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ABSTRACT

When fiscal measures intertwine arbitration, undue mystification sometimes follows. To enhance analytic clarity, tax-related arbitration might be divided into three parts. The first derives from ordinary commercial disputes that become laced with incidental tax questions. A corporate acquisition, for example, might carry tax consequences which in turn implicate contract claims or defences presented to an arbitral tribunal for resolution. The second genre of tax-related arbitration arises in respect of cross-border investment disputes. Rightly or wrongly, foreign investors often perceive host-country fiscal enactments as discriminatory, unfair, or tantamount to expropriation, thus violating international commitments. Finally, arbitration comes into play under income tax treaties when two countries assert rival demands to tax the same pot of income. Within a single multinational corporate group, potential economic double taxation might arise through a mismatch of income and deductions from one country to the other. Such economic double taxation puts the corporate group in the role of fiscal stakeholder, ready to pay tax to one country or the other, but not both. In such a scenario, state-to-state arbitration can promote symmetry in allocating fiscal jurisdiction, as elaborated most recently pursuant to the OECD Base Erosion and Profit Shifting initiative. The modest aim of this essay lies in decorticating some of the themes, both practical and doctrinal, that challenge arbitrators tasked with deciding questions of a fiscal nature.

1. THE CONTOURS OF TAX ARBITRATION

1.1 The tripartite division of fiscal disputes

Undue mystification sometimes attaches to arbitration implicating tax measures. To enhance analytic clarity, one might take inspiration from Caesar's tripartite characterization of ancient Gaul, dividing tax arbitration into three parts.[1]

1.1.1 Commercial transactions

The first type of tax arbitration derives from commercial disputes spiced with a heavy dose of tax content: private business relationships where buyers and sellers agree to settle their disputes out of court. Arbitrators often address tax matters as incidental to more basic contract claims and defences, related to taxes paid or credited.

1 Analogously, Julius Caesar offered a tripartite division of Gaul (Western Europe): 'Gallia est omnis divisa in partes tres', as recorded in 8*De Bello Gallico* (Book I, ch 1): (i) Gallia Aquitania (modern southwestern France, north of the Pyrenees), (ii) Gallia Belgica (Belgium/the Netherlands), and (iii) Gallia Celtica (inhabited by Celtic tribes in today's France, Switzerland, and Germany on the west bank of the Rhine.

For example, parties to a corporate transaction might elect to treat a stock purchase as an acquisition of underlying company assets pursuant to domestic fiscal legislation.[2] Absent the election, sellers would benefit from favourable tax rates on capital gain, whereas, the election, in contrast, could result in higher rates on 'ordinary' income. The contract might provide adjustment to the purchase price to compensate for incremental tax costs. If a dispute later arises because one side fails to pay what the other considers appropriate adjustments, then arbitrators designated to resolve contract disputes might need to consider the correctness of the parties' respective tax positions, including, for example, the tax basis and right to amortize acquired assets.

With respect to such tax arbitration derived from commercial transactions, common scenarios implicate contract clauses designating dispute resolution pursuant to the rules of some arbitral institution such as the International Chamber of Commerce (ICC), the American Arbitration Association, or the London Court of International Arbitration. An action for breach of contract, brought by a seller for the unpaid purchase price, might trigger the buyer's defence that the relevant tax code justified deduction of the controverted amounts. The arbitration proceeds under the normal statutory framework of whatever *lex loci arbitri* proved applicable as the arbitral venue, such as the Federal Arbitration Act for a matter heard in New York, or the relevant provisions of the *Code de procédure civile* for a case seated in Paris.

1.1.2 Investor–state arbitration

A second form of fiscal arbitration arises from investor–state controversies. Investors from abroad might perceive the host-country tax enactment as discriminatory, unfair, or tantamount to expropriation. The investor's aim at vindicating its rights may trigger a claim under a bilateral convention for protection of cross-border investment, or multilateral arrangements such as the Energy Charter Treaty (ECT)[3] as well as any of the bilateral treaties such as the Korea–US Free Trade Agreement,[4] or the North America Free Trade Agreement (NAFTA) and its successor, the Agreement between the USA, The United Mexican States, and Canada (USMCA).[5]

Such treaties often contain provisions related to fair and equitable treatment or guarantees against expropriation. The investor might see the controverted tax as disguised or indirect expropriation. The host state, in contrast, would consider the tax as nothing more than a reasonable revenue-raising measure, imposed pursuant to its sovereign prerogatives.

2 See, eg the US Internal Revenue Code, s 338(h)(10). See also IRC ss 1245 and 1366 related to tax rates concerning gains from sale of depreciable property and 'pass-through' of income items to shareholders.

3 ECT, Lisbon, 17 December 1994, 2080 UNTS 95; 33 ILM 360 (1995), initially intended to facilitate East–West cooperation between countries of the former Soviet Union (holders of large oil and gas resources) and western European countries with a strategic interest in diversifying energy supplies.

4 See, eg art 11(16), South Korea–US Free Trade Agreement, 1 July 2007.

5 The NAFTA (which entered into force in 1994) led to backlash against investor–state arbitration. NAFTA's successor, the USMCA), was initially signed in 2018, with a revised version signed in December 2019, awaiting ratification at the date of this article.

With respect to NAFTA's successor the USMCA, substantial changes lie on the horizon in resolution of investor–state disputes. What had been Chapter 11 of NAFTA, providing investment protection, has now become Chapter 14 in USMCA. Substantive guarantees for investment remain in place, including provisions on application of customary international law and expropriation. However, Canada has taken itself out of the arbitration provisions, which now apply only as between the USA and Mexico. Provisions on Expropriation continues to apply to taxation measures, but for arbitration between the USA and Mexico, a 'tax filter' process precludes the arbitration from going forward if designated national tax authorities determine that the contested measure is *not* an expropriation.[6]

These arbitrations may implicate national arbitration law as well as international treaty commitments. For example, a Dutch court pronounced an annulment in respect of the US$50 billion 'Yukos Oil Company' awards against Russia in a well-publicized instance of arbitration claims based on host state tax measures.[7]

In such scenarios, debate will focus on whether a controverted fiscal measure constitutes expropriation, discrimination, or lack of fair and equitable treatment, implicating questions of arbitral jurisdiction under relevant treaties, as well as liability and damages for the allegedly wrongful measures.

In some instances, analogous investor–state arbitration might follow from specific commitments between a government and a foreign company, such as a concession to exploit mineral resources. The investor might invoke alleged promises of favourable tax rates meant to encourage capital and technology flows from abroad. Such proceedings often take a hybrid flavour, blending aspects of commercial cases (with contract rights and duties derived from the concession) and notions of fair treatment such as found in treaty cases.

1.1.3 Income tax treaties

The final setting for tax arbitration implicates bilateral income tax treaties concluded to reduce double taxation and fiscal evasion as between two countries. Two countries might assert rival claims to tax the same pot of income, resulting in economic double taxation. For example, licence payments by a domestic subsidiary might flow to its foreign parent. The subsidiary's country of incorporation and residence might see the payment as excessive and characterize the amount as lower in order to reduce the deduction taken by the subsidiary. Such re-characterization often occurs pursuant

6 Arbitration provisions between the USA and Mexico have been included in USMCA Annexes 14-D and 14-E for investment disputes relate to certain government contracts. Substantive guarantees for investment include Annex 14-A (customary international law) and Annex 14-B (expropriation), with some new limitations such as a 'case-by-case, fact-based' test for indirect expropriation under Annex 14-B(3). Provisions on Expropriation (USMCA art 14.8) continues to apply to taxation measures, subject to the 'tax filter' process contained in the Exceptions of art 32.3.8, the successor to NAFTA art 2103(6).

7 See *infra* discussion of three Yukos arbitrations, with 2014 awards rendered against the Russian Federation in favour of Hulley Enterprises (Cyprus) (PCA No AA 226), Yukos Universal Limited (Isle of Man) (PCA No AA 227), and Veteran Petroleum Limited (Cyprus) (PCA No AA 228). The annulment by the Hague District Court, on 20 April 2016, was pronounced on the basis that no valid arbitration agreement existed to support jurisdiction by the Permanent Court of Arbitration (PCA) tribunal under the ECT. Proceedings were brought by shareholders of the Moscow-based OAO Yukos Oil Company. The claims arose from government actions against Russian oligarch Mikhail Khodorkovsky and his Bank Menatep.

to 'anti-avoidance' or 'transfer pricing' regulations. Without coordination between the two countries, income might be attributed to one entity without an appropriate deduction to subsidiary: the parent company might report $5, while the subsidiary would be able to deduct only $3 on its side of the transaction.

With respect to such controversies, arising under income tax treaties, recent attention has focused on the initiatives of the Organization for Economic Cooperation and Development (OECD) to address Base Erosion and Profit Shifting (BEPS) that aim to enhance the efficiency and effectiveness of tax-treaty dispute resolution. A double tax convention might permit taxpayer recourse to the treaty's Mutual Agreement Procedure (MAP), which provides for arbitration of disputes that resist resolution by the two countries' competent authorities.[8] Such arbitration provisions have made their way into model fiscal conventions drafted by the USA and the OECD.[9]

Allocation of income and deductions among trading partners most often affects corporate groups with operations in more than one country.[10] With respect to a sale of goods between affiliated business entities in two countries, tax authorities in the seller's jurisdiction might consider the contract price to be artificially low, not reflecting a commercially reasonable 'arm's length' payment, and thus seek to increase the income attributable to the vendor. In contrast, the country with jurisdiction over the buyer might see the payment as unreasonably high, thus seeking to lower the notional purchase price, in order to reduce deductions that would otherwise decrease tax liability. The multinational group, of course, would seek consistency, permitting items of income in one country to be matched by deductions in the other. Arbitration would address the overlapping or inconsistent fiscal jurisdiction that could result in either double taxation, or in some instances, in escape from otherwise fair taxation of the multinational enterprise.

1.2 The ripeness of an idea

A lively debate surrounds the extent to which arbitration should play a role in each of the three of the above-mentioned contexts: commercial transactions, investor–state disputes, and income tax treaties.[11] In this connection, a great American tax scholar and practitioner once mused playfully that tax arbitration was an idea 'whose time always seemed just about to arrive'.[12] That advent has now edged towards reality on several levels.

8 US–Belgium Income Tax Treaty, 27 November 2006, arts 24(7) and 24(8).

9 See art 25 of the Model Income Tax Convention drafted by the OECD and art 25 of the US Model Income Tax Convention.

10 Analogous questions, of course, do arise with respect to cross-border activities of individuals. See, eg *Boulez v Commissioner* (1984) 83 TC 584, implicating whether amounts due the famous French conductor Pierre Boulez, for work performed in the USA, should be characterized as royalties or payment for services. Mr Boulez, who at the time was living in Germany, had made sound recordings in New York. Characterization of the payments as 'royalties' might result in a reduced American withholding tax under the relevant bilateral income tax treaty between the USA and Germany.

11 See generally, William W Park, *Arbitration of International Business Disputes* (OUP 2006; 2nd edn 2012) 679ff.

12 David R Tillinghast, the author of that quip, served to pioneer serious academic and practical thinking on tax treaty arbitration in a seminal article that examined the prospect of arbitrators deciding questions

Tax arbitration often suffers from needless mystery and misapprehension. To start with, the tax profession often (and understandably) communicates by reference to code numbers and titles, which serve as shorthand for more complex notions. 'Subpart F' might cover imposition of tax on a parent company with respect to undistributed foreign subsidiary profits. 'Section 482' provides a catch-all designation for the way income and deductions may be allocated among related taxpayers.

Just as problematic, a certain insularity might on occasion attach to the tax profession itself. Perhaps overly secure in their specialized knowledge, some tax practitioners may see no reason to learn new material, such as the legal framework for recognizing arbitral awards, even though increasingly vital to the fiscal context for cross-border business.

Controversy about tax arbitration should not be surprising, given that survival of modern political collectivities rests in large measure on taxation, stirring vigorous debate not only about 'how' tax matters should be arbitrated but also whether tax disputes may be settled by arbitration at all.[13] It should not be surprising that nation-states would be jealous of the traditional sovereign prerogative to decide disputes implicating interpretation of the revenue-raising on which their existence depends. Some commentators caution against arbitration for international 'double taxation' disputes without first addressing potential or perceived imbalances between developing economies, on one hand, and multinational enterprises from more advanced economic systems, on the other.[14]

As an initial matter, the notion of 'tax arbitration' often proves a misnomer. The arbitrator might well be simply interpreting the parties' contract, rather than construing any revenue statute as such. The real dispute in a corporate acquisition might relate to what the buyer agreed to pay the seller for a particular asset.

related to (i) transfer pricing, (ii) permanent establishments, and (iii) taxpayer residence. David R Tillinghast, 'Choice of Issues to Be Submitted to Arbitration under Income Tax Conventions' in H Alpert and K van Raad (eds), *Essays on International Taxation* (1993) 349. Tillinghast later gave another boost to tax arbitration by co-authoring the International Fiscal Association study on the subject: William W Park and David R Tillinghast, *Income Tax Treaty Arbitration* (IFA 2004). Two decades earlier, Swedish scholars addressed the topic in Gustaf Lindencrona and Nils Mattson, *Arbitration in Taxation* (1981). See generally, William W Park, 'Income Tax Treaty Arbitration' (2002) 10 George Mason L Rev 803, reprinted in (2002) 31 Tax Management Int'l J 219, translated as *L'arbitrato nei trattati sulle imposte sui redditi, Rivista di Diritto Tributario Internazionale* 3 (gennaio-dicembre 2003).

13 See generally Bernard Hanotiau, 'L'Arbitrabilité', *Recueil des cours* (2002), in *Académie de Droit International de la Haye* (2003) 171–80; Pascal Ancel, 'Arbitrage et ordre public fiscal' (2001) Rev Arb 269; Matthieu de Boisseson, *Le Droit français de l'arbitrage* (1990), s 33, 37; Ibrahim Fadallah, 'L'ordre public dans les sentences arbitrales', Recueil des cours (2002), in *Académie de Droit International de la Haye* (1994) 369, paras 54–56, 410–11; Philippe Fouchard, Emmanuel Gaillard and Berthold Goldman, *International Commercial Arbitration* (E Gaillard and J Savage (eds), English Language edn, 1999) 348 and 359 (ss 579, n 478, and 589–1); Luca Melchionna, 'Tax Disputes and International Commercial Arbitration' (2003) 74 *Diritto e Pratica Tributaria Internazionale* 769 (2003); Luca Melchionna, 'Arbitrability of Tax Disputes' IBA Section on Business Law, Arbitration and ADR Committee Newsletter 21 (May 2004); Thomas Carbonneau and Andrew Sheldrick, 'Tax Liability and Inarbitrability in International Commercial Arbitration' (1992) 1 J Trans'l Law & Policy 23, 38 ('[T]he resolution of statutory claims involving tax issues is unsuitable for arbitration.').

14 See Michael Lennard, 'Transfer Pricing Arbitration as an Option for Developing Countries' (2014) 42(3) Intertax 179, 179–80.

However, determining that price could implicate tax consequences that prove elusive at the beginning of the transaction.

For example, a sale of shares might implicate an election for treatment as a purchase of underlying assets, thus permitting a 'step up' in basis to the buyer.[15] On the sellers' side, a sale of stock without the election would have been treated as capital gain, taxed at a lower rate than with the election that resulted in taxation at higher 'ordinary' rates.

If acquired assets include a contingent claim, the contract might provide for a price adjustment to the seller for the additional tax to be paid when the contingent claim finalized gets settled and proceeds become realized. A difference of opinion on what this tax should be, and what adjustment would be owing to the sellers, would be sent to arbitration under the contract's general dispute resolution clause. Of course, a superficial observation of the deal might ask why a dispute should arise if the tax code provides clarity. The same could be said about any of the myriad disputes arising from corporate acquisitions which trigger legal consequences viewed differently from divergent perspectives.

Nevertheless, despite scholarly doubts and doctrinal objections, the binding private resolution of tax-related disputes through arbitration remains very much a reality. Arbitrators routinely address tax measures in the context of both commercial contracts and investor claims against host states for discrimination, expropriation, and unfair treatment.[16]

Tax arbitration remains highly fact-intensive, with few general rules. In some instances, the claim may not be ripe for adjudication, perhaps because the government has not yet ruled on the amount of tax (if any) payable. In other cases, the relevant investment treaty or arbitration clause may remove certain types of tax controversies from the arbitrators' power.[17]

This essay compares the various contexts in which fiscal matters may be subject to arbitration, exploring why tax measures affect the universe of questions that arbitrators could normally be expected to address. In part, the modest aims of the paper lie in (i) helping the reader to understand how tax arbitration can enhance efficiency and fairness in economic relationships, particularly with a cross-border element, and (ii) with respect to investor–state relations, suggesting an analytic starting point for distinguishing legitimate from illegitimate taxation.

Augmenting these initial hurdles, understanding tax arbitration implicates a further challenge. Arbitrators hear fiscal controversies in at least three dramatically

15 See discussion *infra* noting US Internal Revenue Code, s 338(h)(10), where the seller and the buyer make a joint election for such deemed asset acquisition treatment.

16 In this connection, one recollects the story of an elderly Maine farmer asked by his pastor about his belief in baptism. Being a sceptic, but hoping to avoid a theological controversy that would delay supper, the old man replied, 'Believe in it? Reverend, I've seen it done!' Likewise, much discussion of tax arbitration resembles the proverbial law faculty exchange in which one professor confronts his colleague with the taunt, 'Well, even if your ideas work in practice, they do not work in theory.'

17 Distinctions are sometimes made between arbitral jurisdiction (compétence) and the 'admissibility' (recevabilité) of a claim. When claims are barred for reasons such as ripeness, they are said to be not admissible (receivable). While otherwise subject to an arbitrator's jurisdiction, the pre-conditions for their proper consideration have not been met. By contrast, a treaty prohibition on arbitration of particular tax claims could constitute a bar to the legitimate authority of an arbitrator even to consider such matters.

divergent contexts: commercial transactions, tax treaties, and investor–state disputes. Each field implicates its own particular legal framework, to which we shall now turn.

The following sections address the details of tax arbitration for the above-noted three contexts of tax controversies: commercial, investor–state, and income tax treaty.

2. COMMERCIAL TRANSACTIONS

With respect to arbitration of tax matters arising from private business relationships, several different scenarios arise.[18] In the wake of a corporate acquisition, the buyer and the seller might disagree on who should bear taxes due for tax liabilities imposed on the company that had been the object of the sale. Or, an allegation might be made that the seller misrepresented corporate tax liabilities, either by reason of accounting irregularities or in hiding investigations by local revenue authorities.

In some instances, disagreement on the balance sheet might relate to whether certain items of machinery should (or should not) have been capitalized, with a reasonable useful life established for later depreciation.

On occasion, a seller will withhold a portion of the payment price under an acquisition agreement providing for arbitration. Or a buyer may fail to pay the full amount provided in the contract. A dispute may arise about the appropriateness of the withholding or failure to pay, related to grievances and disagreements about taxation of certain items of corporate revenue.

Some legal regimes permit stock purchases to be treated as asset acquisitions, thus permitting a 'step up' in basis.[19] The buyer thus obtains greater depreciation and/or amortization deductions, with an agreement that appropriate adjustments of the price might follow in due course. If the contract so provides, an arbitral tribunal might determine any differences of opinion between buyer and seller about the correct measure of adjustment.

There might be issues about which party gets the benefits and/or burdens of credits and liabilities under a 'tax allocation agreement' concluded pursuant to a corporate spin-off. In some instances, disputes among joint venture partners might arise with respect to whether one partner was authorized to make payments to a foreign country on behalf of another.

And last but not least, of course, taxpayers have been known to sue their advisers. Often claims arise when advice about a tax shelter proves unfounded and leads to liability.[20] The contract with the legal or accounting adviser may well include an arbitration clause, calling for the arbitrator to assess whether due diligence was exercised by the service provider.

18 For examples of domestic and international tax arbitration, see *Ace Ltd v Cigna Corp* (2001) WL 767015; ICC Award Nos 6515 and 6516, in *Collection of Arbitral Awards/Recueil des sentences arbitrales de la CCI*, vol IV (Jean-Jacques Arnaldez ed., 1996–2000) 241. For tax arbitration within the USA, see IRS Ann 2000–04 and 2002–60.

19 Internal Revenue Code, s 338(h)(10). The seller and the buyer make a joint election for such treatment.

20 *Reddan v KPMG* (2006) 457 F 3d 1054 (9th Cir) (tax shelter sponsor held bound to arbitrate on the basis of an arbitration clause in brokerage contract related to the tax shelter transaction); *Vassaluzzo v Ernst & Young* (2007) WL 2076471 (Mass Super Ct); *Vassaluzzo v Ernst & Young and Sidley Austin* (2007) CA No 06-4215 (Mass Super Ct) (malpractice action for advice on an unsuccessful tax shelter, arbitration clause in engagement letter found to cover some but not all transactions).

Sometimes, tax rules may serve to obfuscate the real nature of the disagreement. For example, a corporate acquisition agreement might provide (allegedly) for additional payments on recovery of contingent claims. If the buyer withholds payment, the real dispute might implicate questions concerning what the acquisition agreement provides: did the seller, in fact, have an obligation to reimburse the buyer for the full amount of the recovered claim? Or just the claim less the tax liability? If the latter, what basis might be taken for determining the amount due the tax authorities? If for tax purposes the transaction will be characterized as an asset acquisition, rather than a stock purchase,[21] the complexities of that fiscal context may hide (at last from some observers) the more fundamental issue of what precisely the two sides agreed to allocate from buyer to seller. For instance, to what extent will an asset's amortization or depreciation be offset by tax due? Legitimate tax issues often intertwine nuances of party agreement.

Human nature being what it is, it should be no surprise that each side will be tempted to muddy analytic waters (or provide clarity, depending on perspective) by mixing and matching issues of tax code interpretation with contract construction. Each aspect of the dispute will play a part in its resolution by the arbitrator. Often, neither the tax code nor the contract may be a model of clarity.

