dispute resolution is heightened. Pushing taxation-based claims outside the scope of investor-state arbitration tasks the state and its government branches, such as its tax administrations and judiciary, with resolving taxation disputes. The result is state oversight and control over the resolution of disputes whose subject matter is one in which states have a heightened sensibility and interest.

Independent arbitral tribunals, on the other hand, offer neutrality that may not readily be found in host states' dispute resolution processes. As noted in *Burlington*: "[t]he purpose of investment arbitration is neutral adjudication of a dispute by a tribunal independent from both parties."[67] Indeed, underlying the modern IIA regime's goal of encouraging global economic cooperation and foreign investment flows is the assumption that the rights afforded investors will be protected in a politically and procedurally neutral manner.[68] But in the absence of investor-state arbitration, international fiscal dispute resolution ends up in the hands of national courts, which inherently lack the procedural and political neutrality to attract party acceptance, and thus results inconsistent administrative and judicial decisions.[69] Instead depoliticizing tax disputes by enabling investor-state arbitration under the IIA regime would open the door to greater compromise and allow for meaningful investor-state dialogue regarding tax matters. The availability of neutral and fair dispute resolution for tax measures would enhance investor confidence while nonetheless ensuring states retain the flexibility to enact and modify tax legislation as they see fit. Therefore, neutral adjudication in this politically sensitive area of investor-state relations is logical and necessary, and an appropriate framework to meet these objectives is required.

B. The Complexity of Tax Matters

[67] *Burlington*, *supra* note 34 at para 410.
[68] Park, "Arbitrability", *supra* note 20 at 188–89; Park, "The Fisc," *supra* note 21 at 231, 240.
[69] William W Park, "Income Tax Treaty Arbitration" (2002) 31:5 Tax Management Intl J 219 at 221–22 [Park, "Treaty Arbitration"].

The increasing complexity of the global economy and the intricate interplay between the various tax systems that arises in foreign investment means that the impact of changes in taxation measures and regimes in one jurisdiction may have a broader impact on investors elswhere. Existing principles based on national experiences of sharing and delineating tax jurisdiction have been outpaced by the changing business environment. Additionally, both domestic rules for international taxation and internationally agreed upon standards are still grounded in an economic environment characterised by a lower degree of global economic integration.[70] Wälde and Kolo note that "[a]s the development of the law proceeds at a slow and majestic pace, new approaches – international disciplines – and traditional approaches – tax sovereignty – wrestle with each other in treaty language, application, and commentary."[71]

Consequently, the intricacy and sophistication of the modern economy vis-à-vis the jurisdictional nature of taxation lends itself better to resolution by arbitrators. They generally have more sensitivity to the international economy, as well as greater experience in global investment and international dispute resolution, than the judiciary of a particular host state. In transfer pricing scenarios, for instance, international arbitrators may be better able to rationalize cross-border intercompany transactions in order to reconcile divergent national approaches and, in so doing, arrive at more consistent and fair results for investors.[72] In addition, the availability of panels with more than one arbitrator in international arbitration allows for a more rigorous decision-making process than may be available domestically.[73] Arbitral tribunals are also typically constituted by highly competent and independent arbitrators who have the ability to balance the competing interests and rights of states and investors alike.[74] Therefore, achieving a balanced dialogue between individuals with varying experiences to resolve taxation-based disputes may be more likely in international arbitration than in domestic processes, increasing the chances of reaching a solution that is fair and respects the interests of investors and states alike.

C. Misplaced Concerns Regarding Loss of Sovereignty

States have been reluctant to agree to submit tax matters to investor-state arbitration given their importance to their sovereignty.[75] They tend to limit taxation-based dispute resolution to the realm of DTTs, where the focus is on compromise and dialogue between competing states, engendering a greater sense that sovereignty is preserved than in a forum where investors have direct recourse against them.[76]

However, this argument loses its credence in light of the fact that other disputes subject to international arbitration, including the use of natural resources and economic infrastructure, as well as the administration of justice, are also matters of vital national interest. If states trust arbitral tribunals to resolve disputes in these areas, which are arguably of equal importance to the national interest and state sovereignty as taxation, it is unclear why the latter should be treated differently.[77] Furthermore, as discussed above in Section III.B, arbitral tribunals tend to show deference to states in taxation matters,

[70] OECD, "Addressing BEPS", *supra* note 10 at 5.
[71] Wälde & Kolo, *supra* note 5 at 357.
[72] Park, "The Fisc", *supra* note 21 at 240–41. Transfer pricing is generally covered by DTTs. Nonetheless, Park illustrates that it is an important area of international taxation that may be better suited for international arbitration.
[73] Park, "Treaty Arbitration", *supra* note 69 at 225.
[74] Kolo, *supra* note 8 at 492.
[75] See section II.B.
[76] See section II.A.
[77] Park, "Arbitrability", *supra* note 20 at 184; Park, "The Fisc," *supra* note 21 at 239–40; Kolo, *supra* note 8 at 486.

