

**Taxation of Foreign Investments
under International Law:
Article 21
of the Energy Charter
Treaty in Context**

by Uğur Erman Özgür
for Energy Charter Secretariat



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ENERGY CHARTER SECRETARIAT
2015

ABOUT THE ENERGY CHARTER

The Energy Charter Secretariat is a permanent office based in Brussels supporting the Energy Charter Conference in the implementation of the Energy Charter Treaty.

The Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994 and entered into legal force in April 1998. To date, the Treaty has been signed or acceded to by 52 states, the European Community and Euratom (the total number of its members is therefore 54).

The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues by creating a level playing field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-related investment and trade.

In a world of increasing interdependence between net exporters of energy and net importers, it is widely recognised that multilateral rules can provide a more balanced and efficient framework for international cooperation than is offered by bilateral agreements alone or by non-legislative instruments. The Energy Charter Treaty therefore plays an important role as part of an international effort to build a legal foundation for energy security, based on the principles of open, competitive markets and sustainable development.

The Treaty was developed on the basis of the 1991 Energy Charter. Whereas the latter document was drawn up as a declaration of political intent to promote energy cooperation, the Energy Charter Treaty is a legally-binding multilateral instrument.

Between 20 and 21 May 2015 the Energy Charter Conference and partner countries adopted the International Energy Charter which is a renewed political declaration mapping out common principles for international cooperation in the field of energy. The historic adoption and signing of the International Energy Charter took place at a High-Level Ministerial Conference in The Hague, Netherlands.

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Boulevard de la Woluwe, 56
B-1200 Brussels, Belgium

English, PDF
ISBN 978-905948-172-5

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Foreword by the Energy Charter Secretary General

I welcome the publication of another Energy Charter report on the implementation of the investment chapter of the Energy Charter Treaty. By means of these reports, together with Energy Charter occasional papers, the Secretariat aims at providing interested readers with reflections on topics of current interest and debate in the international investment community. The ultimate goal is raising awareness on the Energy Charter Treaty and on its implementation, on international investment practice as well as on decisions by arbitral courts and tribunals.

These publications are of particular relevance after the adoption of the International Energy Charter in May 2015 by 75 countries and organisations as the first step towards the modernization of the Energy Charter Process, i.e. renewed discussion on the scope and on the instruments for international energy collaboration under the Energy Charter Treaty.

This work by Energy Charter research fellow Mr Erman Ozgur discusses the relation between investment protection and taxation under international investment agreements. It is common practice that taxation is a sovereign and legitimate regulatory exercise which usually remains excluded by international standards of investment protection. In this respect, Article 21 of the Energy Charter Treaty provides a complex mechanism preserving the sovereign taxation powers.

This study is published without prejudice to the position of Contracting Parties/Signatories or to their rights or obligations under the Energy Charter Treaty or any other international investment agreement.

I hope that this report will be of use to readers and I look forward more publications in this series.