In this context, public policy objections to tax arbitration prove a red herring, a purported clue that misleads or distracts, rather than assists sound analysis. Often, arbitrators in a commercial tax dispute will not be interpreting the relevant revenue code, as such, but will be construing the parties' agreement, with tax as a background.

For example, returning to the corporate acquisition scenario evoked above, the arbitrators might determine that the share purchase agreement, signed in 2016, required the buyer to pay the seller for the recovery of a contingent litigation claim when the value has been ascertained, which occurred in 2018, less the tax incurred by buyer on that recovery. Evidentiary hearings might have been held to determine proper construction of the contract or to investigate any purported side agreement between the two parties. The bottom line would be an award to pay $36 million.

To reach that result, however, the arbitrators might be bombarded with submissions and arguments touching on the so-called 'technicalities' of fiscal law. What was the 'basis' for the claim, to be used in determining tax liability? Can the recovered claim be amortized for tax purposes? What effect, if any, will be played by the 'open transaction' doctrine, permitting postponement of recognition of gain or loss until the amount realized is readily ascertainable. If the purchasing corporation makes the appropriate tax election, the target corporation may be treated as having sold its assets at fair market value, with the appropriate tax consequences of revaluing buyer's basis,[22] a Treasury filing might be made (such as Form 8883 in the USA), memorializing the assets transferred. The arbitrators might need to determine the import of that filing.

21 For example, in the USA the sale might trigger an election under Internal Revenue Code, s 338(h)(10), which as noted above permits the stock purchase to be 'deemed' (treated as) an asset acquisition for tax purposes, providing later consequences *inter alia* in respect of depreciation.

22 US Internal Revenue Code, s 338.

The basic question for decision by the arbitrators, however, still relates to what the seller agreed with the buyer: not an interpretative analysis of disputed matters of national fiscal policy. The distinction remains vital to assessing the viability of tax arbitration, given how critics sometimes fret that private decision-makers usurp public functions in relation to revenue laws, thus long raising questions on arbitrability that may miss the mark when viewed against the background of what does, or even what could, happen in tax arbitration.[23] Of course, the concern about 'subject matter arbitrability' arises in other contexts, each of which must be assessed on its own merits. [24]

3. INVESTOR–STATE DISPUTES

3.1 Expropriation and its fiscal cousins

In considering the interaction between taxation and investment protection, one may recall the line attributed to Jean-Baptiste Colbert, proposing that the art of taxation consists in 'so plucking the goose as to obtain the largest amount of feathers with the smallest amount of hissing'.[25] Among the constants in taxation through the ages, few have been more persistent than the need to distinguish taxes '*à la Colbert*' (looking simply to seize the most money with the least fuss) from the more legitimate form of revenue-raising that enables or shapes desirable social and economic behaviour.[26]

Arbitration provides one mechanism for such line-drawing in the context of concrete cross-border investment disputes between foreign investors and host states. On rare occasions, a government may agree on an *ad hoc* basis to arbitrate disputes over the quantum of a foreign investor's tax liability.[27] Much more common, however, are treaty-based claims by investors alleging that the host state imposed tax in a discriminatory or arbitrary manner, or used tax as a vehicle for expropriation without compensation.[28] Such tax-related investment disputes remain qualitatively different from

23 See, eg survey in Hanotiau (n 13); Ancel (n 13).

24 Analogous questions, albeit quite distinct, arise in connection with religious 'courts', which from the perspective of the secular state would be considered arbitration tribunals, as, eg a Muslim or Jewish body applying Sharia or Halakha. See, eg Robert Blackett, 'Revisiting the Status of Religious "Courts" in English Law' in Melanie Willems (ed), *The Arbiter* (2018) 8–10. See also *Soleimany v Soleimany* [1998] 3 WLR 811 (refusal to enforce Beth Din award giving effect to smuggling operation by family carpet business), discussed in Shai Wade, 'Westacre v. Soleimany: What Policy? Which Public?' (1999) 3 Int'l Arb Law Rev 97.

25 In 17th-century France, of course, taxation implicated a tangle of *ad hoc* mechanisms to finance royal lifestyle, rather than a systematic instrument of economic or social policy. See André Meurrisse, *Histoire de l'impôt* (1978) 83–90, recounting more than a century of tax escapades ultimately contributing to the French revolution of 1789. Nevertheless, many aspects of taxation continue from one century to another, including the perennial need for more money in wartime. Shortly after Colbert's death in the late 17th century, French aggression in the German Palatine created a need for more creative revenue-raising measures, and also triggered a half century of armed conflict against the so-called Grand Alliance, a prototype EU, minus France of course.

26 For an in-depth treatment of conduct-shaping taxation, see Xavier Oberson, *Les Taxes d'Orientation* (1991).

27 See Jean-Pierre LeGall, 'Fiscalité et arbitrage' (1994) Rev Arb 3 (noting at 24–25 several international tax arbitrations); Emmanuel Gaillard, 'Tax Disputes Between States and Foreign Investors' (1997) NYLJ, 3.

28 See generally, Thomas Wälde and Abba Kolo, 'Investor-State Tax Disputes: The Interface Between Treaty-based International Investment Protection and Fiscal Sovereignty' (2007) 35 Intertax 424; Richard Happ, *Beilegung von Steuerstreitigkeiten zwischen Investoren und ausländischen Staaten durch*

the commercial or tax treaty context. In an investment dispute, questions arise about the very legitimacy of the tax.

The controversy does not concern shifting normal fiscal burdens between a buyer and a seller, or the tax authorities in the parent's home state as opposed to the subsidiary's country of incorporation. Rather, an assertion might be made that the tax liability is not really a tax at all, but rather a disguised attempt at confiscation or a pretext for confiscation. It is to these types of controversy that we now turn our attention.

3.2 The *Matryoshka*: rules within rules

The current network of investment and free trade agreements was adopted to enhance economic cooperation and cross-border capital flows through a two-part regime: (i) substantive investor protections against discrimination, confiscation, and other unfair governmental measures and (ii) a relatively neutral dispute resolution mechanism in the event of disagreement on how those protections should operate.[29]

The cornerstone of most investment treaties lies in a prohibition of uncompensated expropriation of foreign-owned property, whether such expropriation is direct or indirect.[30] However, the treatment of tax measures related to expropriation remains far from simple and brings to mind the Russian nested doll, or *matryoshka*. One carved figure opens to reveal another, which in turn unlocks to yield yet more diminutive figurines. Treaty-based investor protection schemes contain fiscal provisions that unfold with exceptions to the exceptions.

Schiedsgerichte IStR 2006) 649–54; Alireza Salehifar, 'Rethinking the Role of Arbitration in International Tax Treaties' (2020) 37 J Int'l Arb 87 (Kluwer). See also discussion of the Yukos arbitrations, infra, brought by the three Cypriot entities that together held 70.5% of the former Yukos Oil Company: Hulley Enterprises, Yukos Universal, and Veteran Petroleum. The three awards rendered on 18 July 2014 were *Hulley Enterprises Limited (Cyprus) v The Russian Federation* (2014) Award, UNCITRAL, PCA Case No AA 226; *Yukos Universal Limited (Isle of Man) v The Russian Federation* (2014) PCA Case No AA 227; *Veteran Petroleum Limited (Cyprus) v The Russian Federation* (2014) PCA Case No AA 228.

29 See generally, William W Park and Guillermo Aguilar Alvarez, 'The New Face of Investment Arbitration' (2003) 28 Yale J Int'l L 365 (2003). Not all would agree with this positive assessment of investment protection regimes, as witnessed by Bolivia's denunciation of its obligations under the ICSID Convention (effective in late 2007), followed by Nicaragua's threat to withdraw from that Convention, Venezuela's decision to withdraw from the World Bank and Ecuador's declaration of intent to abrogate its bilateral investment treaty with the USA and remove ICSID jurisdiction related to oil and mining. See Emmanuel Gaillard, 'The Denunciation of the ICSID Convention' (2007) NYLJ. For a historical view of investment protection, see William W Park, 'Legal Issues in the Third World's Economic Development' (1981) 61 BUL Rev 1321. For an intriguing perspective on the origins of the debate, see Eugene Staley, *War and the Private Investor* (1935).

30 On indirect expropriation, see Michael Reisman and Robert Sloane, 'Indirect Expropriation and Its Valuation in the BIT Generation' (2003) 74 Brit Yrbk Intl L 115; Rachell Edsall, 'Indirect Expropriation under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare Regulations' (2006) 86 BUL Rev 931; Burns H Weston, '"Constructive Takings" under International Law: A Modest Foray into the Problem of "Creeping Expropriation"' (1975) 16 Va J Intl L 103. For an illustration of indirect expropriation, see Case Concerning the Barcelona Traction, Light and Power Co, Ltd (*Belgium v Spain*) (2d Phase) (1970) ICJ 3, 9 ILM 227, where a Canadian company's profitable Spanish assets were taken through a bankruptcy proceeding allegedly orchestrated to reward a supporter of then-dictator General Francisco Franco. The bankruptcy resulted when Spanish authorities refused to permit transfer of foreign currency necessary to service Sterling bonds.

In one significant way, however, interpreting investment treaties differs from opening a *matryoshka*. While the doll releases smaller figures, treaty exceptions often reveal other exceptions that prove as capacious as the provision from which they derogate.

To illustrate, the ECT[31] establishes a general rule on fiscal measures in Article 21: 'Nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties.'[32] The same Article then enumerates provisions that *will* apply to tax measures: prohibitions against discrimination[33] and uncompensated expropriation,[34] for which investors may seek redress through arbitration.[35] The non-discrimination rule, however, excludes from its application both income and capital taxes, as well as tax collection measures. A carve-out for collection measures that 'arbitrarily' restrict treaty benefits creates another exception from the exclusion, thus allowing claims based on some (but not all) collection practices.[36]

Thus, the interaction of investment treaties and tax measures often contains a level of complexity that makes discourse difficult, with multiple qualifiers for even simple propositions. Other than insurance policies and revenue codes, few public documents present as many exegetical challenges, leading some to suggest that ECT Article 21 is 'barely intelligible' and possibly ripe for amendment, while others suggest that the ability of a number of investor–state tribunals to apply Article 21 in a balanced manner indicates that its provisions are sufficiently clear.[37]

31 **ECT (n 3)**. The ECT was intended to facilitate East–West cooperation between countries of the former Soviet Union (holders of large oil and gas resources) and western European countries with a strategic interest in diversifying their energy supplies. See generally, Thomas W Walde, *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (1996); Julia Doré and Robert De Bauw, *The Energy Charter Treaty: Origins, Aims and Prospects* (1995); Thomas W Walde, *Investment Arbitration and the Energy Charter Treaty* (Clarisse Ribeiro ed, 2006); Mirian Kene Omalu, *NAFTA and the Energy Charter Treaty* (1999). See also, Kaj Hobér, 'The Energy Charter Treaty – Awards Rendered' (2007) 1 Disp Res Int'l 36 (IBA); Steivan Defilla, 'Trade under the ECT and Accession to the WTO' (2003) 21 J Energy Nat Resources L 428; Lawrence Herman, 'NAFTA and the ECT: Divergent Approaches with a Core of Harmony' (1997) 15 J Energy Nat Resources L 131.

32 Other bilateral or multilateral investment regimes have analogous provisions. See, eg NAFTA art 2103(1), now USMCA art 32.3.8; 2004 US Model BIT, art 21; US–Ecuador BIT, art 10; Canada–Ecuador BIT, art 12. See the Appendices for the text of these provisions.

33 art 21(3) says that arts 10(2) and 10(7) 'shall apply to Taxation Measures of the Contracting Parties other than those on income and on capital'. These two subsections of art 10 relate to non-discrimination and most favoured nation treatment. In turn, exceptions to the exception exist *inter alia* for tax collection mechanisms or provisions of economic integration organizations and income tax treaties in art 21(7)(a)(ii). The carve-out for tax on income and on capital leaves some of the most significant categories of fiscal measures, including value added tax, import and export duties, and stamp taxes. Significantly, the ECT exclusion does not refer to art 10(1), mandating 'fair and equitable treatment'.

34 ECT art 21(5) says that 'Article 13 shall apply to taxes.' art 13(1)(d) requires nationalization, expropriation, or measures equivalent to nationalization or expropriation to be accompanied *inter alia* by 'the payment of prompt, adequate and effective compensation'.

35 ECT art 26 permits arbitration under the rules of ICSID, UNCITRAL, and the Stockholm Chamber of Commerce. For investors from countries that are not a party to the 1965 Washington Convention, the dispute may be subject to the rules of the ICSID Additional Facility.

36 ECT art 21.

37 See Uğur Erman Özgür, 'Taxation of Foreign Investments under International Law: Article 21 of the Energy Charter Treaty in Context' (2015) Energy Charter Secretariat Report, 16, 64–65 (suggesting options including, an amendment to the ECT, issuing a Protocol or a Declaration as per art 1(13)(a) and (b) of the Treaty, and an interpretative note in order to clarify the object and purpose of ambiguous

As mentioned above, the ECT states that it does not create rights or impose obligations with respect to taxation measures.[38] However, the Treaty continues by making an exception for its most favoured nation provisions, which the Treaty says *do* apply to tax measures,[39] but only as to indirect taxes such as value added tax (VAT), excise tax, and stamp duties, as well as import and export duties, rather than taxes on income and capital.[40]

Moreover, the rule that non-discrimination provisions apply to tax measures contains several exceptions that include, *inter alia*, tax collection mechanisms.[41] This exception to an exception contains its own additional exception, with respect to measures that 'arbitrarily' discriminate against investors from the other contracting party. There are also exceptions for advantages accorded under regional economic integration organizations[42] and income tax treaties.[43] As to these items, one is sent back into the general rule that no rights are created or obligations imposed.

The ECT definition of 'taxes' further complicates things by explicitly excluding customs duties.[44] If customs duties are *not* taxes, then the initial exclusion (creating no rights and imposing no duties with respect to tax measures) would not apply in the first place. So the otherwise applicable investor protections (including fair and equitable treatment) remain in force, notwithstanding that they were initially excluded with regard to tax measures.[45]

As a general matter, a number of treaties contain restrictions on the ability to bring claims based on fair and equitable treatment with respect to fiscal measures.[46] These restrictions stem from the concern that notions of fairness and equity remain

terms and provisions in art 21 of the ECT as per art 31(3)(a) of the VCLT). *Compare* Sebastián Green Martínez, 'Taxation Measures under the Energy Charter Treaty after the Yukos Awards Articles 21(1) and 21(5)' (2019) 34(1) ICSID Rev 85, 87, 106 (concluding that amending ECT art 21 'would be a time and resources-consuming negotiation that no longer appears to be necessary').

38 ECT art 21. At some places, the ECT refers to 'Taxation Measures' (art 21, sub-ss 1–4), while at other places the Treaty uses the term 'taxes' (see art 21(5) concerning expropriation rules under art 13), without any explicit indication of why the different phraseology was chosen.

39 ECT arts 10(2) and 10(7).

40 By way of comparison, consider the General Agreement on Tariffs and Trade (GATT) which covers import barriers of a fiscal nature in respect of indirect taxes such as sales taxes, excise taxes, and VATs. Direct taxes might be seen as violating the GATT 'most favored nation' provisions. For a general treatment of 'tax and trade', see Reuven S Avi-Yonah and Martin G Vallespinos, 'The Elephant Always Forgets: US Tax Reform and the WTO' (University of Michigan Law School 2018) Law & Economics Working Papers <https://repository.law.umich.edu/law_econ_current/151>.

41 ECT, art 21(3)(b).

42 ibid, art 21(3)(a).

43 See ibid, art 21(3)(a), with its cross-reference to art 21(7)(a)(ii), which includes any international agreement 'for the avoidance of double taxation'.

44 ibid, art 21(7)(d).

45 art 21(3) states explicitly that the non-discrimination and most favoured nation provisions of art 10(2) and (7) will apply to taxation measures, but makes no mention of art 10(1), the provision mandating 'fair and equitable treatment' with a goal to 'encourage and create stable, equitable, favourable and transparent conditions for investors'.

46 See, eg art X of the US–Ecuador Bilateral Investment Treaty, Signed 27 August 1993; entered into force 11 May 1997, 103d Congress, Senate Treaty Doc 103-15; art 2103 of NAFTA, now art 32.3 of USMCA, 32 ILM 289, 605 (1993); art XIII, paras 3 and 4 of the UK–Colombia Bilateral Investment Treaty, signed 17 March 2010, entered into force 10 October 2014.

too malleable and chameleon-like to be useful, and could lend themselves to mischief, at least from the host state's perspective.

Other treaties focus more narrowly on restricting claims for discrimination. NAFTA and its successor USMCA allow a limited category of investor claims for discrimination,[47] albeit with carve-out provisions for claims related to fair and equitable treatment. Other international treaties carve out protections for non-discrimination in tax measures, which makes sense because many countries have concluded treaties or economic unions providing reciprocal fiscal privileges with some countries, but not others.

Investment treaties based on the Dutch Model BIT (such as the Netherlands–Venezuela treaty)[48] contain a limitation on the scope of national treatment and most favoured nation treatment with respect to tax measures and claims arising out of discrimination as a result of, *inter alia*, participation in economic unions.[49]

Exceptions to tax measures with regard to national treatment and most favoured nation treatment often found in modern investment treaties, echo provisions in the General Agreement on Trade in Services which similarly limit the extent to which national treatment and the most favoured nation obligations apply to taxation measures.

Carve-outs also arise when discrimination occurs as a result of features in tax codes, which apply in a discriminatory fashion as a result of administrative convenience. For example, foreigners and nationals might receive different fiscal treatment for capital gain and ordinary income,[50] given the difficulty of arranging overseas audits and enforcement.

To illustrate, US Internal Revenue Code section 884 imposes a tax on the 'dividend equivalent amount' of profits earned by foreign (but not domestic)

47 NAFTA art 2103(4), now art 32.3.6 of USMCA, allows the non-discrimination provisions to apply to taxation measures on income and capital gains in relation to the purchase or consumption of certain services, but disallows application of certain non-discrimination provisions with respect income or capital gains regarding estates, inheritances, and the like. In the case of *Feldman v Mexico*, the investor won an award of damages due to Mexico's violation of non-discrimination provisions with respect to fiscal measures. *Marvin Roy Feldman Karpa v United Mexican States*, ICSID Case No. ARB(AF)/99/1; Award and Dissenting Opinion of 16 December 2002, published in 42 ILM 625 (2003), finding Mexico liable for discriminatory tax under NAFTA, which in s 2803(4) says that non-discrimination provisions of art 1102 shall apply to tax measures.

48 art 4 of the Netherlands–Venezuela Treaty provides *inter alia* that taxes by one state, on nationals of the other Contracting Party with respect to investments in its territory, shall not receive treatment less favourable than that accorded to its own nationals or to those of any third state.

49 The OECD has also interpreted art 4 of the Dutch Model BIT as a limitation on most favoured nation and national treatment with regard to fiscal measures. See OECD, 'Most-Favoured-Nation Treatment in International Investment Law' (2004) OECD Working Papers on International Investment 2004/02, 6 <http://dx.doi.org/10.1787/518757021651>. In some instances, ICSID tribunals interpreting art 4 of the Netherlands–Venezuela BIT have construed the provision as constituting the entirety of treaty obligations that Venezuela and the Netherlands owed to each other with regard to fiscal measures. See *ConocoPhillips Petrozuata BV, ConocoPhillips Hamaca BV and ConocoPhillips Gulf of Paria BV v Bolivarian Republic of Venezuela* (2013) ICSID Case No ARB/07/30, decision on Jurisdiction and the Merits dated 3 September 2013, paras 301–316.

50 See, eg US IRC, ss 897 and 1445, taxing non-resident aliens and foreign corporations on sales of realty as if the foreign person were engaged in a trade or business, and overriding any otherwise applicable income tax treaty provisions. The special treatment, dating to 1980, derived from a concern at that time over increasing foreign purchases of American real estate following the oil crisis of 1973/74.

corporations. This tax tends to equalize the burden imposed on foreign entities operating through branches and those using corporate subsidiaries. Nevertheless, the measure subjects foreign companies to a tax not imposed on their domestic counterparts. Indeed, the American tax authorities have recognized that in appropriate instances, relief may be available through non-discrimination provisions of double tax conventions.[51]

Most developed countries tax non-resident aliens and foreign corporations on their passive income (such as dividends and interest) based on gross receipts although citizens and residents, in contrast, pay tax on net income.[52] For example, the default rule in the USA remains a 30-per cent tax on gross amounts of dividends received by foreigners, and 10 per cent on the gross realized by them on real estate dispositions.[53] In contrast, residents and citizens are taxed only on net gain, whether from securities or real estate.

3.3 The nature of tax measures

3.3.1 Fire, passion, and taxes

Like fire and passion, taxation can bring ruin as well as blessing. Justice Oliver Wendell Holmes rightly observed that taxes provide the wherewithal for public benefits we associate with civilized life. In one of his famous dissents, he observed, 'Taxes are what we pay for civilized society.'[54]

Fiscal measures also have a darker side, sometimes serving as a vehicle for indirect asset confiscation. As the oft-cited paraphrase of another American Supreme Court Justice suggests, 'The power to tax is the power to destroy.'[55]

This special potential for abuse reflects itself in the fiscal provisions of most investment treaties, which set forth intricate rules to assist in the fact-intensive *triage*

51 See Treasury Regulations, s 1.884-1(g). See also art 24 ('Non-Discrimination'), US Model Income Tax Convention, 16 November 2006.

52 See, eg Reuven Avi-Yonah, 'Globalization, Tax Competition and the Fiscal Crisis of the Welfare State' (2000) 113 Harvard L Rev 1573; Michael J Graetz, *Foundations of International Income Taxation* (2003) ch 7.

53 See, eg IRC, ss 871 and 881 on dividends and other passive income. When applicable, most treaties reduce this gross amount to more reasonable proportions. See OECD Model Income Tax Convention, arts 10 (dividends), 11 (interest), and 12 (royalties). With respect to real estate dispositions, IRC, s 1445, imposes a tax on the gross amount realized, which can in some instances be adjusted if the taxpayer reaches an agreement with the government. Unlike passive income, however, real estate dispositions do not benefit from treaty-based tax benefits. See FIRPTA 'Treaty Override' in PL 96-499 (1980) s 1125.