something demonstrated in the few successful taxation-based investor claims surveyed. Tribunals also repeatedly recognitze both the importance of taxation to states and that changes to tax regimes are a risk inherent to foreign investment. This deference shown to states with respect to taxation-based claims should arguably addresses sovereignty concerns, and brings into question states' reluctance to subject such claims to investor-state arbitration.[78] Kolo further suggests that jurisprudence indicates states' fear of investors making vexatious taxation-based claims is misplaced; rather, they are the ones who tend to use taxation for protectionist purposes, or to squeeze foreign investors' property rights.[79]

Thus, it is unfair for states to single out taxation as a category distinct from other issues of equal national importance. International arbitration tribunals are cognizant and respectful of the special role taxation plays in the proper functioning of states. Within an established framework, providing broader rights to submit taxation matters to investor-state arbitration will not erode states' sovereignty any more than the existing IIA regime does.

V. A FRAMEWORK FOR THE SCOPE OF TAXATION-BASED CLAIMS IN INVESTOR-STATE ARBITRATION

This section outlines a basic framework for managing investors' taxation-based claims within the IIA regime. In so doing, the following underlying considerations and factors established above are assumed. First, current provisions for taxation matters in IIAs, as well as their enforcement by tribunals, create signifciant uncertainty. Stakeholders are consequently unable to meaningfully understand their rights and obligations. Certainty, predictability, and transparency are central objectives in incorporating the resolution of taxation disputes into investor-state arbitration. However, inherent limitations in achieving these goals are acknowledged. Indeed, the extensive network of existing IIAs, numbering over three thousand,[80] means attaining the coherency required for true certainty and predictability in investor-state arbitration of taxation matters is unlikely. Second, states have a legitimate and longstanding right to tax investors, as well as the freedom to adjust their fiscal policies as required to achieve their objectives and preserve sovereignty. Consequently, certainty and predictability must be balanced against the need for state flexibility in a way that ensures that a 'regulatory chill' regarding taxation does not occur.

A. Modernizing the Tax Veto

Rather than being eliminated, the tax veto – which in various IIAs applies exclusively to expropriation claims – should be modernized and expanded to apply to all taxation-based claims (subject to the limitations outlined below in Section V.B). As mentioned in Section III.C, the current weaknesses in the tax veto can be addressed by creating a more robust process. While states should retain a high degree of control over taxation-based dispute resolution, investors should nonetheless be able to meaningfully partake in matters relevant to them.

The gatekeeping function served by the tax veto is useful to evaluate the validity of taxation-based claims, which assists in ensuring only meritorious claims go forward, and in so doing, preserves the

[78] Kolo, *supra* note 8 at 476.
[79] Kolo, *supra* note 8 at 476–77.
[80] Davie, *supra* note 4 at 211.

integrity of – and confidence in – the IIA regime for investors and states alike.

To modernize the tax veto, however, several aspects of its procedure should be refined and improved. First, the process of analyzing whether to exercise the tax veto should be a transparent one for the investor. They should have the right not only to have their voices heard in the proceedings, but also to be present throughout if they so desire, thereby faciliating a greater understanding of the reasoning for the ultimate decision. At a minimum, if the veto is exercised, the reasons for this should be clearly explained to the investor. Second, to limit the risk of information or evidence shared by investors being used against them, tax veto proceedings should be confidential. State members should be precluded from communicating with other states who may be involved in future investor-state arbitration. Third, state actors beyond competent authorities should also be engaged in the tax veto process. As tax administrators, states' competent authorities have a particular interest in taxation-based disputes beyond the general sovereignty concerns felt by states because taxation is the core subject matter they are responsible for. Competent authorities focused on taxation may also lack specific IIA-related knowledge.[81] However, completely excluding competent authorities from the tax veto process may not be the most appropriate solution. While they may not always be neutral, competent authorities have intimate and relevant knowledge and experience regarding the subject matter of taxation disputes and may consequently be well-placed to assess the merits of claims about the abusive nature of impugned taxation matters.

While it is beyond the scope of this paper to contemplate the precise state entities – or mix thereof – best placed to neutrally assess the merits of claims, a more balanced mix of state representatives would surely lead to more impartial assessments of taxation-based claims. In identifying other state entities and actors to include in the tax veto process, an important consideration is ensuring they have knowledge of the intricacies of international investment as well as its interplay with – and interpretation of – IIAs. Further, an independent party could be appointed to the process by states or investors in an advisory capacity to help ensure neutrality.

