

KEY POINTS

- Some tribunals set a higher threshold for expropriation as a result of taxation measures.
- Other tribunals apply ordinary principles.
- The general trend towards analysing the purpose of the fiscal measure is to be welcomed.

Author Matthieu Gregoire

Taxation and expropriation under bilateral investment treaties: setting the standard

Barrister Matthieu Gregoire considers the differing approaches of tribunals in Bilateral Investment Treaty disputes in determining whether tax measures imposed by the State amount to expropriation of an investor's assets.

INTRODUCTION

A prudent investor will factor in the likelihood that a tax regime may change over the course of its investment in the host State.¹ Despite this, radical shifts in tax regimes may have catastrophic consequences for an investor.

Tribunals have been ready to find that tax measures may amount to expropriation. However, the difficulty in balancing investors' rights under Bilateral Investment Treaties (BITs) with the importance of allowing States to regulate their own fiscal affairs has led to radically different approaches by tribunals.

BITS AND TAXATION: THREE APPROACHES IN INTERNATIONAL TREATIES

The level of protection afforded against taxation measures within BITs varies:²

- Many investment treaties have clauses that exclude tax matters from the jurisdiction of an investment treaty dispute, mostly in relation to the Most Favoured Nation (MFN) or National Treatment clauses.³ This approach is consistent with the view that a State's control over its fiscal regime is a linchpin of sovereignty.
- Investment treaties occasionally contain qualified exclusions, such as Art 21(1) of the Energy Charter Treaty, Art 2103 of NAFTA or Art XIII of the US model BIT, which delineate the circumstances in which taxation measures may be arbitrable.

- Some BITs contain no limitation or exclusion of tax measures from the protections they afford.

For those treaties that do not contain a carve-out for fiscal measures, tribunals have readily asserted jurisdiction over disputes arising out of tax measures.⁴ This is largely because rather than the tax measure itself being the subject of the arbitration, it is the effect of that measure on the investor, which elevates the dispute to an investment-treaty dispute.

DEALING WITH TAXATION: ARBITRAL PRACTICE

Allowing for the differences in wording of the relevant BITs, arbitral tribunals have dealt with the matter in two main ways: some have appeared to set a distinctly higher threshold for (usually indirect) expropriation as a result of taxation measures; others apply – or seek to apply – the same standard for expropriation regardless of the measure at issue.

Applying a higher standard to taxation measures

The narrow relationship between sovereignty and regulations of fiscal measures has led some tribunals to adopt an arguably more deferential approach. In *EnCana v Ecuador*, the tribunal considered that:⁵

“From the perspective of expropriation, taxation is in a special category. In principle a tax law creates a new legal

liability on a class of persons to pay money to the State in respect of some defined class of transactions, the money to be used for public purposes. In itself such a law is not a taking of property; if it were, a universal State prerogative would be denied by a guarantee against expropriation, which cannot be the case. Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised.”

It further emphasised that:

“In the absence of a specific commitment from the host State, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment. Of its nature taxation reduces the economic benefits an enterprise would otherwise derive from the investment; it will only be in an extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed.”⁶

In *Link-Trading v Moldova*,⁷ a dispute concerning the withdrawal of customs and tax exemptions, the tribunal also appeared to consider that, by its very nature, taxation warranted special treatment. Noting that “customs policy is a matter that clearly falls within the customary regulatory powers of the state”,⁸ the tribunal emphasised that “[a]s a general matter, fiscal measures only become expropriatory when they are found to be an abusive taking”.⁹

Feature

Toward the application of ordinary principles of expropriation to tax measures?

Other tribunals have considered that the ordinary principles of expropriation are perfectly capable of dealing justly with fiscal measures. Prior to the *EnCana v Ecuador* decision, the tribunal in *Feldman v Mexico*¹⁰ had considered that a tax measure may amount to expropriation where the investor had an acquired right, with regard to which, the authorities, by virtue of a “sufficiently restrictive” measure, had behaved in a discriminatory, or arbitrary way. However, the tribunal found that there had been no (indirect) expropriation,¹¹ on the basis of a combination of the following:¹²

- trol over the investment);
- was not a disproportionate exercise of State power, taking into account the need the measure was addressing;
- was not permanent.