54 The line comes from a dissent while a Justice on the US Supreme Court, in the case *Compañía General de Tabaco de Filipinas v Collector of Internal Revenue* (1927) 275 US 87, 100. The catchphrase was later taken by President Franklin D Roosevelt, who said that taxes were 'the dues that we pay for the privileges of membership in an organized society'. Address in Worcester, Massachusetts, 21 October 1936. See Franklin D Roosevelt, *Public Papers and Addresses of Franklin D. Roosevelt*, vol 5 (Samuel I Rosenman ed 1938) 522–23.

55 *McCulloch v Maryland* (1819) 17 US (4 Wheat) 316, 327. A federally chartered bank had established branches in various states, one of which was Maryland. When that state imposed a tax on bank operations, the cashier of the Baltimore branch (one James McCulloch) refused to pay. The opinion by Chief Justice Marshall, upholding the power of Congress to create a national bank and ruling the Maryland tax unconstitutional, contained the following language: 'An unlimited power to tax involves, necessarily, a power to destroy; because there is a limit beyond which no institution and no property can bear taxation.'

between normal and abnormal taxes. Some tax measures give rise to claims for expropriation or discrimination, while others do not. As we shall see, line-drawing resists facile analysis in respect of these two categories.

3.3.2. Tax as taking

No consensus exists on why tax measures should receive special attention in investment treaties. Raising revenue does constitute a core activity of all political collectivities. However, the same can be said of many other government functions (such as administration of justice or environmental protection) that regularly give rise to claims by foreign investors.[56] For example, an effective judiciary remains vital to any concept of sovereignty.[57] Nevertheless, court proceedings have long been a fruitful source of state responsibility under both customary international law[58] and modern investment treaties.[59]

Any explanation for the treaty carve-outs given to tax measures remains tentative, and unlikely to give complete satisfaction. However, one rationale may prove more right than wrong. The best account for taxation's special status probably lies in the very nature of taxation. As mentioned earlier, tax constitutes a form of confiscation, thus opening the way to investor arguments (however, misconceived) that an actionable taking of property has occurred. Money leaves private hands and enters government coffers without any necessary *quid pro quo*. In particular, taxes lend themselves to characterization as a form of indirect or 'creeping' confiscation, which might in

56 The new generation of investment and free trade agreements now include reservations for other types of regulatory measures in the new generation of investment treaties, particularly for environmental and health regulation. See, eg Annex 10.11 of the Canada–Honduras Free Trade Agreement concerning indirect expropriation, which provides in s (c) that 'except in rare circumstances, such as when a measure or series of measures is so severe in light of its purpose that it cannot be reasonably viewed to have been adopted and applied in good faith, a non-discriminatory measure of a Party that is designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, does not constitute an indirect expropriation'.

57 Biblical scholars remember that Absalom's revolt against his father King David started with the son's claim that his father was unable to put in place an effective adjudicatory mechanism. Absalom would stand on the roadside and shout to those with pending litigation: 'Your claims are good and right; but there is no one deputed by the king to hear you. If only I were judge in the land! Then all who had a suit or cause might come to me [for] justice.' II Samuel 15 2–4. See generally Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (eds and trs Peter Baehr and Gordon Wells, 2002), Appendix II, Collected Essays in the Sociology of Religion, 365 ('Modern rational capitalism requires ... calculable law and administration conducted according to formal rules, without which no rational private economic business with standing capital ... is possible.'). See also Max Weber, *General Economic History* trans. F. Knight (Frank Knight tr, 1966) 277.

58 See JL Brierly, *The Law of Nations* (1963) 286–87, noting different views on what constitutes *déni de* justice. A narrow interpretation contends that denial of justice exists only when foreigners have been refused access to courts. The broader view includes substandard judicial acts such as corruption, dishonesty, and unwarranted delay. The term is sometimes misapplied to national court disregard of international law. In his study, *Denial of Justice in International Law* (2005), Jan Paulsson rightly suggests abandonment of the term 'substantive' denial of justice to describe such violations of the law of nations. See also AW Freeman, *The International Responsibility of States for Denial of Justice* (1938); Ian Brownlie, *Principles of Public International Law* (6th edn, 2003) 506–08.

59 See, eg *Mondev International Ltd v United States of America* (2002) ICSID Case No ARB (AF)/99/2, Award of 11 October 2002 published in 42 ILM 85 (2003); *Loewen Group, Inc v USA* (2003) ICSID Case No ARB (AF)/98/3, Final Award 26 June 2003, 42 ILM 811 (2003).

principle give rise to claims under investment treaty provisions related to expropriation and discrimination.[60]

Unlike charitable contributions or purchases of goods and services, wealth transfer through taxation remains involuntary. Taxpayers have no option to say, 'Sorry, we'll just skip this year's contribution.' The only escape lies in ceasing the activity that otherwise triggers the tax.[61]

In attempting to distinguish legitimate revenue measures from *de facto* confiscation through taxation, one is reminded of the line by US Supreme Court Justice Potter Stewart reversing a movie theater's obscenity conviction. Admitting an inability to define 'hard core' pornography, Stewart added, 'But I know it when I see it.'[62] British judges sometimes apply a similar (but less risqué) characterization test. In deciding that a floating crane was not a 'ship or vessel' for purposes of insurance policy, Lord Justice Scrutton referred to the gentleman who 'could not define an elephant but knew what it was when he saw one'.[63]

Like elephants and obscenity, the contours of legitimate taxation leave many fuzzy edges that frustrate rigorous discussion. Although telling them apart is not always easy, differences do exist between what might be called 'normal' and 'abusive' taxes. The former aims to fund government. The latter is crafted to force abandonment of a business enterprise by ruining its economic value or to provide an investor's competitors with a beneficial fiscal framework that permits more favourable competition.

As discussed below, various treaty-based limitations come into play when an investor contends that an allegedly abusive tax violates some provision of an investment convention or free trade agreement. The relevant distinctions go far beyond technical matters such as depreciation methods and timing of rebates, and touch on the very notion of revenue-raising legitimacy.[64]

60 For a South American view on tax as indirect expropriation, see Marco Chavez, 'La expropiacion indirecta y el Capitulo 10 del TLC suscrito por el Peru con Estados Unidos de Norteamerica' 4 Revista Peruana de Arbitraje (Magna, Lima ed, 2007) 367.

61 From the perspective of a government (democracy and dictatorship alike), taxation can be compared to payment for benefits such as roads, schools, and diplomatic protection. They need not involve either discrimination or a design to damage the underlying business activity. Like any analogy, the comparison is far from perfect. Analytic problems arise when one examines the relationship between the tax and the service. Although fiscal jurisdiction assumes some taxpayer contact with the state, the benefit received is rarely calibrated to the fee paid. In towns where real estate taxes finance public education, wealthy but childless homeowners pay more towards schools than modestly housed residents with large broods.

62 See *Jacobellis v Ohio* (1964) 378 US 184, 197 (concurring opinion), examining when erotic expression falls outside the limits of constitutionally protected speech. The object of inquiry was a Louis Malle film Les Amants about a woman in an unhappy marriage. See also Paul Gewirtz, 'On "I Know It When I See It"' (1996) 105 Yale LJ 1023.

63 See *Merchants Marine Insurance Co Ltd v North of England Protecting & Indemnity Association* [1926] 26 Lloyd's Rep 201, 203, 32 Com Cas 165, 172. In the Charente River near Rochefort, a steamship had collided with the crane. If the crane was a 'ship or vessel', then the insurance company apparently paid three-fourths of the damages; otherwise the damage was paid by the North of England Protecting & Indemnity Association. See also *O'Callaghan v Elliot* [1966] 1 QB 601 (a Denning decision that attributes the saying to Balfour); *Cole Brothers Ltd v Phillips* [1981] STC 671, 55 Tax Cases 188. The statement is attributed to Balcombe in the article 'Land Contracts: An Evolving Policy' (1996) J Bus Law 39, 46.

64 See discussion below in Section 3.3.3 et seq.

3.3.3. The Silesian claims

Tax-related claims have not always benefited from investment protection regimes. In the early 20th century, an arbitral tribunal took the view that fiscal measures by their nature did not constitute an expropriation. Under this now-discredited doctrine, investors had no general recourse to arbitration for relief from abusive taxation.

The origins of the case, Kügele v Polish State,[65] *lie* in a part of Central Europe called Upper Silesia, now found in the southeast corner of Poland.[66] Following the First World War, the ethnically Polish portion had become an autonomous region, while the largely German-speaking areas remained in Germany. Following uprisings among the Polish-speakers, part of Upper Silesia was awarded to Poland pursuant to a Geneva Convention brokered by the League of Nations.[67]

To address claims by Germans for expropriation, the treaty established what seems to be the first modern European investment protection regime, giving investors a direct cause of action against the host country.[68] The Arbitral Tribunal of Upper Silesia (officially '*Tribunal Arbitral de la Haute Silésie*') provided an avenue for vindication of investor rights independent of either local courts or the diplomatic protection of the investor's home state.

Under the label 'license fees' (which today might be called excise taxes), Poland had imposed an allegedly confiscatory levy on a brewery owned by an ethnic German, which according to the owner was forced to cease business because of the tax. Claiming that the tax was tantamount to expropriation, the German proprietor filed a claim for compensation.

In a 1932 decision, the Arbitral Tribunal rejected the claim on the basis that taxation by definition cannot give rise to expropriation. According to the Tribunal, the imposition of a tax implies the existence of a business, which in turn presupposes that the enterprise has not been confiscated. The arbitral tribunal, chaired by the eminent Belgian Professor, Georges Kaeckenbeeck, reasoned as follows:

65 *Kügele v Polish State* (1932). English language summary, Case No 34, *Annual Digest of Public International Law Cases* (Hersch Lauterpacht ed, 1931/1932). The terms of the relevant treaty are reproduced in Case No 33 of the Annual Digest.

66 The adjective 'Upper' remains somewhat of an irony, since the region appears in the lower right corner (the southeast) of most maps of Poland, near its borders with the Czech Republic and Slovakia. Apparently labelled for its location between the 'upper' parts of two rivers (the Oder and the Vistula) flowing down from the Silesian highlands, the region was alternatively under the control of Poland, Bohemia, Austria, Prussia, and Germany. Rich in agriculture and coal, the area included towns such as Chorzow, Katowice, and Bytom (Beutem).

67 Geneva Convention of 15 May 1922, Poland and Germany.

68 The 1922 treaty (apparently concluded only in French) can be found as an Annex in Georges Kaeckenbeeck, *The International Experiment of Upper Silesia: A Study in the Working of the Upper Silesia Settlement 1922-1937* (1942). Kaeckenbeeck served as President of the Arbitral Tribunal from 1922 through 1937. See also Georges S Kaeckenbeeck, 'Essential Human Rights' (1946) 243 Annals Am Acad Pol & Soc Sci 129. North America had experimented with a prototype of investment arbitration in 1794, when the so-called 'Jay Treaty' (named for its American negotiator John Jay) gave British creditors the right to arbitrate claims of alleged despoliation by American citizens and residents. See Treaty of Amity, Commerce and Navigation, London, 19 November 1794, US–UK, 8 Stat 116. Under art 6, damages for British creditors were to be determined by five commissioners, two appointed by the British and two by the USA. The fifth was to be chosen unanimously by the others, in default of which selection would be by lot from between candidates proposed by each side. See generally Barton Legum, 'Federalism, NAFTA Chapter Eleven and the Jay Treaty of 1794', 18 ICSID News (Spring 2001).

> The increase of the tax cannot be regarded as a taking away or impairment of the right to engage in a trade, for such taxation presupposes the engaging in the trade. *** The trader may feel compelled to close his business because of the new tax. But this does not mean that he has lost the right to engage in the trade. For had he paid the tax, he would be entitled to go on with his business.[69]

Today, such reasoning would be difficult to accept for most thoughtful observers.[70] As discussed in the following section, barriers to the arbitrability of tax disputes still exist. None of them rests on the view that fiscal measures cannot constitute a deprivation of property. Nevertheless, as will be discussed below, the question of when a tax is so burdensome as to constitute a taking is far from settled in the context of international arbitration disputes.

3.3.4 The competent authority filter

To distinguish normal and abusive taxes, many investment treaties require that claims of tax-related expropriation may be sent to arbitration only after the matter is first referred to the two competent fiscal authorities of the host and investor states.[71] For example, under NAFTA and its successor USMCA, tax authorities are given six months to try to work things out, and together may veto any arbitration implicating tax measures. The veto (sometimes called a 'filter') must be exercised *jointly* by both countries, which means that the investor loses the right to file an expropriation claim only if its own home state authorities have not been convinced to endorse the view that the tax is confiscatory.

Under the USMCA, successor to NAFTA, Article 14.8 on Expropriation and Compensation applies to a taxation measure, but only as between the USA and Mexico,[72] and only hemmed fore and aft by restrictions, including a bar on investor–state arbitration of claims for 'indirect expropriation'.[73] Other restrictions include the

69 Case No 34 (n 65) 69, summarizing with excerpts from Schiedsgericht für Oberschlesian, vol III, No 1, 24 (1932).

70 Arbitral tribunals have sometimes found, depending on the circumstances, that taxes which force a business to close may be expropriatory in nature, particularly where tax measures breached specific commitments. In determining whether the expropriation provision of an OPIC insurance policy had been triggered, the *Revere Copper* tribunal concluded that the Jamaican government's repudiation of the tax stability agreement had an economic impact forcing Revere to end operations in an environment that was no longer rational. *Revere Copper and Brass Inc v Overseas Private Investment Corporation* (1978) Award, 17 ILM 1321, 1331 and 1337. Addressing the circumstances needed to trigger the OPIC insurance policy, the tribunal considered the 'cumulative impact of the inability to make rational decisions' asking whether an investor must 'wait until there has occurred something akin to the troops coming in, little by little or all at once, in a nineteenth century sense'? The award concluded that such dramatic impact was not necessary.

71 ECT art 21(5) provides, 'The Investor or the Contracting Party alleging expropriation shall refer the issue of whether the tax is an expropriation or whether the tax is discriminatory to the relevant Competent Tax Authority.' Compare NAFTA art 2103(6) and its successor art 32.3.8 of USMCA.

72 USMCA, art 14.2(4), and Annex 14-C allow investor–state arbitration involving Canada or Canadian investors for up to three years after NAFTA's termination in relation to 'legacy investments' established or acquired prior to the USMCA.

73 US or Mexican investors may submit claims to arbitration under Annex 14-D (Mexico–US Investment Disputes) 'except with respect to indirect expropriation'. USMCA, art 14.D.3(1)(a)(i)(B). However,

procedural requirement that claimant has first initiated proceedings before a court or administrative tribunal of the host state, that claimant has received a final decision of the court or 30 months have elapsed from when the first proceedings were initiated, and that no more than four years have elapsed since the alleged breach was identified.[74] One might question how this is consistent with Appendix 3 of Annex 14-D, under which US investors may not bring arbitration against Mexico if they have alleged breach of obligations under USMCA Chapter 14 in proceedings 'before a court or administrative tribunal'. [75]

With respect to the USMCA's 'filter' provision (Article 32.3.8), arbitration between US and Mexican parties is permitted under Annex 14-D of the investment chapter, but subject to a 'filter' of government authorization. No investor may invoke expropriation as the basis for a claim if tax authorities of the two countries have determined that the measure is *not* an expropriation.[76] That provision requires an investor of the USA or Mexico seeking to invoke the expropriation provisions with respect to a taxation measure first to refer to the designated authorities of the Party of the investor and the respondent state the issue whether that measure is not an expropriation. Such reference must be made when the investor files its notice of intent to submit a claim to arbitration.

If the designated authorities do not agree to consider the issue, or fail to agree that the measure is *not* an expropriation, an investor of the USA or Mexico may submit its claim to arbitration.[77] The authorities will be given six months to determine whether the relevant measure is or is not an expropriation.

Significantly in the context of US–Mexico economic relations, the USMCA contains a provision on applicable 'Customary International Law'[78] which the Parties confirm, as referenced in relation to the 'Minimum Standard of Treatment', results from a general and consistent practice of States implicating protection of the investments of aliens.

The ECT analogue to USMCA Article 32.3.8 says only that the competent authorities shall 'strive to resolve' the issues.[79] Thus, the governmental 'meet and confer' process under the ECT takes on the nature of a conciliation stage followed by binding arbitration.[80]

'indirect expropriation' claims are apparently not excluded in relation to 'covered government contracts' under Annex 14-E.

74 USMCA, art 14.D.5(1)(a)–(c).

75 See, eg Alan Lederman, INSIGHT: USMCA Reduces NAFTA's Panel Reviews of Tax Cases, Bloomberg Daily Tax Report (15 January 2019).

76 USMCA, art 32.3.8.

77 Arbitration may be requested under either Annex 14.D.3 (the general submission of expropriation claims to arbitration) or para 2 of Annex 14.E, the Mexico/US provisions on investment disputes related to government contracts.

78 USMCA, Annex 14-A.

79 ECT, art 21(5)(b)(ii).

80 Debate exists on the existence and contours of a 'futility exception' to the referral requirement under ECT art 21(5), by which no referral would be required if such referral would obviously be futile. The *Yukos* tribunal excused the claimant investors from the referral requirement based on the exceptional circumstances of that case but other investor–state tribunals have not been interpreted as affirming the existence of a futility exception. See Green Martínez (n 37) 95–100.

3.4. Illustrative case studies

3.4.1. The tale of two cases: Occidental and Encana

In his novel *A Tale of Two Cities*, Charles Dickens addresses themes related to love, justice, and sacrifice during the French Revolution. A dissolute and habitually drunk English barrister voluntarily mounts the guillotine in Paris to save his romantic rival, a French aristocrat wrongly condemned for crimes committed by his cruel uncle. In so doing, the drunkard finds redemption through a noble act far better than he had imagined himself capable.

Tax arbitration has none of the passion of the Dickens novel. However, it does present stark contrasts of a different kind. Slight drafting differences from one treaty to another yield dramatically different levels of investor protection.

Perhaps the most striking illustration presents itself in the different treatments of Ecuador's refusal to refund VAT for purchases made by two foreign oil companies, one American and the other Canadian. The *Occidental*[81] and *Encana*[82] decisions were rendered slightly more than 18 months apart, in July 2004 and February 2006, respectively. Each addressed an oil company's entitlement to VAT refunds on goods and services in Ecuador.[83] Each related to a 'participation contract' for oil and gas exploration, whereby the foreign company bore all risk and expenses in return for a share in the production at the contract area. Each contract calculated the amount due the company as percentages of the oil extracted based on similar factors.

Here the similarities end. In *Occidental* (which arose under Ecuador's BIT with the USA), the investor won a refund. In *Encana* (brought under Ecuador's BIT with Canada), the investor lost. The cases underscore the significance of subtle treaty wording.[84]

3.4.1.1 Occidental I (2004). 3.4.1.1.1 The award. The dispute between Occidental and Ecuador arose under the 1993 bilateral investment treaty between the USA and Ecuador, with respect whether Occidental was entitled to obtain VAT refunds on payments made for goods and services purchased in connection with the production

81 *Occidental Exploration and Production Company v Ecuador* (1 July 2004). Charles Brower, Francisco Orrego Vicuña, and Patrick Barrera Sweeney. UNCITRAL arbitration, with LCIA serving as Registrar. Susan Franck, Note in 99 Am. J. Int'l L. 675 (2005).

82 *Encana v Republic of Ecuador* (6 February 2006). James Crawford and Christopher Thomas in the majority, with Horacio Grigera Naón issuing a Partial Dissenting Opinion on expropriation, reprinted 45 ILM 895 (2006) with comment by Devashish Krishan. UNCITRAL arbitration, with LCIA, serving as Registrar.

83 Taxes were imposed on local purchases and services, as well as imports of goods.

84 For other investment cases that implicate the nuance of tax measures, see eg *Marvin Roy Feldman Karpa* (n 47); Award and Dissenting Opinion of 16 December 2002, published in 42 ILM 625 (2003), finding Mexico liable for discriminatory tax under NAFTA, which in s 2803(4) says that non-discrimination provisions of art 1102 shall apply to tax measures. It is reported that the 'tax filter' discussed below was in fact applied in this case, allowing two of the three expropriation claims to pass through. See also Enron Corporation and Ponderosa Assets, *LP v The Argentine Republic*, ICSID Case No ARB/01/3, Decision on Jurisdiction of 14 January 2004. *El Paso Energy International Company v Argentine Republic*, ICSID Case No ARB/03/15, Decision on Jurisdiction of 27 April 2006; *Duke Energy International Peru Investments No 1, Ltd v Peru*, ICSID Case No ARB/03/28, Decision on Jurisdiction of 1 February 2006; *Tza Yap Shum v Peru*, ICSID Case No ARB/07/6, Award dated 7 July 2011. See generally, *Yukos v Russia* (n 28).

and export of oil under the parties' Participation Contract. Initially, Ecuador had refunded the VAT, but later changed position. Occidental alleged that the actions of the Ecuadorian revenue service amounted to breaches of Article II of the BIT, which prohibits discrimination and mandates 'fair and equitable' treatment.

The contractual aspect of the *Occidental I* dispute implicated the question of whether or not the formula for determining the oil company's participation (referred to as 'Factor X'[85]) implicitly took into account VAT reimbursement. In other words, did the contract fix the oil company's revenue (calculated according to Factor X) at a level higher than it would have been otherwise, so that the company would make enough money to offset the payment of VAT? Was the revenue participation a 'back door' form of VAT reimbursement?

The arbitral tribunal answered that question in the negative and found that Ecuador's denial of VAT refunds breached the treaty's non-discrimination provision and its duty of 'fair and equitable' treatment. Consequently, Ecuador was ordered to reimburse the VAT in an amount of $71 million plus interest.