Ultimately, by striving to establish a more balanced panel of representatives to participate in the tax veto process while simultaneously limiting the flow of information with respect to such proceedings, a fairer, more balanced outcome would be achieved without eliminating the tax veto's benefits. It is acknowledged that there may be costs incurred by investors and states alike in expanding the tax veto process in such a manner. However, these would be mitigated. First, meritless claims would be less likely to lead to arbitration proceedings; and, second, where claims do proceed to arbitration, parties would be more aware of their strengths and weaknesses, and the proceedings may accordingly be shorter. In this way, costs would be 'shifted' to a different stage of the process.

This being said, there is a remaining weakness in the tax veto mechanism that should be addressed. It is difficult to imagine a situation where a host state would agree that their taxation measure was abusive; therefore, veto power effectively always rests with the home state. In situations where the host state is in a relative position of power vis-à-vis the home state, the former may try to use any advantage it has to force the latter not to exercise its tax veto. While this risk is definitely material, it is one which must be accepted because it is outweighed by the benefits associated with the tax veto previously described. Furthermore, enhancing transparency and involving investors, who are often large MNEs with considerable global influence, would serve to mitigate the risk of this occuring.

[81] Kolo, *supra* note 8.

B. The Basis for Taxation-Related Claims in IIAs

Depending on the applicable IIA, taxation-based claims can currently be brought under expropriation, FET, and NT provisions, as well as some combination thereof. As a consequence, investors may on one hand be left with little or no protection when faced with abusive taxation measures; on the other, they are more likely to argue their case based on any and all guarantees available in the IIA. This adds unnecessary complexity to the proceedings, enhances the likelihood of inconsistency as tribunals struggle to coherently address each claim, and leads to more costly and lengthy arbitral proceedings.

Due to taxation's importance related to its unique capacity for achieving governmental objectives, IIAs should therefore contain separate provisions for taxation-based claims clearly delineating what protections investors have for taxation matters, as well as when and how states breach those protections. The use of 'screws' in tax regulation by governments, for instance, makes it more difficult to detect abuse of state power against foreign investors than traditional state behaviour modern IIAs typically target.[82] Taxation may be used in subtle ways to slowly eliminate an investment's economic value, and distinguishing between normal and excessive taxation is an imprecise and challenging exercise.[83] Furthermore, taxation is inherently discriminatory given that states make legitimate policy and administrative decisions to, for example, favour one industry over another,[84] or, due to enforceability concerns, impose different taxation burdens on non-residents.[85] For these reasons, FET and NT provisions in IIAs cannot appropriately regulate taxation. Notions of fairness and equity are very "malleable and chameleon-like," thus lending themselves to mischief.[86] FET and NT guarantees are often excluded from the jurisdiction of IIAs because the balance between tax sovereignty and investor vulnerability is different than in other types of matters. Whereas investors have less exposure, at least in comparison to expropriation matters, there is greater interference here with states' regulatory discretion.[87] Consequently, subjecting taxation-based claims to FET and NT guarantees fails to meet states' objective of retaining sovereignty over taxation matters without producing greater investor protection. Further, it does not result in more certainty or confidence in the IIA regime, thus failing to provide a pertinent solution.

For the same reasons, expropriation provisions in IIAs do not offer a suitable basis for taxation-based disputes. As explored previously, taxation-based claims for expropriation have generally failed, which is arguably because taxation, with its often indirect and 'creeping' impact on investments, is not suitable for analysis within the expropriation framework. In *EnCana*, *Occidental*, and *Burlington*, the tribunals failed to find expropriation had occurred primarily on the basis that the investors still controlled their investments and could earn future profits.[88] Furthermore, as exemplified by the US and Canadian model BITs, modern IIAs are striving to clearly delineate tests for expropriation, requiring investors to demonstrate substantial deprivation and disappointment of legitimate investment-backed expectations, as well as considering the measure's character.[89] However, considering the subtle ways in which taxation

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[82] Wälde & Kolo, *supra* note 5 at 307–11.
[83] Park, "The Fisc", *supra* note 21 at 237–38, 239.
[84] See e.g. *Paushok*, *supra* note 45 at para 310.
[85] Park, "Arbitrability", *supra* note 20 at 202.
[86] Park, "Arbitrability", *supra* note 20 at192.
[87] Wälde & Kolo, *supra* note 5 at 339.
[88] *Encana*, *supra* note 31; *Occidental*, *supra* note 31; *Burlington*, *supra* note 34.
[89] Wälde & Kolo, *supra* note 5 at 343.

measures can be used to deprive investors of economic value, taxation's often inherently discriminatory nature, and states' rights to change their fiscal regimes, it is unclear whether taxation matters could or should ever be deemed to effect an expropriation. This observation is particularly acute when considering that taxes are often levied on profits. It is hard to imagine a situation where, short of a 100 percent taxation rate, changes to income tax could result in a 'substantial deprivation' of an investor's rights. Therefore, grounding the right to taxation-based investor-state arbitration under IIAs in expropriation provisions will continue to frustrate claims made by investors. It will thus fail to promote certainty in – or the integrity of – the IIA regime.