The tribunal appeared to base its rejection of the expropriation claim largely on the experts’ concession on the profitability of the investments despite the measures, impliedly accepting the test put forth by the Respondent.¹⁵

In *Occidental v Ecuador*,¹⁶ the tribunal also appeared to apply a more general threshold of expropriation,¹⁷ finding that the measure was “tantamount to expropriation” on the basis of the test set out in *Metalclad v Mexico*, namely that:¹⁸

... the difficulty in dealing with fiscal regimes in the context of investment treaty arbitration has led to somewhat contradictory decisions.

- not every business problem experienced by a foreign investor is an expropriation under Art 1110;
- NAFTA and principles of customary international law do not require a State to permit “grey market” exports of cigarettes;
- at no time had the relevant law afforded Mexican cigarette resellers a “right” to export cigarettes;
- the Claimant’s investment remained under the complete control of the Claimant.

In *Paushok v Mongolia*,¹³ the tribunal appeared to reject the Claimant’s analysis, which was based on its interpretation of *EnCana v Ecuador*. The Respondent had maintained that the ordinary principles set out in *LG&E v Argentina* applied to expropriatory claims,¹⁴ and that there therefore could not be a finding of expropriation as the measure:

- did not deprive the investor of essentially the entire benefit of their investment (there was no substantial impact translating into a loss of con-

“Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State”

Practical effects of contrasting approaches by tribunals

In practical terms, the difficulty in dealing with fiscal regimes in the context of investment treaty arbitration has led to somewhat contradictory decisions. In rejecting a claim for expropriation, the tribunal in *Paushok v Mongolia*¹⁹ considered the fact that other mines were able to operate under the relevant tax legislation, that there was no loss of control of the investment on the part

of the investor and that the investor made a slight profit notwithstanding the measure. The tribunal in *EnCana v Ecuador* also found the fact that the investor made a profit to be a relevant consideration.²⁰

In contrast, in *Revere Brass and Copper*,²¹ the (domestic) arbitration tribunal found that the imposition of a new production tax which prevented Revere “from exercising effective control over the use of disposition of a substantial portion of its property” amounted to expropriation even though the investor was making a profit.

A purposive approach?

Consistent with the application of an “ordinary” standard for expropriation, certain recent decisions have sought to focus on the effects of the measure rather than the decision itself. In *Quasar de Valores et al v The Russian Federation*,²² the tribunal set out the test as follows: “if the ostensible collection of taxes is determined to be part of a set of measures designed to effect a dispossession outside the normative constraints and practices of the taxing authorities”,²³ these could amount to expropriation for purposes of the investment protection treaty.

The tribunal in *Yukos v The Russian Federation* appeared to have adopted a similarly purposive approach. Responding to the question put by Counsel for the claimant to the arbitral tribunal in the *Quasar* arbitration, namely “[w]hy would Russia have treated Yukos as it did if its purpose was to collect taxes?”,²⁴ the tribunal concluded that “the primary objective of the Russian Federation was not to collect taxes but rather to bankrupt Yukos and appropriate its valuable assets”.²⁵

Given this primary purpose, the tribunal concluded that while the Russian Federation had not explicitly expropriated Yukos, or the holdings of its shareholders, the measures that the Russian Federation had taken in respect of Yukos had an effect equivalent to nationalisation or expropriation.²⁶

Biog box

Mathieu Gregoire is a barrister practising from Henderson Chambers, specialising in arbitration (both investment treaty and commercial) and commercial litigation.
Email: mgregoire@hendersonchambers.co.uk

CONCLUDING REMARKS

While the importance of fiscal measures to national sovereignty cannot be disputed, there appears to be no foundation – whether in international customary law or on the basis of treaty interpretation – for tribunals to heighten the threshold for a finding of expropriation to be made where the offending measure is taxation. The general trend towards analysing the purpose of the measure, and applying the usual standard for expropriation, is to be welcomed. ■