To get to this point, however, the tribunal had to decide a preliminary jurisdictional matter related to Article 10(2) of the US–Ecuador BIT, which applies the treaty to tax matters but only with respect to several limited provisions. One was expropriation.[86] However, the tribunal found no evidence of direct or indirect expropriation and held that claim inadmissible.[87]

Another portion of Article 10(2) said that the treaty would apply to tax matters with respect to 'the observance and enforcement of terms of an investment agreement or authorization'.[88] The arbitrators found that the Participation Contract between the host state and the investor was just such an investment agreement, and the Factor X dispute related to that agreement. Consequently, the tribunal confirmed its jurisdiction.[89]

An additional consideration was found in the introductory provision in Article 10(1) which stated that with respect to its tax policies, each country should 'strive to accord fairness and equity' in the treatment of investments by the other's nationals. Finding that this provision was 'not devoid of legal significance', the arbitrators determined that its obligations were not dissimilar to the duties of 'fair and equitable' treatment in treaty Article II.[90] The tribunal read this language as imposing an obligation of fairness and equity with respect to the three categories of matters contained in Article 10, including observance of an investment agreement.

85 The terms of 'Factor X' contained in Participation Contract art 8.1 (whose subheading was titled 'Calculating Contractor Participation') apparently contain no references to cost elements or VATs, but simply allocate production volumes between Ecuador and Occidental, with the state participation in subheading 8.5 calculated simply as the difference between the number 100 and Occidental's participation percentage.

86 art 10(2)(a).

87 Occidental Award of 1 July 2004, at para 92.

88 art 10(2)(c). This provision contained its own exception for claims subject to dispute settlement procedures in a double tax treaty, or when such settlement provisions do not resolve the matter in a reasonable time. A third prong of that article (art 10(2)(b)) applied the BIT to tax matters with respect to 'transfers'.

89 Occidental Award of 1 July 2004, at para 7.

90 ibid, para 70.

Ultimately, the arbitrators found that the failure to refund the VAT was due not to any deliberate action, but from the arbitrariness of what they called 'an overall rather incoherent tax structure'.[91] Consequently, Ecuador was held to have breached its obligations to guarantee both national treatment and 'fair and equitable' treatment under Article II of the treaty.

This did not end the story, however. Ecuador challenged the award in London (the arbitral seat) under the English Arbitration Act, alleging that the arbitrators exceeded their powers by considering the VAT matter. As discussed below, the English courts supported both the arbitrators' power in the particular case to consider tax matters and the judiciary's general exercise of supervisory jurisdiction over investment arbitration.

3.4.1.1.2 The English Court Action. The 1996 English Arbitration Act contains at least two provisions permitting courts to address arbitrators' excess of authority, often articulated with reference to the French term *excès de pouvoir* or other related notions such as 'jurisdiction' or 'competence'. The first permits challenge as to 'substantive jurisdiction'.[92] For example, arbitrators appointed under a sales agreement might decide a dispute arising under a related contract such as a guarantee. Or arbitrators appointed to decide a dispute with a subsidiary corporation might adjudicate questions related to the parent entity. Questions could then present themselves as to whether power to adjudicate controversies under one agreement permits the arbitrators to address matters arising under another contract, or whether adjudicatory power over a subsidiary allows 'veil piercing' to reach a shareholder. The response, of course, would depend on the facts and circumstances of the particular case, including the language of the relevant dispute resolution clauses.

Under English law, a second ground for challenge of arbitrator excess of authority allows challenge for 'serious irregularity' which the Arbitration Act defines to include a tribunal 'exceeding its powers' in some way not covered by the provision on substantive jurisdiction (noted above), but which causes 'substantial injustice'.[93] This catch-all category could be construed to cover a variety of procedurally irregular acts which might overlap other grounds for challenge. If an arbitrator decides a dispute by flipping a coin, without listening to evidence, such behaviour might be deemed an excess of authority, as well as a refusal to provide a reasonable opportunity to be heard, thus violating the general duties of a tribunal.[94]

In the real world, of course, such matters often present themselves in scenarios that prove less than straightforward, with reasonable observers diverging on whether a decision constitutes an excess of authority or simply a 'bad award'. Indeed, at one point in the history of English jurisprudence, some judges took the position that whenever a tribunal went wrong in law it strayed outside its jurisdiction.[95]

91 ibid, para 200.

92 1996 Arbitration Act, s 67(1).

93 ibid, s 68(2)(b).

94 ibid, ss 33 and 68(2)(a).

95 See, eg the suggestion by Alfred Thompson (Tom) Denning (albeit in an administrative context) that 'Whenever a tribunal goes wrong in law it goes outside the jurisdiction conferred on it and its decision is void.' Lord Denning, *The Discipline of the Law* (1979) 74. See also *Pearlman v Keepers and Governors of*

In the context of the 2004 *Occidental* decision, Ecuador brought an action against the award on both grounds. Each was rejected.[96] Following some of the same lines of argument as the arbitral tribunal, the court determined that the dispute fell within the terms of Article 10(2)(c) of the treaty as it related to the observance and enforcement of an investment agreement. The Participation Agreement was such an agreement, and the dispute over the meaning of 'Factor X' related to that agreement.

Although the investor's claim was based on the treaty rather than a particular investment agreement, this did not prevent the tribunal from possessing jurisdiction by virtue of the treaty provisions related to the observance of investment agreements.[97] The decision was upheld by the Court of Appeal in a carefully reasoned opinion that looked to the Vienna Convention on the Law of Treaties to provide guidance in the construction of the bilateral investment treaty between Ecuador and the USA.[98]

Prior to addressing the jurisdictional challenge, the High Court also had to examine whether the challenge was 'non-justiciable' because it pertained to a treaty between two sovereigns.[99] Although acknowledging that the treaty obligations derived from public international law, the court noted that the performance of treaty-derived rights (ie the arbitration itself) had been made subject to the municipal law of England, permitting English courts to hear challenge to an award.[100]

It is important to keep in mind that the decision on 'justiciability' does not affect arbitrability either way. The award addressing the VAT questions would have remained valid even if the court had found that the BIT questions were *not* justiciable. What would have changed was not the result of the arbitration, but simply the judicial power to look at claims of excess of arbitral jurisdiction under the English Arbitration Act.

3.4.1.2 Encana. 3.4.1.2.1 The majority award. The relevant jurisdictional limits relevant to *Encana* can be found in Article 12 of the Canada–Ecuador BIT, which diverges from the analogous provisions of the US–Ecuador BIT in both form and substance.[101] The opening subsection of Article 12 of the Canadian treaty states

Harrow School [1978] 3 WLR 736, 743 (CA) ('The distinction between an error which entails absence of jurisdiction and an error made within jurisdiction is [so] fine . . . that it is rapidly being eroded.'). See generally the House of Lords decision in *Anisminic Ltd v Foreign Compensation Commission* [1969] 2 AC 147, [1969] 1 All ER 208. Of course, the House of Lords in 2005 rejected this position in *Lesotho Highlands Development Authority v Impreglio SpA* [2005] UKHL 43.

96 *Republic of Ecuador v Occidental Exploration and Production Company* (OEPC) [2006] 1 Lloyd's Rep 773, [2006] EWHC 345, 2006 WL 690585 (QBD (Comm Ct), decided 2 March 2006.

97 ibid, para 113.

98 *Republic of Ecuador v Occidental Exploration & Production Company* [2007] EWCA Civ 656. art 31 of the Vienna Convention takes into account factors such as the object and purpose of the treaty, while art 32 refers to 'supplementary means of interpretation' such as preparatory work and circumstances of conclusion.

99 Apparently the challenge to justiciability was brought with respect to the challenge under s 67 of the 1996 Arbitration Act, but not the challenge under s 68.

100 See decision of Justice Aikens in *Republic of Ecuador v Occidental Exploration and Production Company* (OEPC) [2005] 2 Lloyd's Rep 240, [2005] EWHC 774 (Comm Ct), 2005 WL 1104120, upheld by the Court of Appeal on 9 September 2005, [2005] EWCA Civ 111.

101 In addition, art 13(3)(c) of the Canada–Ecuador BIT provides that an investor may submit a matter to arbitration only if, 'if the matter involves taxation, the conditions specified in para 5 of Article XII have been fulfilled'. art 12(5) states that the tax authorities of the contracting states will be given six months

that '[e]xcept as set out in this Article, nothing in this Agreement shall apply to taxation measures.' The treaty begins with a negative but quickly proceeds to exceptions (including rules for expropriation[102] and breach of specific contracts with the central government[103]) as to which claims may be brought with respect to tax measures.

In contrast, the American convention begins with an affirmation that 'the treaty shall apply to matters of taxation' but only with respect to certain delineated measures that establish protective hedges around the general rule.

Most significant, however, was the absence of any Canadian equivalent to Article 10(1) in the US treaty, which states that the host state will 'strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party'. The Canada treaty did contain a provision stating that the expropriation provisions (requiring prompt, adequate, and effective compensation pursuant to Article 8) would apply to taxation measures.[104] Otherwise, the only tax-related right given the investor derived from fiscal measures that resulted in the breach of an agreement with the host state 'central government authorities' in which event the measures would be considered a claim for treaty violation.

Under the facts of the case, the majority of the tribunal found that failure to provide a VAT refund did not constitute a breach of any agreement between the oil company and the government of Ecuador. Moreover, no evidence persuaded the tribunal majority that the failure to give a rebate constituted a *de facto* expropriation.[105] Unlike the arbitrators in *Occidental*, the *Encana* tribunal was not able to rely on any provision concerning fair and equitable treatment in fiscal matters.[106]

3.4.1.2.2 The dissent: expropriating investment returns. A partial dissent in *Encana* disagreed with the majority's view of the benefits accorded under the investment treaty. According to the highly fact-specific dissent, the Ecuadorian Tax Court and the Ecuadorian Congress interpreted the relevant portions of the national tax statute in a fashion that discriminated against the oil and gas sectors of the economy and resulted in deprivation of property in violation of Article 8 of the investment treaty.

The dissent raised an interesting distinction between investment returns as contrasted with the investment itself, looking to the fruit rather than the tree. While admitting that Ecuador's behaviour did not give rise to indirect expropriation of the investment itself, the dissent expressed a view that revenue seemed to have been 'negatively affected' and in essence expropriated.

to reach a joint determination that a fiscal measure does not contravene an investment agreement with the central government or does not constitute an expropriation.

102 Canada–Ecuador BIT, art 8.

103 Canada–Ecuador BIT, art 13(3).

104 The 'tax filter' is applicable to expropriation claims, giving the two fiscal authorities a six-month window to impose a joint veto by determining that a tax measure does not constitute an expropriation. See Canada–Ecuador BIT, art12(4).

105 As noted below, the dissent considered that an expropriation had occurred to the extent that investment returns were negatively affected by denial of VAT refunds.

106 Pursuant to art 10(1) of the US–Ecuador treaty, a host state should strive to accord 'fairness and equity' in treatment of investments of nationals and companies of the other Party.

As discussed further below, differences of opinion exist with respect to the question of when a tax affects a revenue stream so negatively as to be considered an expropriation. In today's world, few fiscal measures reveal themselves as confiscatory or discriminatory on their face, for example, by taxing foreigners at rates of 100 per cent on profits or asset value. Sound analysis usually implicates a level of sophistication concerning measures allegedly rendering business operation futile, or making property ownership untenable.

3.4.2 *Occidental II, Burlington, and Perenco*

3.4.2.1 The participation sharing contract. Several investment treaty disputes have arisen out of Ecuador's legislation known as Law 42 (Law 2006-42), a law passed during spikes in oil prices in 2006. Law 42 was supplemented by subsequent decrees in 2008, culminating in a *caducidad* decree,[107] and, in certain instances,[108] by a physical takeover of oil blocks. Law 42 replaced a specific provision of Ecuador's hydrocarbons law and provided for a state's participation in unforeseen oil price excess profits.

Investors who initiated investment arbitration disputes in relation to Law 42 have alleged that the impact that said law had on their investments violated provisions of fair and equitable treatment and amounted to expropriation. Investors such as Burlington, Occidental, and Perenco had entered into 'participation sharing contracts' (PSCs) providing that the contractor was to assume the entire risk of oil exploration and exploitation, and would in exchange receive a share of the oil produced in accordance with the allocation formulas specified in each contract.[109] The PSCs shifted the exploration and exploitation risks from the State to the contractor in order to end excessive and inefficient costs incurred at the State's expense.[110] In the

107 In Spanish, *caducidad* literally means expiration, as in a circumstance giving rise to contract termination. Under art 74(4) of the Hydrocarbons Law in Ecuador at the time the Burlington and similar arbitrations were brought, the Ecuadorian Minister could declare *caducidad*, for example, if the Contractor unjustifiably suspended operations in the Blocks for more than 30 days.

108 *Burlington* and *Perenco* are parallel cases arising out of similar facts, because Perenco was the operator of the oil blocks and Burlington was the majority owner. In the similarly intertwined cases of Repsol and Murphy, the facts took a different turn after the imposition of Law 42. In February 2009, Ecuador and Repsol reached an oral agreement with the Ecuadorian government to amend the contract with respect to Block 16. On 12 March 2009, Murphy International sold to Repsol its entire stock in Murphy Ecuador belonging to Canam Offshore Limited, of which Murphy International was the sole owner. See *Murphy Exploration and Production Company International v Republic of Ecuador*, ICSID Case No ARB/08/4; *Murphy Exploration & Production Company – International v Republic of Ecuador*, UNCITRAL, PCA Case No AA434; *Repsol YPF Ecuador, SA and Others v Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (PetroEcuador)*, ICSID Case No ARB/08/10, which settled in February 2011. Murphy alleged in its ICSID claim that Ecuador did not provide a fair and equitable treatment to its investment and that by breaching the contract through Law 42, violated the US–Ecuador BIT's umbrella clause. Murphy further argued that Ecuador violated its duty to afford full protection and security to its investment and that Ecuador expropriated its investment. Murphy's ICSID claim was dismissed at the jurisdiction stage due to a finding that Murphy failed to abide by the BIT's notification of disputes period. Murphy then submitted another request for arbitration under the UNCITRAL Arbitration Rules. No decision on liability has yet been rendered.

109 *Burlington v Ecuador*, ICSID Case No ARB/08/5, Decision on Liability dated 14 December 2012, para 9.

110 ibid, para 10. In the case of Occidental II, under cl 4.2 of the PSC, OEPC would no longer be reimbursed for its expenditures in exploring and producing Block 15 under the previous service contract

case of *Perenco* and *Burlington*, for example, the PSCs exempted the contractor from the payment of royalties or other additional fees. Most importantly, the PSCs contained tax modification clauses, or clauses calling for the application of a 'correction factor' whenever tax changes—be it tax increases or decreases—had an impact on the economy of the contract. There was strong disagreement between the investors and Ecuador on the meaning of the correction factor clauses; in particular, whether the clauses were tax stabilization clauses or renegotiation clauses.[111]

The basic events giving rise to disputes involving Law 42 began in 2002 when oil prices began to rise. By 2006, the price of Oriente crude reached over USD 60/bbl, and Napo crude went over USD 50/bbl. By 2008, the price of oil surpassed the USD 100/bbl landmark for both Oriente and Napo crude from May to July, reaching USD 121.66/bbl for Oriente crude in June 2008.[112] According to Ecuador, this price increase from 2006 to 2008 was not foreseeable and destroyed the economic stability of the PSCs, making the allocation of oil production under the PSCs no longer fair to Ecuador in view of the remarkable increase in oil prices. In November 2005, at a time when the prices of Oriente and Napo crude were about USD 40/bbl, Ecuador invited Burlington to renegotiate the terms of the PSCs. Burlington refused to do so, arguing that the allocation of oil production was independent of the price of oil. Moreover, according to Burlington, although PSCs could be amended under certain circumstances, these circumstances did not include a change in oil prices.

In March 2006, following the breakdown of the renegotiations, Ecuador's President Palacio submitted a bill to the Ecuadorian Congress in which he proposed an additional participation for the State of 'at least 50%' on the so-called extraordinary profits, ie profits resulting from oil prices in excess of the price of oil as it stood when the PSCs were executed. In the letter explaining the purposes of the bill, President Palacio stated that the PSCs with foreign investors breached 'the principle of equity' insofar as there is no clause that allows for a modification of the oil participation share in favour of the State in case of an increase in oil prices. The overall purpose of the bill was 'to restore equity' in favour of the State. On 19 April 2006, Congress approved President Palacio's bill and enacted Law 42.

model. Instead, in return for accepting the obligation to explore, develop, and exploit Block 15, and being responsible for all the associated expenditures, OEPC received a share of the oil produced from Block 15. The amount of OEPC's participation was determined on the basis of the equation set forth in the PSC which took into account a number of factors, including the field, the rate of production, and certain agreed-upon percentages. At the end of 2005, OEPC's participation was approximately 70% of the oil produced from Block 15. *Occidental Petroleum Corporation and Occidental Exploration and Production Company v Ecuador*, ICSID Case No ARB/06/11, Award dated 5 October 2012, paras 116–117; *Perenco Ecuador Ltd v The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)*, ICSID Case No ARB/08/6, Decision on Remaining Issues of Jurisdiction and on Liability dated 12 September 2014.

111 *Burlington*, ibid, para 21. The tax modification clause of the PSC for Block 7 (one of Burlington's investments) provided as follows: in the event of a modification to the tax system or the creation or elimination of new taxes not foreseen in this Contract or of the employment contribution, in force at the time of the execution of this Contract and as set out in this Clause, which have an impact on the economy of this Contract, a correction factor will be included in the production sharing percentages to absorb the impact of the increase or decrease in the tax or in the employment contribution burden. This correction factor will be calculated between the Parties and will be subject to the procedure set forth in art thirty-one (31) of the Regulations for Application of the Law Reforming the Hydrocarbons Law.

112 *Burlington*, ibid, paras 24, 27 and 29.

3.4.2.2 Law 42: government 99 per cent participation. Law 42, which amended the Hydrocarbons Law, called for state participation with respect to 'non-agreed or unforeseen surpluses from oil selling contracts'. Nowhere in Law 42 was the word 'tax' mentioned. Rather it simply called for a 'participation' (participación) for the State with respect to the so-called extraordinary profits[113] of foreign investors who were parties to PSCs. On 13 July 2006, Ecuador issued Decree 1672 implementing Law 42 at the 50 per cent rate of State participation in the so-called 'extraordinary revenues' of the contractor.

On 4 October 2007, Ecuador issued Decree 662 increasing the State's participation in those revenues to 99 per cent. In *Occidental II, Perenco,* and *Burlington,* Ecuador eventually seized the investor's property and took control of the oil blocks.[114]

In two disputes[115] brought under the Ecuador–US Bilateral Investment Treaty, *Burlington v Ecuador* and *Occidental (II) v Ecuador*, the question of whether Law 42 and its related decrees constituted a tax took on decisive importance because of the tax carve-out in the US–Ecuador BIT which, as described above in the context of the *Occidental I* dispute, may operate as a limitation on claims for fair and equitable treatment, subject to certain exceptions.[116]

The *Burlington* tribunal, in its 2010 decision on jurisdiction, decided that Law 42 was a tax.[117] While the claimant had argued that whether Law 42 was a tax or not depended on Ecuadorian law, the *Burlington* tribunal disagreed.[118] The

113 On each barrel of oil sold at a price above the reference prices, therefore, Ecuador would receive the agreed contractual percentage of the price up to the reference price and would receive 50% of the 'extraordinary income' revenue exceeding the reference price.

114 Perenco and Burlington have brought parallel claims concerning Blocks 7 and 21 and their seizure by Ecuador; *Occidental v Ecuador*(n 110) para 200; *Perenco* (n 110) para 256.

115 The Perenco dispute was brought under the France–Ecuador BIT, a treaty which does not have a tax carve-out for fair and equitable treatment. The question of whether Law 42 was a tax, while having less importance for the investor's treaty claim, was nevertheless relevant. As a tax, Law 42 modified rights under the PSCs and breached the correction factor of the PSCs. In this regard, the *Perenco* tribunal held that '[o]n balance, having regard to its economic effect, the fact that it mandated the payment of monies to the State in accordance with a specified formula, and Perenco's contemporaneous characterisation of Law 42 as a tax to which the taxation modification clauses of the Contracts applied, the Tribunal considers that Law 42 should be treated as a taxation measure.' *Perenco* (n 110) para 377.

116 art X provides:

1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.
2. Nevertheless, the provisions of this Treaty, and in particular arts VI and VII, shall apply to matters of taxation only with respect to the following:
    a. expropriation, pursuant to art III;
    b. transfers, pursuant to art IV; or
    c. the observance and enforcement of terms of an investment agreement or authorization as referred to in art VI (1) (a) or (b), to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.

117 *Burlington v Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction, dated 2 June 2010, para 167; *Burlington* (n 109) para 31.

118 *Burlington*, Decision on Jurisdiction, dated 2 June 2010, para 161.

Burlington tribunal concluded that the question of whether Law 42 was a tax or not for the purpose of assessing its jurisdiction over Burlington's treaty claims had to be analysed under international law.

Citing *Encana* and *Duke Energy*,[119] the *Burlington* tribunal held that it did not matter whether or not, as a matter of Ecuadorian law, Law 42 was a tax. As observed by the tribunal:

> for purposes of jurisdiction, the Tribunal needs only to decide whether Law 42 is a tax for purposes of Article X of the Treaty under international law. In other words, there is no point in the Tribunal determining at this stage whether Law 42 is a tax under Ecuadorian law. In this fashion, the question of whether Law 42 is a tax under Ecuadorian law will be decided, if it needs to be decided, at the merits phase.[120]

In the *Burlington* Decision on Liability, there appears to have been no reconsideration of the characterization of Law 42 as a tax.