What is required instead are a distinct provisions delineating states' obligations regarding taxation matters and what constitute a breach thereof. The following are broad strokes proposals regarding what may be successful in enhancing certainty and ensuring that IIAs fairly capture taxation matters. First, as a baseline principle, the taxation measures should have to be discriminatory against the foreign investor. A measure is discriminatory if it arbitrarily subjects a foreign investor, or group of foreign investors, to disparate treatment vis-à-vis domestic investors operating in similar industries. Thus, the investor must demonstrate that the measure specifically targets it based on its status as a foreign investor. The concept of 'discriminaton' should be understood broadly, as it will not be a determinative factor, but rather a basic threshold the investor must demonstrate has been met to allow a taxation-based claim to proceed in investor-state arbitration. As part of this assessment, states inevitably have the opportunity to demonstrate that the taxation measure is justifiable despite its discriminatory nature. For example, the state could demonstrate that the measure was part of a wider change to its regulatory regime to enact a broad social or economic policy, of which the taxation measure was but one part, and that the taxation measure – despite being discriminatory – was necessary to accomplish the state's objectives. The threshold here should be high; specficially, the state should have to demonstrate that it could not achieve its social or economic objectives in any other manner. Clearly, this reintroduces an element of uncertainty and subjectivity into the analysis given that tribunals will have to evaluate whether the taxation measure at issue is part of a broader regulatory scheme, and whether the state's objectives outweigh the measure's discriminatory nature. However, this is a necessary concession to ensure that states retain the requisite flexibility to carry out important fiscal policies, thereby avoiding 'regulatory chill' and ensuring states continue to engage in the investor-state arbitration regime.

More importantly, a financial metric should be inserted to evaluate whether the measure is sufficiently abusive to allow for a taxation-based claim. This could include, for example, determining a percentage impact on profits, such as if the taxation measure results in a deprivation of profits of 50 percent or more. Alternatively, it could be tied to a more robust profitability analysis. For example, an independent party could be relied on to evaluate whether, in the context created by the new taxation measure, a similarly situated investor would have still made the investment. An independent expert, ideally with experience in the investor's industry, would analyze the investment's profitability both at the time the original investment was made *and* at the time the dispute arises, taking into account the new taxation measure as well as the current economic conditions. If the expert determined that no reasonable investor would undertake such an investment, the state would have violated its obligations.

In doing all of this, the analysis would take into account that states often impose new taxes on foreign investors as economic conditions change, and, where the profitability of the foreign investment has risen, that states should be able to seek a greater portion of the returns therefrom. The analysis would also account for any conditions outside the government's control that negatively impacted the investment's profitability. Including these objective criteria in investor-state arbitration of taxation disputes would reduce uncertainty as well as the likelihood of unsubstantiated claims. Investors could undertake analyses to assess potential claims in accordance with the provision of the IIA. States would retain the flexibility to change their taxation regime within clearly defined parameters and have a better understanding of their rights and obligations vis-à-vis foreign investors in this core area of their sovereignty.

VI. CONCLUSION

The continuing evolution of the global economy and increasing integration of business operations worldwide has come with its challenges. Particularly in the context of taxation, balancing state sovereignty with the continued profitability of foreign investment remains vexing. The current IIA regime has failed to achieve an appropriate equilibrium between the competing objectives of certainty and predictability vis-à-vis flexibility, and leaves stakeholders without a clear understanding of their rights and obligations regarding taxation-based claims.

To improve the international investor-state arbitration regime with respect to taxation, a new framework for addressing this area must be created. First, the tax veto process must be revised to enhance its neutrality and transparency. Second, a new basis should be developed and introduced into IIAs to address taxation matters, providing more objective guidelines. While no solution is perfect in this sensitive and highly subjective area of state policy, introducing clearer standards within IIAs to deal with taxation matters, and maintaining a modernized tax veto, will enable all parties to better understand their rights and obligations. In so doing, it will enhance the integrity of, and confidence towards the investor-state arbitration regime for all stakeholders.