- 1 As noted by the tribunal in *Paushok v Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011, at s 302.
- 2 See, more generally, UNCTAD *Series on Issues in International Investment Agreement*, "Taxation", Geneva, 2000.
- 3 See, for example, Art 7(B) of the 1991 BIT between the Republic of Korea and Mongolia; Art 4(3) of the Chilean model BIT; Art 3(3) of the Chinese Model BIT; Art 4 of the French model BIT; Art 3(4) of the German Model BIT; Art 4(4) of the Swiss Model BIT; Art 7 of the UK Model BIT.
- 4 See, for example, in the context of the interpretation of Art 25 of the ICSID Convention; *Amco v Indonesia* ICSID Case No ARB/81/1; *Kaiser Bauxite v Jamaica* ICSID Case No ARB/74/3, Decision on Jurisdiction and Competence of 6 July 1975; *Alcoa Minerals v Jamaica* ICSID Case No ARB/74/2, Decision on Jurisdiction and Competence of 6 July 1975; *Goetz v Burundi* ICSID Case No ARB/95/3, Award of 10 February 1999; *Feldman v Mexico*, ICSID

Case No ARB(AF)/99/1, Award of 16 December 2002. See, generally Matthew Davie, *Taxation-Based Investment Treaty Claims*, J Int. Disp. Settlement (2015) 6 (1): 202–227

- 5 *EnCana Corporation v Ecuador*, LCIA Case No UN3481, Award, 3 February 2006, s 177.
- 6 *EnCana Corporation v Ecuador*, LCIA Case No UN3481, Award, 3 February 2006, s 173.
- 7 *Link-Trading Joint Stock Company v Moldova*, UNCITRAL, Final Award dated 18 April 2002.
- 8 *Link-Trading Joint Stock Company v Moldova*, UNCITRAL, Final Award dated 18 April 2002, s 68.
- 9 *Link-Trading Joint Stock Company v Moldova*, UNCITRAL, Final Award dated 18 April 2002, s 64.
- 10 *Feldman v Mexico*, ICSID Case No ARB(AF)/99/1, Award dated 16 December 2002.
- 11 Direct expropriation was not at issue in that case.
- 12 *Feldman v Mexico*, ICSID Case No ARB(AF)/99/1, Award dated 16 December 2002, at ss110 et seq.
- 13 *Paushok v Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011.
- 14 *LG&E v Argentina*, ICSID Case No ARB/02/1, Award on Liability, 3 October 2006.
- 15 *Paushok v Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011, ss 330–336.
- 16 *Occidental Petroleum Corporation v Ecuador*, ICSID Case No ARB/06/11, Award dated 5 October 2012.
- 17 *Occidental Petroleum Corporation v Ecuador*, ICSID Case No ARB/06/11, Award dated 5 October 2012, ss 453–455.
- 18 *Metalclad Corporation v The United Mexican States* (ICSID Case No ARB(AF)/97/1), Award dated 30 August 2000, s 103.
- 19 *Paushok v Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011.
- 20 *EnCana Corporation v Ecuador*, LCIA Case No UN3481, Award, 3 February 2006, s 174.
- 21 *Revere Copper & Brass, Inc v Overseas Private Investment Corporation* (1978) 56 ILR 258.
- 22 *Quasar de Valores et al v The Russian Federation*, SCC, Award dated 20 July 2012.
- 23 *Quasar de Valores et al v The Russian Federation*, SCC, Award dated 20 July 2012, s 48.
- 24 *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No AA 227, Final Award dated 18 July 2014, at s 755.
- 25 *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No AA 227, Final Award dated 18 July 2014, at ss 756 ; 1579.
- 26 *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No AA 227, Final Award dated 18 July 2014, at s 1579.

Further Reading:

- *Bail-ins and the international investment law of expropriation: in and beyond Cyprus* [2013] 8 JIBFL 475.
- *Expropriation: investment protection and mitigating the risks* [2010] 6 JIBFL 349.

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