The tribunal confirmed its conclusion that the investor's fair and equitable treatment claims resulting from the application of Law 42 were excluded by virtue of Article X of the US–Ecuador BIT. Furthermore, the *Burlington* tribunal found that Law 42 did not fall within the exception to the carve-out for fair and equitable treatment in Article X.2(c) of the BIT, which authorizes review of matters of taxation relating to 'the observance and enforcement of the terms of an investment agreement or authorization'.[121]

Whereas the *Burlington* tribunal focused its attention on the question of whether Law 42 was a tax at the jurisdictional stage in a bifurcated proceeding, or, 'in a vacuum',[122] before a full hearing on the merits, the *Occidental II* tribunal, having decided certain jurisdictional objections launched by Ecuador at a jurisdictional stage dealing with the core of the dispute concerning the effect of a *caducidad* decree on its contractual rights, approached the question of whether Law 42 was a tax in determining quantum in the final award.[123] The impact of Law 42 on quantum resulted from

119 The *Burlington* tribunal observed in its Decision on Jurisdiction, para 164 that '[b]uilding on EnCana's ruling, Duke Energy stands for the proposition that there is "tax" under Article X of the Treaty if the following four requirements are met: (i) there is a law (ii) that imposes a liability on classes of persons (iii) to pay money to the State (iv) for public purposes. Under this definition, the Tribunal is of the view that Law 42 is a tax.' *Citing EnCana Corporation v Republic of Ecuador*, (UNCITRAL) Award dated 3 February 2006; *Duke Energy Electroquil Partners & Electroquil SA v Republic of Ecuador*, ICSID Case No ARB/04/19, Award dated 18 August 2008.

120 *Burlington* (n 117) para 163.

121 The *Burlington* tribunal concluded that because Burlington was not the direct party to the investment agreement (PSC) in question a lack of privity prevented Burlington from relying on that exception.

122 In contrast, see the *Yukos* tribunal's approach to bifurcation in *Hulley* Award, (PCA Case No AA 226) dated 18 July 2014, para 1377, where the tribunal recalled its earlier observation in interim awards that a decision under art 21 of the ECT would go to the 'heart of the merits of the dispute, in that they related to the background to and motivation behind Respondent's tax assessments, enforcement measures and other conduct, and that the Tribunal would not rule on these issues in a vacuum'.

123 This was due to the fact that Occidental's main claim concerned the effect of *caducidad* on its rights in the PSC, not Law 42. At the jurisdiction phase, Ecuador's objections focused on the alleged inarbitrability of *caducidad* decrees under Ecuadorian law. See *Occidental Petroleum Corporation and Occidental*

the fact that the investor contended that compensation for its losses should be equal to the full fair market value of the PSC as of the date of the *caducidad* decree of May 2006.

The *Occidental II* tribunal came to a very different conclusion on the nature of Law 42 than *Burlington*.[124] The *Occidental II* tribunal concluded that Ecuador's characterization of Law 42 as a tax would be 'contrary to the plain text of Law 42'. The *Occidental II* tribunal also found that Law 42 should not be characterized as a tax because it had not been enacted in accordance with the taxation procedures prescribed by Ecuador's Constitution. The *Occidental II* tribunal instead characterized Law 42 as 'a unilateral decision of the Ecuadorian Congress to allocate to the Ecuadorian State a defined percentage of the revenues earned by contractor companies'.[125]

Thus, whereas the *Burlington* tribunal framed the question of whether Law 42 was a tax as an inquiry divorced from Ecuadorian law, the *Occidental II* tribunal judged the factual nature of Law 42 and the factual question of whether it was a tax or not as a matter of Ecuadorian law. The *Occidental II* tribunal's analysis of Law 42 in terms of Ecuadorian law echoes the approach of the *Tza Yap Shum* and *Yukos* tribunals, discussed below, where domestic tax law and domestic tax procedures were assessed as part of the factual matrix to determine the purpose and effect of a tax measure under international law.[126] It also echoes the approach of the *Occidental I* tribunal (composed of different arbitrators dealing with different claims).[127] There the tribunal found that Ecuador's own behaviour and interpretation of the VAT dispute in its own courts lifted the measure outside of the meaning of a 'tax' for the purpose of a tax carve-out.

The *Occidental II* tribunal also explored the alternative interpretation of Law 42 as a tax. It found that 'even if Law 42 were a tax', it would fall within the 'exception to the exception' found in Article X.2(c) of the BIT, which authorizes review of matters

Exploration and Production Company v Ecuador, ICSID Case No ARB/06/11 (*Occidental II*), Decision on Jurisdiction dated 9 September 2008, para 42. The *Occidental II* tribunal dismissed Ecuador's jurisdictional objections. At the liability and quantum stage, the *Occidental II* tribunal examined the effects of Law 42 on damages and, therefore, had to decide whether Law 42's effects were excluded due to the tax carve-out in art X. See *Occidental v Ecuador* (n 110) para 457.

124 *Occidental v Ecuador* (2012) ibid.

125 ibid, para 510.

126 In the Yukos awards, for example, the tribunal concluded that the Russian Federation's position on VAT contradicted the Russian Federation's justification for re-attributing taxes of the trading companies to Yukos. See *Hulley Enterprises Limited* (n 28) paras 670–71. The *Tza Yap Shum v Peru* tribunal assessed whether the Peruvian tax authorities had acted in accordance with Peruvian tax and administrative law in determining whether they had disproportionate measures in breach of international law. *Tza Yap Shum* (n 84) paras 218 and 237.

127 *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN 3467, Award dated 1 July 2004, paras 72–74. The Tribunal, assessing whether the challenged tax measures were excluded from its jurisdiction under a tax carve-out provision in the Ecuador–US bilateral investment treaty, observed in para 74:

> This dispute has also a very particular meaning for the parties. In spite of it having been extensively discussed as a tax matter, a closer look might lead to the conclusion that what is really disputed is whether there is a right to refund of taxes unchallengedly due and owing and in fact paid, and, if so, how to achieve such reimbursement. In fact, the parties do not dispute the existence of the tax or its percentage. What the parties really discuss is whether its refund has been secured under Factor X of the Contract, as claimed by the Respondent, or if that is not the case, whether, as argued by the Claimant, it should be recognized as a right under Ecuadorian Tax Law.

of taxation relating to 'the observance and enforcement of the terms of an investment agreement or authorization' (ie OEPC's Participation Contract).[128]

Having determined that it had jurisdiction to review Law 42, the Tribunal concluded that 'by taking 50% of OEPC's revenues from ... production above the agreed reference price', Law 42 had 'modified unilaterally and in a substantial way the contractual and legal framework that existed at the time the claimants negotiated', and upon which they had relied in making their investment. The *Occidental II* tribunal, therefore, ruled that Law 42 breached Ecuador's treaty obligation to accord 'fair and equitable treatment' to OEPC's investment, but declined to rule on whether Law 42 breached 'other provisions' of the BIT. Most significant in terms of the investor's victory, in this case, was that the *Occidental II* tribunal refused to factor Law 42 into its valuation of OEPC's assets for damages purposes.

The *Perenco* tribunal had to examine Law 42 *not* for the purpose of determining whether a treaty tax carve-out applied, but in terms of deciding whether the law breached the tax modification provisions of the PSCs. The *Perenco* tribunal determined that Law 42 was a tax that breached Ecuador's contractual obligations under the PSCs.

The *Perenco* tribunal concluded that Decree 662 (Law 42 amended with a 99-per cent participation on extraordinary revenues) constituted an act of coercion when viewed within the context of the parties' contractual relations and could thus be regarded as a 'deviation of power'. The tribunal stated that its reliance on that expression ('deviation of power') derived from Ecuadorian law.

The tribunal further decided that the application of Decree 662, and statements of senior officials, signalled a new phase in the State's relationship with Perenco and other similarly situated oil companies. The tribunal considered the disruption of the contractual relationship by price increases to rise to an unanticipated magnitude. According to the tribunal, the 99-per cent measure converted the Participation Contracts into *de facto* service contracts, thus breaching initial agreements.[129] The *Perenco* tribunal also concluded that the 99-per cent windfall tax triggered a series of measures which, according to the tribunal, were coercive and abusive and, thus, violated the obligation to afford fair and equitable treatment under the France–Ecuador BIT.

3.4.2.3 The Decrees Qua Expropriation. The next question facing tribunals hearing disputes involving Ecuador's Law 42 was whether Law 42 itself, or any of its subsequent decrees, amounted to an expropriation. In the *Burlington* case, the investor alleged that Ecuador expropriated its investment through a series of measures, beginning with the imposition of Law 42, and ending with the physical takeover of the blocks. Burlington maintained that these measures constituted an unlawful expropriation of its investment both individually and in the aggregate.

Burlington argued that both the purpose and effect of Law 42 were expropriatory. The purpose of Law 42, as expressed by Ecuador's own congressional debate, was to re-write the terms of the PSCs through legislation. Burlington argued that Law 42

128 *Occidental v Ecuador* (n 110) para 499.

129 *Perenco* (n 110) paras 407, 409, 411, 593 and 606.

resulted in a direct expropriation of its contractual rights in the PSCs, rights that formed part of the definition of investment in the US–Ecuador treaty. In addition, Burlington argued that the economic impact of Law 42 was a substantial deprivation of its investment.[130]

In terms of the purpose of Law 42 as a tax, the *Burlington* tribunal considered that Law 42 affected the economy of the PSCs and that Ecuador failed to apply a correction factor pursuant to the tax absorption clauses and further held that Ecuador breached the tax absorption clauses of the PSCs. All of this, the *Burlington* tribunal concluded, was relevant, although by no means decisive, consideration for purposes of the expropriation analysis, which entails a broader inquiry into the investment's overall capacity to generate commercial returns for the benefit of the investor.

Thus, notwithstanding the illegality of the purpose of Law 42 as a tax designed to force an abdication of contractual rights, the *Burlington* tribunal determined that said purpose was not sufficient to characterize Law 42 as an expropriation. Rather, what mattered was the economic impact that Law 42 had on Burlington's investments.

The *Burlington* tribunal went further, stating, as a matter of general international law, that a wrongful purpose in a tax, such as a discriminatory purpose, could only be an expropriation if it resulted in a substantial deprivation. In passing, an observer might ask whether such a statement accurately represents international law. A tax imposed only on the basis of ethnicity or religion, for example, might constitute a wrongful confiscation.[131]

The *Burlington* tribunal, in explaining why the economic impact of the tax mattered more than its purpose, began by observing that it was highly doubtful that a windfall profits tax could ever constitute an expropriation because '[b]y definition, such a tax would appear not to have an impact upon the investment as a whole, but only on a portion of the profits.'[132]

Nevertheless, before dismissing the question of whether Law 42's economic impact could ever be considered expropriatory, the tribunal asked 'whether Law 42, first at 50% and then at 99%, amounted to an expropriation of Burlington's investment' in terms of economic impact.[133]

In respect to the impact of Law 42 at 50 per cent, the tribunal concluded that in relative terms:

130 *Burlington* (n 109) paras 114, 254, 337, 402 and 419.

131 Even if Nazi taxes on Jewish-owned assets did not confiscate 100% of the relevant property, such discriminatory decrees could constitute unlawful takings. The *Suhneleistung* ('atonement payment'), also known as the Jewish Capital Levy, was enacted on 12 November 1938, imposing a tax of 20% (later 25%) on the registered assets of the Jews. See generally Richard Epstein, *Takings* (1985) ch 18, 283–305. AR Albrecht, 'The Taxation of Aliens under International Law' (1952) XXIX British Yearbook of International Law, 173. According to Albrecht, 'confiscation in the guise of taxation cannot be permitted when confiscation itself is prohibited', ibid. According to the late Sir Ian Brownlie, 'Taxation which has the precise object and effect of confiscation is unlawful.' Sir Ian Brownlie, *Principles of Public International Law* (7th edn, 2008) 532.

132 The *Perenco* tribunal made a similar observation with respect to windfall profit taxes, observing that '[w]hile like any other windfall tax, Law 42 reduced Perenco's profitability, it did not deprive the Claimant of its rights of management and control over the investment in Ecuador, nor did it reach the requisite level of a substantial diminution in the value of that investment.' *Perenco* (n 110) para 672.

133 *Burlington* (n 109) paras 419, 425, 426, 429, 430 and 450.

> Law 42 at 50% reduced Burlington's take on the total oil revenues (after taxes and including operating costs) produced by the Blocks from 48.9% to 34.6% in Block 7 (a 29.2% reduction), and from 57.4% to 38.6% in Block 21 (a 32.8% reduction). If Burlington's operating costs are subtracted from its revenues, Law 42 at 50% reduced Burlington's take on total oil revenues from 38.3% to 24% in Block 7 (a 37.3% reduction), and from 48.6% to 29.9% (a 38.5% reduction) in Block 21.

The tribunal further observed that Law 42 at 50 per cent reduced Burlington's net profits by around 40 per cent (USD 23 million out of a total of USD 56.14 million). In addition, Law 42 diminished Burlington's net profits by around 62.9 per cent in 2007 (USD 52.64 million out of USD 83.6 million). On the basis of those figures among other evidence, the tribunal concluded that the effects of Law 42 at 50 per cent did not amount to a substantial deprivation of the value of Burlington's investment. Next, the *Burlington* tribunal turned to whether Law 42 at 99 per cent constituted an expropriation. The tribunal concluded that:

> Law 42 at 99% reduced Burlington's take on the total oil revenues produced by the Blocks – after taxes but including operating costs – from 48.9% to 20.5% in Block 7 (a 58% reduction), and from 57.4% to 17.1% in Block 21 (a 70.2% reduction). This approach confirms that Law 42 at 99% considerably diminished Burlington's profits, but does not prove that Burlington's investment became unprofitable or worthless.

In other words, for the *Burlington* tribunal, the Pope & Talbot 'substantial deprivation' test for expropriation had to result in rendering an investment worthless or unprofitable. According to the *Burlington* tribunal, Law 42 did not reach the level of a substantial deprivation.

The *Perenco* tribunal, like *Burlington*, focused on the economic impact of Law 42 and its subsequent decrees. As in the case of *Burlington*, the *Perenco* tribunal came to the conclusion that as long as the investor could operate and pay bills, it was not expropriated. Specifically, the *Perenco* tribunal held that 'the financial burden of paying 99% of the revenues above the reference price, while disadvantageous to Perenco, did not bring its operation to a halt or, to revert to the tests previously cited, effectively neutralise the investment or render it as if it had ceased to exist'.[134]

The findings of the *Perenco* and *Burlington* tribunals seem to support a view that in tax cases, investment arbitral tribunals require a substantial or even total economic deprivation more than simply abusive or illegal intent.[135] The economic effects-

134 *Perenco* (n 110) para 685.

135 Ilias Bantekas and Ali Lazem, *The Treatment of Taxation as Expropriatory in International Investor-State Arbitration* (OUP 2015) online, aiv030 <https://doi.org/10.1093/arbint/aiv030>; hard copy version in 35 Arbitration International 2019. Economic coercion has been found to constitute an act of unlawful expropriation. See, eg *CME v Czech Republic*, Partial Award dated 13 September 2001, para 591, where the tribunal found that '[w]hat was destroyed was the commercial value of the investment in ČNTS by reason of coercion exerted by the Media Council against ČNTS in 1996 and its collusion with Dr. Železný in 1999.'

based approach of the *Perenco* and *Burlington* tribunals is generally in line with the USA' view of 'takings', which have been found to occur when government regulations have a substantial negative economic effect on private interests.[136] When American courts address the matter of regulatory takings, they ask what governmental actions might be the functional equivalent of traditional government ouster of owners from their property.[137]

While the *Burlington* and *Perenco* tribunals asked whether Law 42 was the functional equivalent of a physical taking of property or shutdown of operations, the approach of the *Yukos* tribunal, as discussed below, focused more on illegal motive. The difference between 'effects-focused' and 'motive-based' approaches may prove significant in deciding whether a tax should be considered as a legitimate fiscal measure.[138]

3.4.3 The Yukos saga

3.4.3.1 The dispute and the Awards. In relation to tax measures implicating takings of foreign investment, perhaps the best-known case involves OAO Yukos Oil Company ('Yukos'), one of the largest oil companies in Russia before its bankruptcy in 2006. The Russian revenue authorities imposed substantial taxes and fines for alleged fiscal evasion, allegedly to remove from the political arena the company's controlling shareholder, Mr Mikhail Khodorkovsky.[139]

Ultimately, some non-Russian shareholders of Yukos initiated arbitration proceedings after failing to settle the dispute within the prescribed period under the ECT. In 2007, the shareholders filed at the PCA claims for which US$50 billion was awarded seven years later. There were in fact three Yukos arbitrations with 2014 awards rendered against the Russian Federation in favour of Hulley Enterprises, Yukos Universal Limited, and Veteran Petroleum Limited, finding that Russia's conduct had constituted an assault on Yukos and its beneficial owners in order to bankrupt Yukos and appropriate its assets.[140]

Claimants asserted that the Russian Federation failed to treat claimants' investments in Yukos in a fair and equitable manner and on a non-discriminatory basis and expropriated claimants' investments in breach of its obligations under Articles 10(1) and 13(1) of the ECT, therefore entitling claimants to full damages.

Article 10(1) of the ECT provides, *inter alia*, that all parties to the treaty shall 'encourage and create stable, equitable, favourable and transparent conditions for

136 For example, US Constitution art V provides that 'private property [shall not] be taken for public use without just compensation'.

137 *Lingle v Chevron USA Inc* (2005) 544 US 528.

138 In the Methanex case, a ban on the MTBE gasoline additive had a substantial impact on the viability of Methanex's business. However, the tribunal found that the purpose underlying the ban was not to deprive Methanex of its investment, nor was it discriminatory. *Methanex Corporation v United States of America* (UNCITRAL) Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, 44 ILM 1345.

139 See generally, Ruth Teitelbaum, 'What's Tax Got to Do with It? The Yukos Tribunal's Approach to Motive and Treaty Interpretation' (2015) 12(5) Transnational Dispute Management (TDM, OGEMID).

140 Awards of 18 July 2014 in *Hulley Enterprises Limited* (n 28); *Yukos Universal Limited* (n 28); *Veteran Petroleum Limited* (n 28) para 515.

Investors of other Contracting Parties to make Investments in its Area'. The treaty also provides for investments to be accorded 'fair and equitable treatment' not to be impaired by 'unreasonable or discriminatory measures' that interfere with management, maintenance enjoyment, or disposal of the asset.

Russia asserted that its tax authorities found Yukos to have evaded billions of rubles in Russian taxes by misrepresenting profits, requiring tax assessments to be satisfied by the auction of assets to satisfy fiscal obligations following the tax evasion. In contrast, claimants argued that Russia singled out Yukos, treating the company in a markedly different manner from other similarly situated oil companies in Russia. Moreover, differential treatment in the bankruptcy proceedings was alleged, as between creditors related to Yukos, on the one hand, and state-related creditors, on the other. In reply, Russia argued that its disputed measures were taken in accord with international standards, were reviewed and upheld by the Russian courts, and represented a legitimate exercise of state taxation power.[141]

Article 13(1) of the ECT prohibits expropriation and defines 'expropriation' as a measure 'having effect equivalent to nationalization or expropriation', except when it is '(a) for a purpose which is in the public interest; (b) not discriminatory; (c) carried out under due process of law; and (d) accompanied by the payment of prompt, adequate and effective compensation'. The claimants said that none of the four conditions were satisfied under the international legal standards; thus, the contested measure constituted 'expropriation' which resulted in the deprivation of their investments, and therefore a violation of the ECT. In response, Russia argued that measures having an effect equivalent to nationalization or expropriation must be shown to establish their claim under Article 13(1). The respondent claimed that as the tax strategy that Yukos used was an illegal tax evasion scheme under Russian law, which accords with the international legal standard, thus the respondent was exercising legitimate police power.

The arbitral tribunal unanimously declared that Respondent had breached its obligations under Article 13(1) of the ECT. The arbitral tribunal, however, found that although Russia had not explicitly expropriated the shareholders, the measures taken by Russia, in fact, had an effect equivalent to nationalization or expropriation, with the four conditions in Article 13(1) of the ECT not having been met. The result was a cost-free takeover by the state-owned oil company, Rosneft, which could not be seen as in the public interest or comporting with the due process of law. Nor had there been 'prompt, adequate, and effective compensation' paid to the claimants.

In an interim award issued earlier, on 30 November 2009, the arbitral tribunal had upheld its jurisdictional authority, subject to joinder of two jurisdictional issues on the merits phase.[142] The jurisdictional issue decided in that interim award related

141 *Yukos Universal Limited*, ibid, para 109 (quoting from Respondent's Skeleton Argument).

142 Those two reserved matters related to (i) whether claimants' allegedly illegal conduct deprived them of protection under the ECT (an 'unclean hands' objection) and (ii) whether the tribunal had competence with respect to 'Taxation Measures' other than those based on expropriatory taxes, as provided under ECT art 21. As noted below, ECT art 21 provides a general rule that 'Nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties.' The same Article then enumerates provisions that *will* apply to tax measures, including prohibitions against

to ECT application on a provisional basis, following Russian signature on 17 December 1994, even without ratification, thus benefiting investments made during the period of provisional application. Russia had argued that it could only apply provisionally those treaty provisions consistent with Russian law, which did not include the dispute resolution clauses. Yukos shareholders contended that Russia remained bound by the ECT under Article 45, which allows application of the ECT on a provisional basis.

The arbitral tribunal found that provisional application of the ECT was an 'all-or-nothing' matter. In other words, Russia could not pick between some treaty items whose provisional application might be consistent with Russian law, and some that might not. Provisional application covered the ECT treaty as a whole, which was found not inconsistent with Russian law. A keyword in the arbitral tribunal's reasoning was the 'such' in Article 45(1) of the ECT, allows a country's provisional application of the treaty only if '*such* provisional application is not inconsistent with its constitution, laws or regulations' (emphasis added). According to the arbitral tribunal, the 'such' implied application of the treaty as a whole, not particular items such as arbitration provisions.

3.4.2.2 Dutch annulment and reinstatement of the awards. These awards were ultimately annulled in the Netherlands, at the seat of the proceedings, by the Hague District Court on the basis that no valid arbitration agreement existed to support jurisdiction by the PCA tribunal under the ECT. A District Court in The Hague on 20 April 2016 annulled the awards on jurisdictional grounds, expressing a view that under Russian law, private entities could not normally arbitrate with state entities.