Brussels, June 2015

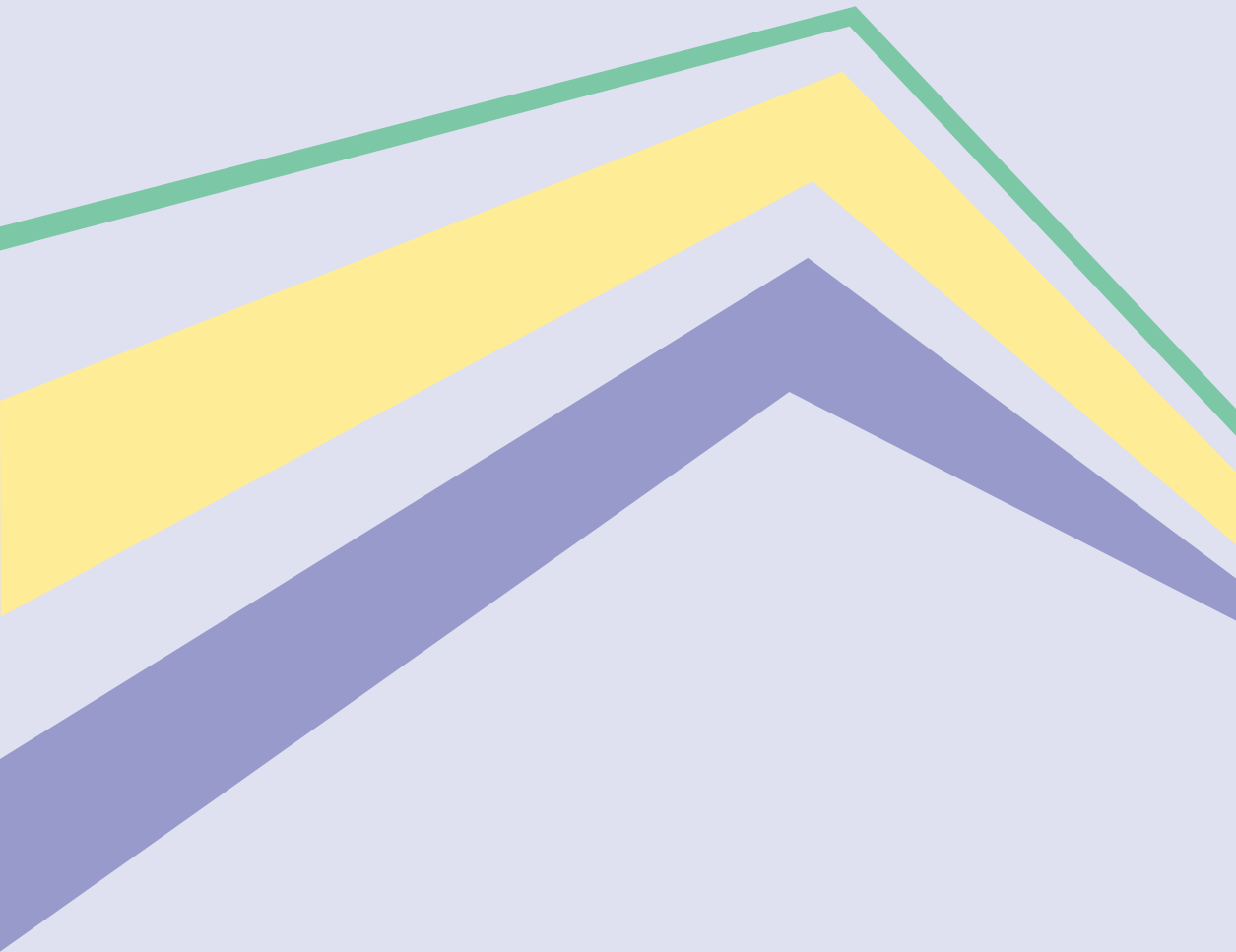


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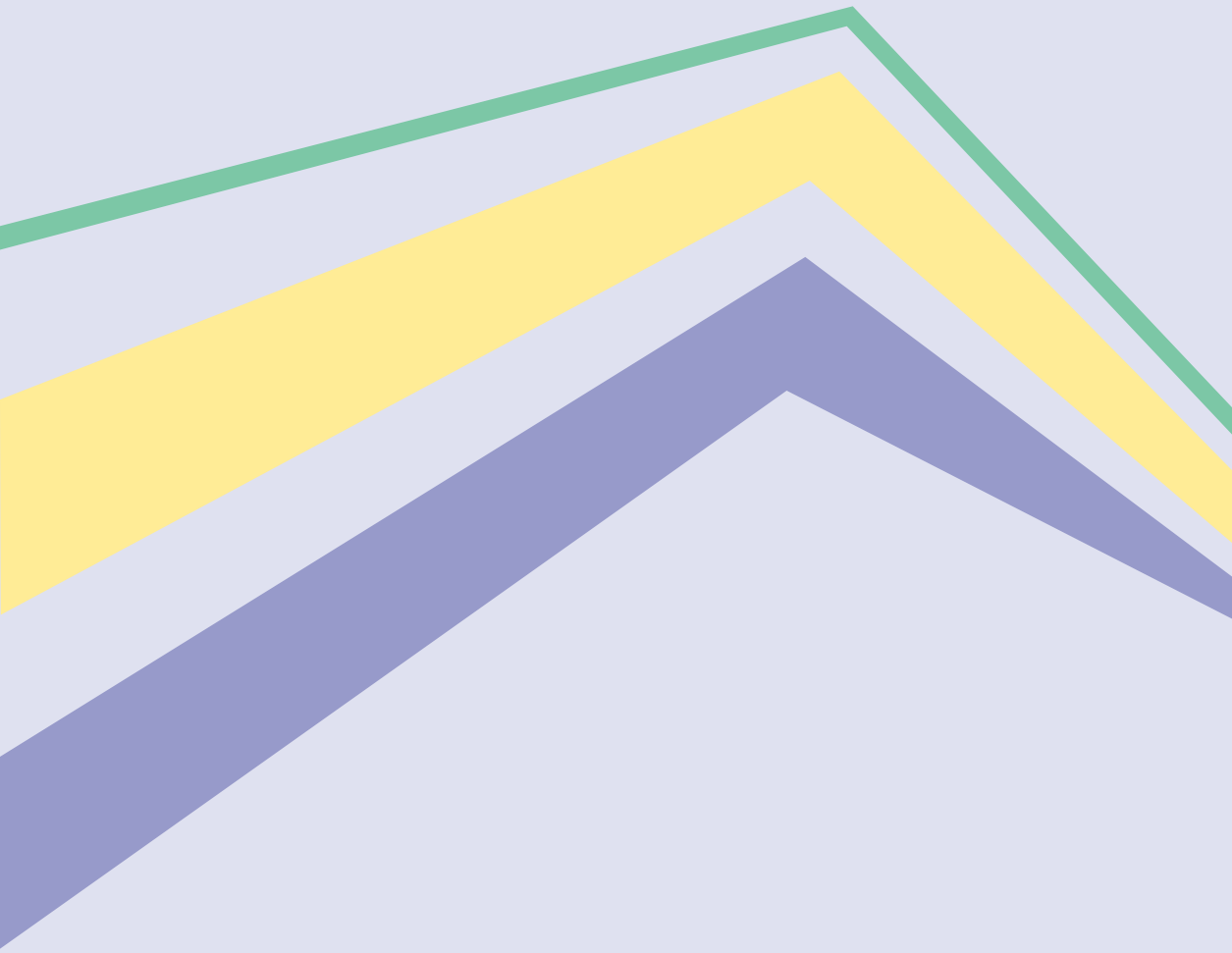
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EXECUTIVE SUMMARY