Yukos shareholders appealed the decision of the Hague District Court. On 18 February 2020, as this note goes to press, the Court of Appeal reinstated the award, overturning the District Court jurisdictional findings.[143] The decision implicated an analysis of Dutch Code of Civil Procedure, Article 1065, as well as the ECT provisions related to a state's consent to be bound. The Court of Appeal considered the commitment to arbitrate created when the Russian Federation signed the ECT on 17 December 1994, interpreted in light of Articles 31 and 32 of the Vienna Convention on the Law of Treaties, provide for attention to the text of the treaty as well as a principle of good faith.[144]

discrimination and uncompensated expropriation, for which investors may seek redress through arbitration. The non-discrimination rule, however, excludes from its application both income and capital taxes, as well as tax collection measures.

143 Press reports of this appellate procedure appeared in various sources. Appellate Court decision has appeared *inter alia The Economist* ('Putin v The Oligarchs: How One World in a Treaty Could Cost Russia Billions for Seizing Yukos' *The Economist* (16 February 2020) <http://www.economist.com/news/business/21696960-russia-trying-impede-enforcement-massive-damages-award-baiting-bear>. For a report on the appellate decision itself, see *Financial Times,* 19 February 2020, reports by Henry Foy and Michael Peel. The arbitration Press on 18 February 2020 reported the Hague appellate decision, eg in *Global Arbitration Review*, in a report Tom Jones titled *Russia Reels as Yukos Awards are Revived.*

144 Marike Paulsson, 'Revival of the Yukos Awards Against Russia Following the Decision of 18 February by the Court of Appeal in the Hague' (*Kluwer Arbitration Blog*, 22 February 2020) <http://arbitrationblog.kluwerarbitration.com/2020/02/22/revival-of-the-yukos-awards-against-russia-following-the-decision-of-18-february-by-the-court-of-appeal-in-the-hague>.

The final word will lie with the Dutch Supreme Court, on the Russian Federation filing of an appeal. In the interim, shareholders of Yukos may pursue proceedings to enforce the PCA decisions in jurisdiction, including the UK, the USA, France, Belgium, Germany, and India.[145]

3.5 Confiscation and tax: when do fiscal measures go too far?

Recent disputes involving tax measures and investor–state cases raise the interesting question of what constitutes a confiscatory tax on its face. In this context, one might return to the quotation of Justice Holmes that served as epigraph to this essay: taxes are what we pay for civilized society.[146] The statement appeared in a case decided at a time when the Philippine islands were an American colony. A local tax had been levied on fire insurance premiums paid by a Spanish tobacco company to English and French insurers. The majority opinion by Chief Justice Taft held the taxes to be invalid. '[A]s a state may not deprive a person of his liberty without due process of law', reasoned Taft, 'it may not compel any one within its jurisdiction to pay tribute to it for contracts or money paid to secure the benefit of contracts made and to be performed outside of the state'.[147]

Justice Holmes disagreed in a dissent that bears closer scrutiny. 'It is true', wrote Holmes, 'that every exaction of money for an act is a discouragement to the extent of the payment required'.[148] He continued, however, by noting that 'there may be a difficulty in deciding whether an imposition is a tax or a penalty. While noting that the intent to prohibit activity may be plainly expressed, Holmes concluded that sometimes a tax may be 'shown to be a penalty by its excess in amount over the tax in similar cases.[149]

This last expression, the 'excess in amount over the tax in similar cases', lies at the heart of distinctions between normal and abusive taxes. The test looks not only to the way the fiscal legislation is drafted but also to the fashion in which the measures are implemented, comparing how taxpayers are treated when in similar circumstances. While not likely to address all situations of abusive taxation, the 'similar cases' test serves as a useful starting point for identifying taxes intended to expropriate assets rather than raise revenue.

145 Yet another aspect of the Yukos saga has been reported in connection with a Swedish decision, where the Svea Court of Appeal set aside a Stockholm Chamber of Commerce award in favour of the Spanish investors in the *Quasar de Valores* arbitration (formerly known as *Renta4*), putting an end to a case that has been running for several years. The 2012 award in *Quasar de Valores* was issued by a Stockholm-seated tribunal chaired by Jan Paulsson, with Charles Brower and Toby Landau QC as co-arbitrators. The award found that Russia's actions with regard to Yukos were in breach of art 6 of the Spain–Russia bilateral investment treaty on expropriation and that the state should pay compensation.

146 *Compañía General de Tabaco de Filipinas* (n 54).

147 ibid 95.

148 It was in this context that Holmes characterized taxes as 'what we pay for civilized society, including the chance to insure'.

149 ibid 100–01. With respect to the specific tax at issue, Holmes continues, 'But here an act was done in the Islands that was intended by the plaintiff to be and was an essential step towards the insurance, and, if that is not enough, the government of the Islands was protecting the property at the very moment in respect of which it levied the tax.'

For example, taxes imposed only on people of a particular religion or race would normally be suspect, even if levied at very low rates.[150] However, the same tax (or one at a much higher rate) would pass muster if all creeds and colours were required to pay equally.[151]

Not every discriminatory tax will lack legitimacy, however. For administrative convenience, most countries impose special fiscal burdens on non-resident aliens and foreign corporations. As mentioned earlier, these include a tax on gross receipts (rather than net income) for investment returns such as dividends, interest, and royalties received by non-resident aliens, as well as taxes on the gross amount received from real property gains and taxes on branches of foreign corporations that are not imposed on domestic entities.[152]

3.6 Tax arbitration and economic prosperity

Arbitration can play a significant role in reducing the prospect of both 'hometown justice' and 'gunboat diplomacy' as twin triggers to dampen prospects for economically beneficial exchanges. Thus, enhancing reliability and impartiality in cross-border dispute resolution, arbitration can serve the long-term expectations of governments and business managers alike.

Notwithstanding that such an approach has long seemed non-controversial to thoughtful observers, not all would agree. For whatever reason, politicians of several stripes have advanced problematic rhetoric criticizing investor–state dispute resolution of the type which provides a fair resolution of tax-related conflicts. For example, such scepticism has been expressed by President Trump's appointee as US Trade Representative, Ambassador Robert Lighthizer, in exchanges with Congressman Kevin Brady, who raised concern that investor–state dispute resolution would result in lost sovereignty and facilitate business plants moving overseas.[153]

150 As has been discussed above, the *Burlington* Decision on Liability concluded that a discriminatory tax could only be expropriatory if imposed as a substantial deprivation.

151 See generally, Epstein (131) ch 18, 283–305. Professor Epstein distinguishes various forms of taxation (such as special assessments, progressive income taxes, and estate/gift taxation), with particular attention to proposals for the so-called 'flat tax' discussed in the USA from time to time.

152 On the branch profits tax, see US Internal Revenue Code, s 884, which is so patently aimed at foreigners that it can trigger application of anti-discrimination prohibitions of income tax treaties.

153 On 21 March 2018, during a House Ways & Means Committee hearing, Mr Lighthizer suggested as follows:

> 'We are skeptical about ISDS [Investor–State Dispute Resolution] for a variety of reasons .... Number one, on the U.S. side there are questions of sovereignty. **** On the outgoing side, there are many people who believe that in some circumstances, and I can discuss the varieties, that in some circumstances it's more of an outsourcing issue. So what is it? It's a situation where somebody says "I want to move a plant from Texas and I want to put it in Mexico; and when I go down there, I don't want to take the political risk that AMLO is going to win in Mexico and change my bargain. So I want the U.S. government essentially to buy political risk insurance for me." **** Our view was that rather than have this mandatory ISDS provision, which we think is a problem in terms of our sovereignty in the United States, encourages outsourcing and losing jobs in the United States, and by the way lowering standards in a variety of places, that we should be very careful before we put something like that into place.'

<https://worldtradelaw.typepad.com/ielpblog/2018/03/brady-lighthizer-isds-exchange.html>.

On the other side of the political spectrum, Senator Elizabeth Warren of Massachusetts has joined the negative assessment, both in a newspaper publication[154] and in exchanges with US government officials.[155]Similar views have been expressed by Senator Bernie Sanders and Senator Hillary Clinton.[156]

Sentiment against treaty-based investment arbitration has also been evidenced in Europe, as manifested in the landmark decision of the European Court of Justice (ECJ) in the now well-known *Achmea* decision, where the ECJ held that an arbitration provision, in a treaty between two European Union (EU) Member States,

154 Elizabeth Warren, Washington Post, 25 February 2015, Opinion, "'The Trans-Pacific Partnership Clause Everyone Should Oppose."' The Washington Post (25 February 2015). After raising the spectere of foreign companies causing damage by toxic chemicals, and then avoiding American law through international arbitration, Senator Warren asks, "'What's so wrong with the U.S. judicial system? Nothing, actually."' And of course, she would likely be correct from the perspective of Americans. One wonders, however, whether a similar perspective would be shared by companies from the USAnited States investing in Russia or China or even less exotic venues <https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html?utm_term=.9b9236872987>.

155 See Senator Warren's letter to Ambassador Robert Lighthizer, US Trade Representative, 19 September 2017, suggesting *inter alia* that:

> NAFTA's investor-state dispute settlement ("ISDS") provisions tilt the playing field even further in favor of large corporations, all while undermining United States sovereignty and leading to corporate offshoring. **** ISDS provisions allow foreign corporations to challenge U.S. laws without ever stepping foot in a U.S. court. Instead, foreign companies who do business in the U.S. are given a free pass to ignore our rules and bypass our courts - a privilege not extended to the millions of Americans living in this country.

<https://www.warren.senate.gov/files/documents/2017_09_19_NAFTA_ISDS_letter.pdf>.

Regarding NAFTA's successor, the USMCA, although her views on ISDS seem unchanged, Senator Warren has voiced support for the revised version of the treaty, invoking enhanced labour protections and the interests of farmers, despite continued availability of ISDS under the USMCA. *The Boston Globe*, 'Why Elizabeth Warren Came Around on Trump's Trade Deal' (6 January 2020) <https://www.boston.com/news/politics/2020/01/06/elizabeth-warren-trump-trade-deal>.

156 On 20 April 2016, in response to questions about the international trade partnership agreements, Senator Clinton replied, 'With respect to the flawed ISDS provisions in TPP [the Trans-Pacific Partnership Agreement] which I even wrote about in my book – I think we need to have a new paradigm for trade agreements that doesn't give special rights to corporations that workers and NGOs don't get' <https://toddntucker.com/2016/04/20/clinton-and-sanders-go-deep-on-isds/>. Senator Sanders' answered: 'The TPP creates a special dispute resolution process that allows corporations to challenge any domestic laws that could adversely impact their 'expected future profits. These challenges would be heard before UN and World Bank tribunals which could require taxpayer compensation to corporations. This process undermines our sovereignty and subverts democratically passed laws including those dealing with labor, health, and the environment. As president, I will not approve any trade agreement that gives foreign corporations the right to undermine American democracy through the disastrous Investor State Dispute Settlement system.' The Sanders quote is available at the following link, which contains his responses to a questionnaire: <https://www.citizenstrade.org/ctc/pennsylvania/files/2016/04/PAFTCPresidentialQuestionnaire_Sanders2016.pdf>.

should be deemed incompatible with EU law,[157] although the logic of that approach appears to be far from universally accepted in tax contexts, even within the EU.[158]

Putting aside rhetoric, one assumption of some attacks on investment arbitration has been that the host state (usually the respondent) will lose to the investor. While investors do sometimes win, they can also lose, as illustrated by two recent arbitral awards with tax implications. One of these cases involved Poland, and the other involves Uzbekistan.

The first case, a federal court decision involving Poland,[159] implicated allegations by American investors that the Polish government arbitrarily enforced its tax law against a company in which a predecessor of the claimant 'Schooner Capital' held a majority interest. After Poland retroactively enacted fiscal reporting requirements that the company could not comply with, seven criminal investigations were filed over a half-dozen years, with approximately 55 million zlotys (now about $14.4 million) to be paid in taxes and penalties. As a result, the company went bankrupt. The investors had filed for arbitration in Paris, under the terms of a 1994 treaty between the USA and Poland.

An arbitral tribunal consisting of three well-known arbitrators (Makhdoom Ali Khan of Pakistan, the late Professor Francisco Orrego Vicuña of Chile, and Professor Claus von Wobeser of Mexico) rendered an award on 24 November 2015, rejecting most of the investors' claims and ordering payment of net costs incurred by the state in an amount of US$2,640,447. On 2 April 2019, the *Cour d'appel de Paris*, which had heard an application to vacate the award, issued a decision rejecting the motion for award annulment.[160] In an action brought by Poland to collect the costs assessed against the investors, the Federal court in Massachusetts stayed the enforcement action brought by Poland, pending the final outcome in France pursuant to appeal to

157 ECJ Case C-284, *Slovak Republic v Achmea* (6 March 2018) (published in Official Journal on 20 April 2018). As part of a reform of its health system, the Slovak Republic opened its market to both national operators and operators of other Member States offering private sickness insurance services. Achmea, an undertaking belonging to a Netherlands insurance group, set up a subsidiary in Slovakia through which it offered sickness insurance. In 2006, the Slovak Republic partly reversed the liberalization of the private insurance market, and in 2007 prohibited the distribution of profits generated by private sickness insurance activities. Achmea brought arbitration proceedings against the Slovak Republic in 2008 pursuant to art 8 of the Bilateral Investment Treaty between Slovakia and the Netherlands. As permitted under the BIT, the Dutch claimant opted for the UNCITRAL Arbitration Rules, before an arbitral tribunal in Frankfurt. An award of €22 million in favour of Achmea was challenged in an unsuccessful annulment action, with a subsequent appeal to the German BGH (Bundesgerichtshof), which decided to stay the action with referral of key questions to the ECJ, which ultimately found that the investor–state arbitration clause in the Dutch–Slovak BIT was incompatible with EU law because it violated the principle of autonomy.

158 See 'Resolution of Tax Disputes in the European Union', EU Council Directive of 10 October 2017, proposing resolution of tax disputes by 'Advisory Commissions' or 'Alternative Dispute Resolution Commissions' composed of 'independent persons of standing' effective as of July 2019. Although competent authorities may take decisions that depart from the opinion of an Advisory Commission or Alternative Dispute Resolution Commission, failure to reach agreement will result in their being bound by the relevant opinion.

159 *Republic of Poland v Vincent Ryan, Schooner Capital and Atlantic Investment Partners*, US District Court, District of Massachusetts, 28 May 2019, Civil Action No 1:18-cv-12382-RGS. Federal Judge Stearns, looking to the 1958 New York (United Nations) Arbitration Convention, granted the investors' motion to stay recognition and enforcement of an award made in Paris pending resolution of the investors' appeal to the Cour de cassation.

160 Cour d'Appel de Paris, Pôle 1 - Chambre 1, Arrêt 2 avril 2019, N° RG 16/24358 P.

the Cour de cassation. As a condition for such stay, the court required the investors to post a bond from the date of the award until December 2020.

The other case implicated an investment in Uzbekistan by now-defunct Oxus Gold Mining PLC,[161] following a US$13 million award (approximately $10 million plus interest) which although against the host state, did not meet the expectations of the British investor, which had sought US$1.2 billion. The award had been confirmed by the Cour d'Appel in Paris, the seat of the arbitration. As in the case involving Poland, the American court stayed the enforcement action pending final resolution of the matter in France.

4. TAX TREATIES AND THE MAP[162]

4.1. The double tax concern

Traditional bilateral income tax treaties address several concerns. The taxpayer wishes to avoid double taxation, which as discussed below will often implicate the same income being taxed to the same entity by two different countries. As discussed below, in addition to such 'juridical' double taxation (two taxes on the same juridical person), the international fiscal system must also be concerned with 'economic' double taxation where the profits within a multinational group might be taxed in one country without an appropriate deduction in another. For example, a royalty included in the income of the parent licensor (in one nation) should normally be offset by a deduction in the country of the subsidiary paying the royalty fee. Yet such symmetry often proves elusive in practice.

At the same time, however, the taxing authorities have a legitimate interest in reducing instances where transactions among members of a multinational group result in erosion of the tax base through improper intra-group shifting of profits.

In respect of both concerns, tax treaties have pursued, with differing measures of vigour, the notion of 'mutual agreement' between different countries' tax authorities, with arbitration as a backstop when negotiations fail to produce a bargain acceptable to both sides. The first OECD Model Tax Convention in 1963 set forth an 'MAP', which in Article 25 required a competent authority to 'endeavor' to derive a solution, without any option of arbitration as an ultimate form of recourse.[163] Subsequently, treaties included MAP mechanisms directing negotiation, with binding arbitration as an option for competent authorities: a permissive 'may' but not a mandatory 'must'

161 *Gretton Ltd v Republic of Uzbekistan* (2019) Docket 2018cv01755 (DDC). The name of the American decision derives from the third-party funder of the arbitration, successor in interest to Oxus.

162 See generally Michelle Markham, 'The Comparative Dimension Regarding Approaches to Decision-making in International Tax Arbitration' in John H Farrar, Vai Io Lo and Bee Chen Goh (eds), *Scholarship, Practice and Education in Comparative Law: A Festschrift in Honour of Mary Hiscock* (2019) ch 7, 115; Michelle Markham, 'Litigation, Arbitration and Mediation in International Tax: An Assessment of Whether This Results in Competitive or Collaborative Relations' (2018) 11(2) Contemp Asia Arbitr J 277; Michelle Markham, 'Mandatory Binding Tax Arbitration: Is This a Pathway to a More Efficient Mutual Agreement Procedure' (2019) 35(2) Arb Int'l 149. Hans Mooij, 'Tax Treaty Arbitration' (2019) 35(2) Arb Int'l 195; Jake Heyka, 'A World Tax Court: The Solution to Tax Treaty Arbitration' (*Tax Analysis*, 15 August 2016); PK Sidhu, 'Is the Mutual Agreement Procedure Past Its "Best Before Date" and Does the Future of Tax Dispute Resolution Lie In Arbitration?' (22 October 2014) IBFD Bulletin for International Taxation No 11, 68.

163 Michelle Markham, 'The Comparative Dimension' ibid 118.

to resolve differences.[164] Later, pursuant to an OECD initiative, some treaties were amended in 2008 to require mandatory arbitration if negotiations failed.[165] Finally, the OECD initiated a 'BEPS' project addressing 'BEPS' resulting in a multilateral instrument with refinements to MAPs. Although the 'Action 14' of the BEPS initiative recommended commitment to make dispute resolution mechanisms more effective by providing for mandatory binding MAP arbitration in the bilateral tax treaties as a mechanism to guarantee that treaty-related disputes will be resolved within a specified time frame, the multilateral instrument itself allowed, but did not require, states to opt into the provisions for mandatory binding arbitration.[166]

Country-to-country arbitration under income tax treaties provides a second fertile ground for fiscal arbitration. International organizations such as the OECD and the ICC as well as several national fiscal authorities, including Austria, Belgium, Canada, Germany, and the USA, have undertaken a number of important efforts to provide for arbitration of disputes arising out of double taxation issues.[167] Such tax treaty arbitration meets the needs of multinational corporate groups seeking symmetrical treatment of income inclusions and deductions in different countries.

For example, a royalty payment might be made by a French subsidiary to its American parent. As between the French and American tax authorities, different views might exist on the correct amount of royalty. The varying applications of national anti-avoidance measures, intended to prevent abusive 'transfer pricing', might

164 See, eg the 1989 Convention between the USA and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, art 25, s 5 (quoted in Appendix A). For a different approach, involving recourse to an 'advisory commission' when mutual agreement fails, see the 1990 EC convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (No L 225/10). Official Journal of the European Communities, 90/436/EEC, art 7.

165 The earliest income tax treaty containing an arbitration provision appears to be the 1926 UK–Irish Free State convention, which in art 7 provides that questions on interpretation of the treaty 'shall be determined by such tribunal as may be agreed between them [the Parties], and the determination of such tribunal shall, as between them, be final'. Other tax treaties with arbitration provisions (both mandatory and non-mandatory) have been set forth in Appendix A.

166 According to one count, out of approximately 3000 bilateral tax treaties in effect in 2017, only 178 contained an arbitration clause. HM Pit, 'Arbitration under the OECD Multilateral Instrument: Reservations, Options and Choices' (2017) 71 Bull Int Taxn 10, Journals IBFD, 445. As discussed below, art 19 of a Multilateral Instrument, adopted that year by the OECD, introduced binding arbitration (Part VI of the Instrument) with the proviso, 'A Party may choose to apply this Part' with respect to its covered tax agreements, and adding for the avoidance of doubt that the arbitration obligations shall apply 'only where both Contracting Jurisdictions have made' notifications with the Secretary General of the OECD, defined as the Instrument's Depository.

167 William W Park and David R Tillinghast, *Income Tax Treaty Arbitration* (2004); Marcus Desax and Marc Veit, 'Arbitration of Tax Treaty Disputes: The OECD Proposal' (2007) 23 Arb Int'l 405; OECD; Improving the Resolution of Tax Treaty Disputes (OECD Committee on Fiscal Affairs, 30 January 2007); Mario Züger, *Arbitration under Tax Treaties* (2001); Zvi D Altman, *Dispute Resolution under Tax Treaties* (2005); Draft Bilateral Convention Article, Doc No 180/455 Rev (10 September 2001) (Draft Proposal by ICC Commission on Taxation); Robert Couzin, 'Arbitration in Tax Treaties' (2002) 29 TPIR 12; Sed Crest, 'A New Way to Resolve International Tax Disputes' *International Tax Review* 24 (May 2005) (Interview with Tjaco van de Houte, Secretary General of PCA). For a more doubtful view of tax treaty arbitration, see Michael J McIntyre, 'Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes' (2006) 9 Florida Tax Rev 622.

result in income to the American parent without an equal deduction to the French subsidiary.

Although not double taxation in a *juridical* sense (given the separate corporate personalities of parent and subsidiary), such situations do present *economic* double taxation. The same income is taxed twice, to the extent that an inclusion in the American company's taxable profits has not been offset by a corresponding deduction in France. The multinational's position would be that of a stakeholder, willing to pay tax to either the USA or to France, but not to both countries. Tax treaty arbitration provides one hope for fiscal symmetry, thereby reducing the fiscal barriers to cross-border trade and investment.

To meet the challenge of double taxation of cross-border transactions, the OECD's model bilateral tax treaty[168] attempts to address a number of these issues, in part by providing an MAP under Article 25 to resolve disputes between tax authorities, investors, and states about double taxation and tax loopholes.[169]

Article 25, which provides for the MAP under the model treaty, allows investors to bring double taxation claims to a 'competent authority' of either contracting state within three years.[170] Under Article 25, the competent authority 'should endeavor' to provide a mutually agreeable solution to the dispute.[171] Any solution must be reached by consensus of the parties. In theory, the MAP should allow investors to bypass unreliable domestic remedies and have their disputes resolved in a timely, predictable manner.[172]

Many countries have incorporated some form of Article 25 into their bilateral tax treaties. For example, the US–Belgium[173] and Japan–Netherlands[174] bilateral tax

168 OECD Model Convention with Respect to Taxes on Income and on Capital <http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf>.

169 In June 2015, the OECD released a package of measures for the implementation of a new Country-by-Country Reporting plan developed under the OECD/G20 BEPS Project.

170 A 'competent authority' is a term used in tax conventions to identify the position, person, or body to whom issues can be addressed within the contracting state that is one of the two parties to a tax convention. The competent authority for each country is typically identified in the Definitions article of the tax convention (for example, under art 3 (General Definitions) of the OECD Model Tax Convention). A typical designation would be 'the Minister of Finance or his authorised representative' or 'the Secretary of the Treasury or his delegate'. The authority is usually delegated within a tax administration to a level that will administer a country's MAP programme.

171 art 25(2), OECD MAP, with 2014 adjustments.

172 For example, the UK's 'Litigation and Settlement Strategy' encourages tax authorities to promote means of alternative tax dispute resolution, such as mediation and arbitration, whenever possible.

173 See art 24 of the Convention between the Government of the USA and the Government of the UK of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed on 27 November 2006, entered into force on 28 December 2007 <http://www.irs.gov/pub/irs-trty/belgiumtt06.pdf>. Arbitration is not allowed until two years after the competent authority first received the case. Belgium has complied with these dispute resolution protocols. See letter dated 14 June 2012 from the US Secretary of the Treasury to Vice-President Biden concerning Belgium's compliance <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/TreasCert-2012-Belgium-Tax-Treaty-Article-25-Certification.pdf>.

174 See art 24(5) and Protocol para 12 of Convention between the Kingdom of the Netherlands and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, which requires exhaustion of competent authority remedies before arbitration, provides for a panel of three arbitrators, and requires parties to implement the arbitral tribunal's decision within two

treaties include arbitration clauses[175] that provide for binding, mandatory, *ad hoc* arbitration governed by a traditional three-arbitrator panel that will use the 'last best offer' (or 'baseball') approach, in which each party submits its best offer and arbitrators choose which of the two offers will be used to resolve the dispute. These treaties characterize binding arbitration as a 'last resort' dispute resolution option, to be used only when the competent authority process has failed to produce voluntary consensus.[176] One scholar has observed that developed economies have chosen to incorporate the least-binding form of mandatory MAP arbitration in order to use strategies like last best offer dispute resolution methods and exhaustion clauses to limit an arbitrator's discretion to interfere with tax sovereignty.[177]

Other OECD member and observer countries have refused to incorporate Article 25(5) due to concerns about national sovereignty, domestic policy, and the relatively broad jurisdictional scope of Article 25.[178] Others have included Article 25 but have required investors to first exhaust domestic tax dispute resolution mechanisms before turning to the MAP. The non-binding, consensus-based nature of the MAP process also leads to undue delays. Even OECD countries that give investors unfettered access to the MAP have found that their competent authorities have become overburdened, with backlogs of disputes leading to three- to five-year delays. In light of the delays in the MAP process and in light of the desire to avoid domestic litigation, some companies have abandoned the MAP for *ad hoc* administrative appeals and mediation. India, for example, offers *ad hoc* tax dispute resolution under its 2009 law.[179] This situation led PricewaterhouseCoopers to declare in 2012 that 'the future [multinational tax] audit and controversy environment may demand grand ideas' such as 'an international court of tax justice', while recognizing the complex jurisdictional, sovereignty, and procedural problems such a court would present.[180]

years of receipt of the decision. Signed on 25 August 2010, entered into force in August 2012 <https://www.government.nl/documents/directives/2010/08/25/tax-treaty-between-japan-and-netherlands>.

175 The US has also included mandatory arbitration clauses in bilateral tax treaties with Canada, Germany, France, and Switzerland and will likely include such clauses in treaties with around 15 other countries in the next five years. The International Centre for Dispute Resolution will administer all US tax treaty arbitrations, see IRS website concerning mandatory tax treaty arbitration <http://www.irs.gov/Businesses/International-Businesses/Mandatory-Tax-Treaty-Arbitration>.

176 See PricewaterhouseCoopers Alert, New US–Japan tax treaty protocol to introduce mandatory arbitration, 30 January 2013.

177 Ehab Farah, 'Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem' (2009) 9 Fla Tax Rev 703, 15–17.

178 See the BEPS December 2014 Action 14 plan, 20 <http://www.oecd.org/ctp/BEPSActionPlan.pdf>. In addition, fn 1 of art 25 of the OECD model as it stood in 2008 recognized that since some members had concerns about national sovereignty and did not intend to adopt mandatory arbitration, it was 'unnecessary for OECD member countries and non-OECD economies to state their observations, reservations, and positions on the provision and its interpretation'. This has led to a lack of information about countries' positions on tax arbitration.

179 See India's 2009 amendment to its Income Tax Act of 1961, Notification No 84/2009 [FNO 142/22/2009-TPL]/SO 2958(E) dated 20 November 2009 <http://www.incometaxindia.gov.in/pages/rules/income-tax-dispute-resolution-panel-rules.aspx>.

180 See PricewaterhouseCoopers alert, Managing Tax Controversy, Challenges on the Horizon, June 2012, 35.

4.2 The OECD initiative: BEPS

4.2.1 BEPS Action Items 14 and 15

Rightly or wrongly, both governmental and private commentators have expressed concern about multinational corporations allegedly shifting profits from one country to another as part of a strategy to reduce fiscal obligations. Of course, a somewhat contrary phenomenon may also occur, as discussed below, when two nations impose an economic double taxation on the same profits, albeit on the books of related companies within a single corporate group.

The OECD initiated a project to address the so-called 'BEPS'.[181] Begun in 2013, this project led to a final report two years later, followed by signature in Paris in 2017 of a multilateral instrument on tax measures aimed at artificially moving profits to locations where the income was subject to reduced taxation.

In respect of tax arbitration, two key provisions in the final BEPS proposals lie within the so-called 'Action Items' numbered 14 and 15, dealing respectively with dispute resolution and a multilateral tax treaty.

The traditional network of international tax agreements aimed (at least ostensibly[182]) at a situation in which two nations might impose a tax on the same profits. In contrast, the BEPS initiative responded to anxiety about a different phenomenon, which in lay language might be termed 'double *non*-taxation'. Gaps or mismatches in national law might result in revenue escaping what some observers considered an appropriate level of taxation. Rightly or wrong, without timidity in asserting simple explanations for complex phenomena, some commentators suggested that base erosion was to blame for 'escalating rates of poverty, inequality and unemployment' by reason of inadequate payments of corporate tax.[183] The OECD published an 'Action Plan' with 15 items, each of which was referred to on its own as an 'Action'.

4.2.2. More effective dispute resolution mechanism

An item styled 'BEPS Action 14' addressing More Effective Dispute Resolution Mechanisms recommended changes to enhance efficiency in the arbitration provisions of Article 25 in the existing OECD Model Tax Convention, added in 2008 to

181 The OECD initiative responded to concerns expressed by the so-called 'Group of Twenty' (G-20) major economies that governments were ill-equipped to address the way global corporations allegedly exploited gaps in national laws such as to undermine fiscal fairness and integrity. The G-20 includes Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK, the USA, and the EU.

182 In some instances, the practical effect of a double tax treaty was simply to shift fiscal jurisdiction from one country to another. Credit for foreign taxes provided by national legislation often alleviated much of the double burden, giving a taxpayer an offset for amounts paid abroad. The treaty typically reduced the maximum rate at source, yielding less offset by credit, and thus more tax to the place where the taxpayer resided. For example, a $100 dividend paid by a Ruritanian company to a shareholder in the USA might be subject to a 10% withholding tax in Ruritania. The American taxpayer subject to 30% tax at home would pay $20 to the USA, with the $30 otherwise payable to the US Treasury reduced by a credit for the $10 collected abroad. If the relevant double tax treaty limited Ruritanian tax to 5%, then allocation of taxing competence would mean $25 paid to the USA and $5 to Ruritania, effectively shifting some fiscal competence from where the dividend had its source to the shareholder's residence.

183 See, eg comments made by Oxfam South Africa to the United Nations <https://www.un.org/esa/ffd/tax/Beps/CommentsEJNandOxfamSA_BEPS>.

the OECD Model Tax Convention on Income and on Capital, first published a half-century earlier.

Paragraph 5 of that article provides as follows:

> Where . . . a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and . . . the competent authorities are unable to reach an agreement to resolve that case . . .. within two years from the presentation of the case to the competent authority of the other Contracting State, [then] any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

Earlier versions of the MAP process had been hortatory (and thus largely ineffective), with an encouragement that governments 'shall endeavor' to resolve cases of disagreement by mutual agreement, but not imposing an obligation to do so.

Realizing the deficiencies in that approach, the OECD had changed its Model Convention even before the BEPS initiative, which went further in Action Item 14 to propose greater efficiencies in binding tax arbitration.

The final BEPS reports published in October 2015 included an Action Item 14 comprised of a 'minimum standard' of best practices that would enhance the commitment to mandatory binding arbitration. The 'minimum standard' includes three specific items. Member countries must ensure that:

1. treaty obligations related to the MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner;
2. the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and
3. taxpayers can access the MAP when eligible.

These standards aim to provide taxpayers with guaranteed measures, such as access to MAPs in transfer pricing, resolution in an average time frame of 24 months, publication of clear rules and guidelines, and identification of documents required for a request to initiate MAPs.

Although Action Item 14 contains detailed and lengthy obligations, the core issues of the MAP process remain unresolved. The 'duty to negotiate' does not include a 'duty to resolve'. Rather, OECD countries remain free to adopt either an optional arbitration process (in the sense that countries arbitrate only if they wish) or no arbitration process at all. The so-called 'minimum standards' impose vague language such as 'good faith' and 'average timeframe' for resolving MAP cases.[184]

Rather, Action Item 14 simply kicks the can down the road, by suggesting that a mandatory binding arbitration provision will be developed as part of the negotiation of a multilateral instrument envisaged by a subsequent Action Item of BEPS, to which we shall now turn.

4.2.3 The OECD multilateral instrument

In the final BEPS Report, Action Item 15 addresses development of a Multilateral Instrument to Modify Bilateral Tax Treaties,[185] to be styled as 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting'. Part V of that Instrument includes the traditional 'Mutual Agreement Procedure' *without* binding arbitration. Competent tax authorities of each contracting party simply confirm that they will endeavour to resolve taxation not in accordance with the treaty.

In contrast, Part VI of the Instrument, with its Articles 18–26, provides a process for mandatory binding arbitration of controversies for which the competent authorities were unable to reach an agreement. These provisions build on the existing arbitration sections in Article 25 of the OECD Model Tax Convention.

In commercial transactions, lawyers sometimes speak of 'pre-dispute' arbitration clauses and 'post-dispute' arbitration agreements.[186] An agreement to arbitrate, reached *after* a dispute arises, will, of course, bind the two disputing parties. However, the 'post-dispute' nature of the agreement makes the prospect of arbitration precarious, given that the side finding a tactical advantage in avoiding binding dispute resolution can simply say 'no' to finalization of the agreement. This distinction between 'pre-dispute' and 'post-dispute' agreements to arbitrate has long been part of national legislation, often with an aim to protect ostensibly weaker or less informed parties. For example, France has long made a distinction between the pre-dispute *clause compromissoire* and the post-dispute *compromis*, the former being valid only in contracts between merchants (*commerçants*) or persons contracting with respect to a professional activity.[187]

184 See generally SP Govind and L Turcan, 'Cross-border Tax Dispute Resolution in the 21st Century: A Comparative Study of Existing Bilateral and Multilateral Remedies' (2017) Derivatives & Financial Instruments IBFD, 3.

185 The Multilateral Instrument itself was promulgated on 24 November 2016, followed by a signing ceremony in Paris on 7 June 2017 at the OECD headquarters, with texts in both French and English, containing arts 18–26 related to arbitration. As of 19 December 2019, 93 countries had signed the instrument, and 38 had deposited an instrument of ratification, acceptance, or approval. See <http://www.oecd.org/tax/beps/beps-mli-signatories-and-parties.pdf> accessed on 11 January 2020. The Instrument came into effect on 1 July 2018. Notably, the USA did not sign the instrument, although American delegates participated actively in the BEPS process.

186 See generally, William W Park, 'Explaining Arbitration Law' in Julio César Betancourt (ed), *Defining Issues in International Arbitration: Celebrating 100 Years of the Chartered Institute of Arbitrators* (2016) 7.

187 See C Civ art 2061 (Fr) (recently liberalized by Law No 2001-420 of 15 May 2001, art 126, JO, 16 May 2001, 7776 (*Loi sur les nouvelles* relations *économiques*, art 126) to provide that '. . . a pre-dispute arbitration clause is valid in contracts concluded with respect to professional activity . . . la clause compromissoire est valable dans les contrats conclus à raison d'une activité professionnelle'). Pre-dispute clauses are now allowed among members of the so-called liberal professions (such as lawyers, doctors, and

Article 18 of the Instrument permits the contracting parties either to accept or to reject the arbitration provisions of that Part. Article 19 then continues with 'Mandatory Binding Arbitration' if the competent tax authorities 'are unable to reach an agreement to resolve' a case presented within a period of two years. In such instances, 'a person' (which is to say, the taxpayer) may trigger arbitration if that person considers that the actions of one or both of the Contracting Jurisdictions (the taxing countries) 'result or will result for that person in taxation not in accordance with the provisions' of the relevant tax treaty. In such instances, any unresolved issues 'shall, if the person so requests in writing, be submitted to arbitration' in the manner described by the instrument.

Article 20 of the Instrument provides for establishment of an 'arbitral panel' (the equivalent of a 'tribunal' in commercial and investor–state cases) with one arbitrator appointed by each state, and those two arbitrators, within 60 days of the latter appointment, selecting a third member to chair the proceedings. In default of appointment, either for a state-selected arbitrator (or for the presiding 'Chair'), the selection will be made by 'the highest ranking official of the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development', provided that such person not be a national of either of the Contracting States which are party to the dispute.

The taxpayer thus makes no direct appointment to the arbitral tribunal, unlike commercial or investor–state arbitration. Although the taxpayer may trigger the arbitration, the process remains in large measure state-to-state dispute resolution, binding on the competent authorities of the two countries.

Other aspects of the arbitral procedure remain worthy of note, contrasting with most other forms of binding international dispute resolution. For better or for worse, the arbitration provision of that multilateral instrument fixes a form of 'baseball arbitration' with an unreasoned decision, with Article 23(c) providing as follows:

> The arbitration panel shall select as its decision one of the proposed resolutions for the case submitted by the competent authorities with respect to each issue and any threshold questions, and shall not include a rationale or any other explanation of the decision. The arbitration decision will be adopted by a simple majority of the panel members. The arbitration panel shall deliver its decision in writing to the competent authorities of the Contracting Jurisdictions. The arbitration decision shall have no precedential value.

The arbitrators must thus select one of the proposed resolutions suggested by the tax authorities. Such a 'last offer' or 'baseball arbitration' process excludes any resolution of the dispute which has not been endorsed by at least one of the two governments.[188]

architects), tradesmen (such as artisans), and farmers (such as agricultures), as well as in professional partnership agreements. See generally Philippe Fouchard, 'La Laborieuse réforme de la clause compromissoire par la loi du 15 mai 2001' (2001) 3 Rev Arb 397; C Com art 631 (Fr) (covering merchants).

188 The notion of 'baseball' arbitration derives from the process for setting compensation of major league American ballplayers in the USA. The late winter often finds baseball players asking for more than the

Finally, the decision will be 'non reasoned' in the sense that it contains no explanation. For those involved in either commercial or investor–state cases, this may appear the most bizarre of provisions, given the traditional assumption that the disputing parties will be entitled to some assurance that the arbitrators have engaged in relatively rigorous analysis, rather than just flipping a coin.

5. CONCLUSION

In a world without supranational courts of mandatory jurisdiction, arbitration supplies a relatively neutral and independent adjudicatory process for the vindication of economic rights. Otherwise, each side may end up seeking the hometown justice of its own courts.

Such hometown justice, even if satisfactory to the hometown boy or girl, will not likely promote the transactional reliability on which efficient economic cooperation rests. Lack of reliable dispute resolution means either less cross-border cooperation or greater prices to justify increased risks. Even if some deals might promise profits high enough to lure adventurous entrepreneurs to take litigation risks without neutral dispute resolution, other wealth-creating transactions will not.

When cross-border business relationships implicate fiscal disputes, arbitration remains a vital option in seeking to enhance the reliability of international transactions. Arbitration of tax disputes commends itself not only for cross-border commercial transactions but also for service related to investment treaties, which attempt to balance competing interests of investors and host states, and state-to-state controversies about a mutual agreement among tax administrations.

team wish to pay. Each side must submit its 'last best offer' from which arbitrators must choose one position or the other. Faced with the prospect of an arbitrator who will see things with a relative amount of realism, the player becomes more modest in his demands, and the team more generous in its compensation. As the player moves from a request for \$10 to a request for \$6, and the team goes from its offer of \$3 to a proposal of \$5.5, the two sides find a common ground that permits last-minute settlement.

APPENDIX A: Illustrative Tax Treaty Arbitration Provisions

Optional Arbitration Provisions

Convention Between the USA and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes (Article 25, Section 5)

Bonn, August 1989

Disagreements between the Contracting States regarding the interpretation or application of this Convention shall, as far as possible, be settled by the competent authorities. If a disagreement cannot be resolved by the competent authorities it may, if both competent authorities agree, be submitted for arbitration. The procedures shall be agreed upon and shall be established between the Contracting States by notes to be exchanged through diplomatic channels.

Amended to provide for mandatory arbitration, as noted in new text (June 2006) set forth *infra*.

US Tax Convention with the Netherlands (Article 29, Section 5)

Washington, October 1993

If any difficulty or doubt arising as to the interpretation or application of this Convention cannot be resolved by the competent authorities in an MAP pursuant to the previous paragraphs of this Article, the case may, if both competent authorities and the taxpayer(s) agree, be submitted for arbitration, provided the taxpayer agrees in writing to be bound by the decision of the arbitration board. The decision of the arbitration board in a particular case shall be binding on both states with respect to that case.

OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Part VI Arbitration, Article 18). NB: Referred to as Multilateral 'Instrument' in BEPS Action Item 15

Paris, November 2016

A Party may choose to apply this Part with respect to its Covered Tax Agreements and shall notify the Depositary accordingly. This Part shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement only where both Contracting Jurisdictions have made such a notification.

Mandatory Arbitration Provision

Convention Between the USA and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Article 24, Section 7)

Bruxelles, November 2006

Where, pursuant to an MAP under this Article, the competent authorities have endeavoured but are unable to reach a complete agreement in a case, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 8 and any rules or procedures agreed upon by the Contracting States if:

a. tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;
b. the case is not a particular case that the competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration; and
c. all concerned persons agree according to the provisions of subparagraph (d) of paragraph 8.

Convention Between the Kingdom of the Netherlands and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Article 24, Section 5)
Tokyo, August 2010
Where,

a. under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention and
b. the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either Contracting State. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

Protocol Amending the Convention Between the Government of the USA and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of the Fiscal Evasion with Respect to Taxes on Income and Capital (Article X)
Paris, August 1994, as amended by the protocol signed on December 2004
Paragraph 5 of Article 26 (MAP) shall be deleted and replaced by the following paragraphs:
Where, pursuant to an MAP under this Article, the competent authorities have endeavoured but are unable to reach a complete agreement, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 6 and any rules or procedures agreed upon by the Contracting States, if:

a. tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;
b. the case is not a particular case that both competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration; and
c. all concerned persons agree according to the provisions of subparagraph (d) of paragraph 6.

An unresolved case shall not, however, be submitted to arbitration if a decision on such case has already been rendered by a court or administrative tribunal of either Contracting State.

Convention Between the USA and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes (Article XIII)
Berlin, June 2006
Paragraph 5 of Article 25 (MAP) of the Convention shall be deleted and replaced with the following paragraph:
where, pursuant to an MAP under this Article, the competent authorities have endeavoured but are unable to reach a complete agreement in a case, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 6 and any rules or procedures agreed upon by the Contracting States, if:
(a) tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;
(b) the case
(aa) is a case that
(A) involves the application of one or more articles that the Contracting States have agreed shall be the subject of arbitration and
(B) is not a particular case that the competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration, or
(bb) is a particular case that the competent authorities agree is suitable for determination by arbitration; and
(c) all concerned persons agree according to the provisions of subparagraph (d) of paragraph 6.
6. For the purposes of paragraph 5 and this paragraph, the following rules and definitions shall apply:
(a) The term 'concerned person' means the presenter of a case to a competent authority for consideration under this Article and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration;
(b) the 'commencement date' for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities;
(c) Arbitration proceedings in a case shall begin on the later of:

(aa) two years after the commencement date of that case, unless both competent authorities have previously agreed to a different date, and
(bb) the earliest date upon which the agreement required by subparagraph (d) has been received by both competent authorities;
(d) the concerned person(s), and their authorized representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board;
(e) unless any concerned person does not accept the determination of an arbitration board, the determination shall constitute a resolution by mutual agreement under this Article and shall be binding on both Contracting States with respect to that case; and
(f) for purposes of an arbitration proceeding under paragraph 5 and this paragraph, the members of the arbitration board and their staffs shall be considered 'persons or authorities' to whom information may be disclosed under Article 26 (Exchange of Information and Administrative Assistance) of the Convention.

APPENDIX B: ECT[189]

ARTICLE 21

1. Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency.
2. Article 7(3) ['no less favorable treatment' provisions] shall apply to Taxation Measures other than those on income or on capital, except that such provision shall not apply to:
   a. an advantage accorded by a Contracting Party pursuant to the tax provisions of any convention, agreement, or arrangement described in subparagraph (7)(a)(ii); or
   b. any Taxation Measure aimed at ensuring the effective collection of taxes, except where the measure of a Contracting Party arbitrarily discriminates against Energy Materials and Products originating in, or destined for the Area of another Contracting Party or arbitrarily restricts benefits accorded under Article 7(3).
3. Article 10(2) and (7) ['no less favorable' treatment provisions] shall apply to Taxation Measures of the Contracting Parties other than those on income or on capital, except that such provisions shall not apply to:

189 ECT (n 3). Entry into Force 1998.

a. impose most favoured nation obligations with respect to advantages accorded by a Contracting Party pursuant to the tax provisions of any convention, agreement, or arrangement described in subparagraph (7)(a)(ii) or resulting from membership of any Regional Economic Integration Organization; or
b. any Taxation Measure aimed at ensuring the effective collection of taxes, except where the measure arbitrarily discriminates against an Investor of another Contracting Party or arbitrarily restricts benefits accorded under the Investment provisions of this Treaty.

4. Article 29(2) to (8) [interim trade matters] shall apply to Taxation Measures other than those on income or on capital.

61 Modification based on Article 2 of the Amendment

5.
   a. Article 13 [expropriation] shall apply to taxes.
   b. Whenever an issue arises under Article 13, to the extent it pertains to whether a tax constitutes an expropriation or whether a tax alleged to constitute an expropriation is discriminatory, the following provisions shall apply:
      i. the Investor or the Contracting Party alleging expropriation shall refer the issue of whether the tax is an expropriation or whether the tax is discriminatory to the relevant Competent Tax Authority. Failing such referral by the Investor or the Contracting Party, bodies called upon to settle disputes pursuant to Article 26(2)(c) or 27(2) shall make a referral to the relevant Competent Tax Authorities;
      ii. the Competent Tax Authorities shall, within a period of six months of such referral, strive to resolve the issues so referred. Where non-discrimination issues are concerned, the Competent Tax Authorities shall apply the non-discrimination provisions of the relevant tax convention or, if there is no non-discrimination provision in the relevant tax convention applicable to the tax or no such tax convention is in force between the Contracting Parties concerned, they shall apply the non-discrimination principles under the Model Tax Convention on Income and Capital of the Organisation for Economic Cooperation and Development;
      iii. bodies called upon to settle disputes pursuant to Article 26(2)(c) or 27(2) may take into account any conclusions arrived at by the Competent Tax Authorities regarding whether the tax is an expropriation. Such bodies shall take into account any conclusions arrived at within the six-month period prescribed in subparagraph (b)(ii) by the Competent Tax Authorities regarding whether the tax is discriminatory. Such bodies may also take into account any conclusions arrived at by the Competent Tax Authorities after the expiry of the six-month period;

iv. under no circumstances shall involvement of the Competent Tax Authorities, beyond the end of the six-month period referred to in subparagraph (b)(ii), lead to a delay of proceedings under Articles 26 and 27.

6. For the avoidance of doubt, Article 14 shall not limit the right of a Contracting Party to impose or collect a tax by withholding or other means.
7. For the purposes of this Article:
   a. The term 'Taxation Measure' includes:
      i. any provision relating to taxes of the domestic law of the Contracting Party or of a political subdivision thereof or a local authority therein; and
      ii. any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound.
   b. There shall be regarded as taxes on income or on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, or substantially similar taxes, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.
   c. A 'Competent Tax Authority' means the competent authority pursuant to a double taxation agreement in force between the Contracting Parties or, when no such agreement is in force, the minister or ministry responsible for taxes or their authorized representatives.
   d. For the avoidance of doubt, the terms 'tax provisions' and 'taxes' do not include customs duties.

APPENDIX C: OECD MULTILATERAL INSTRUMENT[190]

PART VI. ARBITRATION

Article 18: Choice to apply Part VI

A party may choose to apply this Part with respect to its Covered Tax Agreements and shall notify the Depositary accordingly. This Part shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement only where both Contracting Jurisdictions have made such a notification.

190 Multilateral Instrument promulgated on 24 November 2016, followed by a signing ceremony in Paris on 7 June 2017 at the OECD headquarters, with texts in both French and English, containing arts 18–26 related to arbitration. The Instrument came into effect on 1 July 2018. As of December 2019, 93 countries had signed the instrument, and 38 had deposited an instrument of ratification, acceptance, or approval. See <http://www.oecd.org/tax/beps/beps-mli-signatories-and-parties.pdf> accessed on 11 January 2020. Notably, the USA did not sign the instrument, although American delegates participated actively in the BEPS process.

Article 19: Mandatory binding arbitration

1. Where:
   a. under a provision of a Covered Tax Agreement (as it may be modified by paragraph 1 of Article 16 (MAP)) that provides that a person may present a case to a competent authority of a Contracting Jurisdiction where that person considers that the actions of one or both of the Contracting Jurisdictions result or will result for that person in taxation not in accordance with the provisions of the Covered Tax Agreement (as it may be modified by the Convention), a person has presented a case to the competent authority of a Contracting Jurisdiction on the basis that the actions of one or both of the Contracting Jurisdictions have resulted for that person in taxation not in accordance with the provisions of the Covered Tax Agreement (as it may be modified by the Convention); and
   b. the competent authorities are unable to reach an agreement to resolve that case pursuant to a provision of a Covered Tax Agreement (as it may be modified by paragraph 2 of Article 16 (MAP)) that provides that the competent authority shall endeavour to resolve the case by mutual agreement with the competent authority of the other Contracting Jurisdiction, within a period of two years beginning on the start date referred to in paragraph 8 or 9, as the case may be (unless, prior to the expiration of that period the competent authorities of the Contracting Jurisdictions have agreed to a different time period with respect to that case and have notified the person who presented the case of such agreement), any unresolved issues arising from the case shall, if the person so requests in writing, be submitted to arbitration in the manner described in this Part, according to any rules or procedures agreed upon by the competent authorities of the Contracting Jurisdictions pursuant to the provisions of paragraph 10.
2. Where a competent authority has suspended the MAP referred to in paragraph 1 because a case with respect to one or more of the same issues is pending before court or administrative tribunal, the period provided in subparagraph (b) of paragraph 1 will stop running until either a final decision has been rendered by the court or administrative tribunal or the case has been suspended or withdrawn. In addition, where a person who presented a case and a competent authority have agreed to suspend the MAP, the period provided in subparagraph (b) of paragraph 1 will stop running until the suspension has been lifted.
3. Where both competent authorities agree that a person directly affected by the case has failed to provide in a timely manner any additional material information requested by either competent authority after the start of the period provided in subparagraph (b) of paragraph 1, the period provided in subparagraph (b) of paragraph 1 shall be extended for an amount of time equal to the period beginning on the date by which the information

was requested and ending on the date on which that information was provided.

4.

a. The arbitration decision with respect to the issues submitted to arbitration shall be implemented through the mutual agreement concerning the case referred to in paragraph 1. The arbitration decision shall be final.

b. The arbitration decision shall be binding on both Contracting Jurisdictions except in the following cases:

i. if a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. In such a case, the case shall not be eligible for any further consideration by the competent authorities. The mutual agreement that implements the arbitration decision on the case shall be considered not to be accepted by a person directly affected by the case if any person directly affected by the case does not, within 60 days after the date on which notification of the mutual agreement is sent to the person, withdraw all issues resolved in the mutual agreement implementing the arbitration decision from consideration by any court or administrative tribunal or otherwise terminate any pending court or administrative proceedings with respect to such issues in a manner consistent with that mutual agreement.

ii. if a final decision of the courts of one of the Contracting Jurisdictions holds that the arbitration decision is invalid. In such a case, the request for arbitration under paragraph 1 shall be considered not to have been made, and the arbitration process shall be considered not to have taken place (except for the purposes of Articles 21 (Confidentiality of Arbitration Proceedings) and 25 (Costs of Arbitration Proceedings)). In such a case, a new request for arbitration may be made unless the competent authorities agree that such a new request should not be permitted.

iii. if a person directly affected by the case pursues litigation on the issues which were resolved in the mutual agreement implementing the arbitration decision in any court or administrative tribunal.

5. The competent authority that received the initial request for an MAP as described in subparagraph (a) of paragraph 1 shall, within two calendar months of receiving the request:

a. send a notification to the person who presented the case that it has received the request and

b. send a notification of that request, along with a copy of the request, to the competent authority of the other Contracting Jurisdiction.

6. Within three calendar months after a competent authority receives the request for an MAP (or a copy thereof from the competent authority of the other Contracting Jurisdiction) it shall either:

a. notify the person who has presented the case and the other competent authority that it has received the information necessary to undertake substantive consideration of the case; or
b. request additional information from that person for that purpose.

7. Where pursuant to subparagraph (b) of paragraph 6, one or both of the competent authorities have requested from the person who presented the case additional information necessary to undertake substantive consideration of the case, the competent authority that requested the additional information shall, within three calendar months of receiving the additional information from that person, notify that person and the other competent authority either:
   a. that it has received the requested information; or
   b. that some of the requested information is still missing.
8. Where neither competent authority has requested additional information pursuant to subparagraph (b) of paragraph 6, the start date referred to in paragraph 1 shall be the earlier of:
   a. the date on which both competent authorities have notified the person who presented the case pursuant to subparagraph (a) of paragraph 6 and
   b. the date that is three calendar months after the notification to the competent authority of the other Contracting Jurisdiction pursuant to subparagraph (b) of paragraph 5.
9. Where additional information has been requested pursuant to subparagraph (b) of paragraph 6, the start date referred to in paragraph 1 shall be the earlier of:
   a. the latest date on which the competent authorities that requested additional information have notified the person who presented the case and the other competent authority pursuant to subparagraph (a) of paragraph 7 and
   b. the date that is three calendar months after both competent authorities have received all information requested by either competent authority from the person who presented the case.

   If, however, one or both of the competent authorities send the notification referred to in subparagraph (b) of paragraph 7, such notification shall be treated as a request for additional information under subparagraph (b) of paragraph 6.
10. The competent authorities of the Contracting Jurisdictions shall by mutual agreement (pursuant to the article of the relevant Covered Tax Agreement regarding procedures for mutual agreement) settle the mode of application of the provisions contained in this Part, including the minimum information necessary for each competent authority to undertake substantive consideration of the case. Such an agreement shall be concluded before the date on which unresolved issues in a case are first eligible to be submitted to arbitration and may be modified from time to time thereafter.

11. For purposes of applying this Article to its Covered Tax Agreements, a Party may reserve the right to replace the two-year period set forth in subparagraph (b) of paragraph 1 with a three-year period.
12. A Party may reserve the right for the following rules to apply with respect to its Covered Tax Agreements notwithstanding the other provisions of this Article:
    a. any unresolved issue arising from an MAP case otherwise within the scope of the arbitration process provided for by this Convention shall not be submitted to arbitration, if a decision on this issue has already been rendered by a court or administrative tribunal of either Contracting Jurisdiction;
    b. if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions, a decision concerning the issue is rendered by a court or administrative tribunal of one of the Contracting Jurisdictions, the arbitration process shall terminate.

Article 20: Appointment of arbitrators

1. Except to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules, paragraphs 2–4 shall apply for the purposes of this Part.
2. The following rules shall govern the appointment of the members of an arbitration panel:
    a. The arbitration panel shall consist of three individual members with expertise or experience in international tax matters.
    b. Each competent authority shall appoint one panel member within 60 days of the date of the request for arbitration under paragraph 1 of Article 19 (Mandatory Binding Arbitration). The two panel members so appointed shall, within 60 days of the latter of their appointments, appoint a third member who shall serve as Chair of the arbitration panel. The Chair shall not be a national or resident of either Contracting Jurisdiction.
    c. Each member appointed to the arbitration panel must be impartial and independent of the competent authorities, tax administrations, and ministries of finance of the Contracting Jurisdictions and of all persons directly affected by the case (as well as their advisors) at the time of accepting an appointment, maintain his or her impartiality and independence throughout the proceedings, and avoid any conduct for a reasonable period of time thereafter which may damage the appearance of impartiality and independence of the arbitrators with respect to the proceedings.
3. In the event that the competent authority of a Contracting Jurisdiction fails to appoint a member of the arbitration panel in the manner and within the time periods specified in paragraph 2 or agreed to by the competent authorities of the Contracting Jurisdictions, a member shall be appointed on

behalf of that competent authority by the highest ranking official of the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development that is not a national of either Contracting Jurisdiction.

4. If the two initial members of the arbitration panel fail to appoint the Chair in the manner and within the time periods specified in paragraph 2 or agreed to by the competent authorities of the Contracting Jurisdictions, the Chair shall be appointed by the highest ranking official of the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development that is not a national of either Contracting Jurisdiction.

Article 21: Confidentiality of arbitration proceedings

1. Solely for the purposes of the application of the provisions of this Part and of the provisions of the relevant Covered Tax Agreement and of the domestic laws of the Contracting Jurisdictions related to the exchange of information, confidentiality, and administrative assistance, members of the arbitration panel and a maximum of three staff per member (and prospective arbitrators solely to the extent necessary to verify their ability to fulfil the requirements of arbitrators) shall be considered to be persons or authorities to whom information may be disclosed. Information received by the arbitration panel or prospective arbitrators and information that the competent authorities receive from the arbitration panel shall be considered information that is exchanged under the provisions of the Covered Tax Agreement related to the exchange of information and administrative assistance.
2. The competent authorities of the Contracting Jurisdictions shall ensure that members of the arbitration panel and their staff agree in writing, prior to their acting in an arbitration proceeding, to treat any information relating to the arbitration proceeding consistently with the confidentiality and non-disclosure obligations described in the provisions of the Covered Tax Agreement related to exchange of information and administrative assistance and under the applicable laws of the Contracting Jurisdictions.

Article 22: Resolution of a case prior to the conclusion of the arbitration

For the purposes of this Part and the provisions of the relevant Covered Tax Agreement that provide for resolution of cases through mutual agreement, the MAP, as well as the arbitration proceeding, with respect to a case shall terminate if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions:

a. the competent authorities of the Contracting Jurisdictions reach a mutual agreement to resolve the case or
b. the person who presented the case withdraws the request for arbitration or the request for an MAP.

Article 23: Type of arbitration process

1. Except to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules, the following rules shall apply with respect to an arbitration proceeding pursuant to this Part:
   a. After a case is submitted to arbitration, the competent authority of each Contracting Jurisdiction shall submit to the arbitration panel, by a date set by agreement, a proposed resolution which addresses all unresolved issue(s) in the case (taking into account all agreements previously reached in that case between the competent authorities of the Contracting Jurisdictions). The proposed resolution shall be limited to a disposition of specific monetary amounts (eg of income or expense) or, where specified, the maximum rate of tax charged pursuant to the Covered Tax Agreement, for each adjustment or similar issue in the case. In a case in which the competent authorities of the Contracting Jurisdictions have been unable to reach agreement on an issue regarding the conditions for application of a provision of the relevant Covered Tax Agreement (hereinafter referred to as a 'threshold question'), such as whether an individual is a resident or whether a permanent establishment exists, the competent authorities may submit alternative proposed resolutions with respect to issues the determination of which is contingent on resolution of such threshold questions.
   b. The competent authority of each Contracting Jurisdiction may also submit a supporting position paper for consideration by the arbitration panel. Each competent authority that submits a proposed resolution or supporting position paper shall provide a copy to the other competent authority by the date on which the proposed resolution and supporting position paper were due. Each competent authority may also submit to the arbitration panel, by a date set by agreement, a reply submission with respect to the proposed resolution and supporting position paper submitted by the other competent authority. A copy of any reply submission shall be provided to the other competent authority by the date on which the reply submission was due.
   c. The arbitration panel shall select as its decision one of the proposed resolutions for the case submitted by the competent authorities with respect to each issue and any threshold questions, and shall not include a rationale or any other explanation of the decision. The arbitration decision will be adopted by a simple majority of the panel members. The arbitration panel shall deliver its decision in writing to the competent authorities of the Contracting Jurisdictions. The arbitration decision shall have no precedential value.
2. For the purpose of applying this Article with respect to its Covered Tax Agreements, a Party may reserve the right for paragraph 1 not to apply to its Covered Tax Agreements. In such a case, except to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on

different rules, the following rules shall apply with respect to an arbitration proceeding:

a. After a case is submitted to arbitration, the competent authority of each Contracting Jurisdiction shall provide any information that may be necessary for the arbitration decision to all panel members without undue delay. Unless the competent authorities of the Contracting Jurisdictions agree otherwise, any information that was not available to both competent authorities before the request for arbitration was received by both of them shall not be taken into account for purposes of the decision.
b. The arbitration panel shall decide the issues submitted to arbitration in accordance with the applicable provisions of the Covered Tax Agreement and, subject to these provisions, of those of the domestic laws of the Contracting Jurisdictions. The panel members shall also consider any other sources which the competent authorities of the Contracting Jurisdictions may by mutual agreement expressly identify.
c. The arbitration decision shall be delivered to the competent authorities of the Contracting Jurisdictions in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. The arbitration decision shall be adopted by a simple majority of the panel members. The arbitration decision shall have no precedential value.

3. A Party that has not made the reservation described in paragraph 2 may reserve the right for the preceding paragraphs of this Article not to apply with respect to its Covered Tax Agreements with Parties that have made such a reservation. In such a case, the competent authorities of the Contracting Jurisdictions of each such Covered Tax Agreement shall endeavour to reach agreement on the type of arbitration process that shall apply with respect to that Covered Tax Agreement. Until such an agreement is reached, Article 19 (Mandatory Binding Arbitration) shall not apply with respect to such a Covered Tax Agreement.
4. A Party may also choose to apply paragraph 5 with respect to its Covered Tax Agreements and shall notify the Depositary accordingly. Paragraph 5 shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement where either of the Contracting Jurisdictions has made such a notification.
5. Prior to the beginning of arbitration proceedings, the competent authorities of the Contracting Jurisdictions to a Covered Tax Agreement shall ensure that each person that presented the case and their advisors agree in writing not to disclose to any other person any information received during the course of the arbitration proceedings from either competent authority or the arbitration panel. The MAP under the Covered Tax Agreement, as well as the arbitration proceeding under this Part, with respect to the case shall terminate if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions, a person that presented the case or one of that person's advisors materially breaches that agreement.

6. Notwithstanding paragraph 4, a Party that does not choose to apply paragraph 5 may reserve the right for paragraph 5 not to apply with respect to one or more identified Covered Tax Agreements or with respect to all of its Covered Tax Agreements.
7. A Party that chooses to apply paragraph 5 may reserve the right for this Part not to apply with respect to all Covered Tax Agreements for which the other Contracting Jurisdiction makes a reservation pursuant to paragraph 6.

Article 24: Agreement on a different resolution

1. For purposes of applying this Part with respect to its Covered Tax Agreements, a Party may choose to apply paragraph 2 and shall notify the Depositary accordingly. Paragraph 2 shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement only where both Contracting Jurisdictions have made such a notification.
2. Notwithstanding paragraph 4 of Article 19 (Mandatory Binding Arbitration), an arbitration decision pursuant to this Part shall not be binding on the Contracting Jurisdictions to a Covered Tax Agreement and shall not be implemented if the competent authorities of the Contracting Jurisdictions agree on a different resolution of all unresolved issues within three calendar months after the arbitration decision has been delivered to them.
3. A Party that chooses to apply paragraph 2 may reserve the right for paragraph 2 to apply only with respect to its Covered Tax Agreements for which paragraph 2 of Article 23 (Type of Arbitration Process) applies.

Article 25: Costs of arbitration proceedings

In an arbitration proceeding under this Part, the fees and expenses of the members of the arbitration panel, as well as any costs incurred in connection with the arbitration proceedings by the Contracting Jurisdictions, shall be borne by the Contracting Jurisdictions in a manner to be settled by mutual agreement between the competent authorities of the Contracting Jurisdictions. In the absence of such agreement, each Contracting Jurisdiction shall bear its own expenses and those of its appointed panel member. The cost of the chair of the arbitration panel and other expenses associated with the conduct of the arbitration proceedings shall be borne by the Contracting Jurisdictions in equal shares.

Article 26: Compatibility

1. Subject to Article 18 (Choice to Apply Part VI), the provisions of this Part shall apply in place of or in the absence of provisions of a Covered Tax Agreement that provide for arbitration of unresolved issues arising from an MAP case. Each Party that chooses to apply this Part shall notify the Depositary of whether each of its Covered Tax Agreements, other than those that are within the scope of a reservation under paragraph 4, contains such a provision, and if so, the article and paragraph number of each such provision. Where two Contracting Jurisdictions have made a notification with respect to

a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of this Part as between those Contracting Jurisdictions.

2. Any unresolved issue arising from an MAP case otherwise within the scope of the arbitration process provided for in this Part shall not be submitted to arbitration if the issue falls within the scope of a case with respect to which an arbitration panel or similar body has previously been set up in accordance with a bilateral or multilateral convention that provides for mandatory binding arbitration of unresolved issues arising from an MAP case.
3. Subject to paragraph 1, nothing in this Part shall affect the fulfilment of wider obligations with respect to the arbitration of unresolved issues arising in the context of an MAP resulting from other conventions to which the Contracting Jurisdictions are or will become parties.
4. A Party may reserve the right for this Part not to apply with respect to one or more identified Covered Tax Agreements (or to all of its Covered Tax Agreements) that already provide for mandatory binding arbitration of unresolved issues arising from an MAP case.