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Background

Taxation of foreign investments is a key regulatory exercise in every sovereign State. Inasmuch as it is not “designed to effect a dispossession outside the normative constraints and practices of the taxing powers”, the right to tax foreign investments is also a legitimate regulatory exercise. Investment treaty arbitration (ITA) tribunals often examine whether taxation measures by host States are discriminatory, confiscatory and/or tantamount to expropriation in the light of applicable standards under a vast network of international investment agreements (IIAs).

Drawing on its drafting background and interpretation by arbitral tribunals, this paper aims to explore and shed light on the significance, scope and application of the “carve-out” mechanism on taxation under Article 21 of the Energy Charter Treaty (ECT). In this, it takes a comparative approach aiming to spot similarities and differences in drafting methodologies of some IIAs, Free Trade Agreements (FTAs) and the ECT. It provides a detailed analysis of the drafting background of Article 21 based on *travaux préparatoires* as well as interviews with former negotiators/delegates involved in the making of the taxation provision. The paper also focuses on the application of Article 21, and outlines a general guideline in reading the provision.

Carve-Out Mechanisms in Practice

Based on its review on the limits to States’ sovereign prerogative to tax foreign investments under customary international law, and international treaties; the paper points out that *bona fide* taxation measures fall within the ambit of the legitimate regulatory powers of States. In addition, it discusses that State parties might negotiate to include *carve-out provisions* in IIAs that would exempt this key regulatory power from the scope of heightened international disciplines, and thus safeguard the right to tax from direct expansive challenges made by foreign investors.

Carve-out provisions as such might allocate additional authority to bodies other than arbitral tribunals in determining whether a taxation measure is expropriatory and/or discriminatory. The comparative analysis proves that a joint tax consultation or veto mechanism (or in other words a referral mechanism – which reinforces recourse to taxation authorities in order to resolve whether a taxation measure is discriminatory or expropriatory) is common in carve-out provisions. However, in majority of carve-out examples, there is no clarity in that if the joint consultation tax mechanism is a procedure that must be exhausted before proceeding into arbitration of disputes. Drawing on the specific text of the applicable treaty, some tribunals consider the consultation mechanism as a jurisdictional prerequisite. On the other hand, they also agree in that it shall not bar investors from submitting their disputes to arbitration.

A second important point is that some carve-out provisions define what tax or taxation measures are, whereas some others remain silent in defining certain terms. In the absence of definitions embedded in treaties, tribunals refer to general principles of international law, and the supremacy of the rule of law in the imposition of tax measures. If not defined in the applicable treaty or in any other source of international law (which could be read into the treaty), they note that the term “taxation measures” includes taxes on income and capital, customs duties as well as indirect taxes such as VATs. The term “measures” does not only refer to provisions embedded in domestic taxation laws and regulations or treaties. It also includes any measure taken in enforcing or collecting taxes.

Carve-Out Mechanism under Article 21 of the ECT

A carve-out provision is also available in Article 21(1) of the ECT. The provision reads: “[...] *nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties*”. This carve-out provision is, nevertheless, not absolute, as Article 21(5) excludes expropriatory measures from the general carve-out rule under Article 21(1) for direct taxes, i.e. tax on capital and income. Further, Article 21(3) subjects indirect taxes to the national treatment regime.

While, Article 21 of the ECT (particularly subparagraph 5) is praised for providing a fair balance between conflicting objectives of host states and foreign investors, as the expansive discussions and *obiter* on its meaning in the recent *Yukos* awards proves, the provision is “barely intelligible”. The paper points out that the unintelligible drafting of Article 21 may cause inconsistencies in the practice. It is argued that one such inconsistency exists between the *Plama v Bulgaria* and *Yukos* cases: Whereas, the Tribunal in *Plama v Bulgaria* considers the joint tax consultation mechanism as a jurisdictional prerequisite, the Tribunal in the *Yukos* cases considers it as a futile exercise if and when it is clear that the host State has not acted in good faith in treating the foreign investor.

Ambiguities also exist with regard to definition of certain terms. Former delegates involved in the drafting of Article 21 have noted that the term “taxes” is clearly broader than the term “taxation measures” and that this was a purposeful drafting exercise. However there is no proof in the record of preparatory work in this vein.

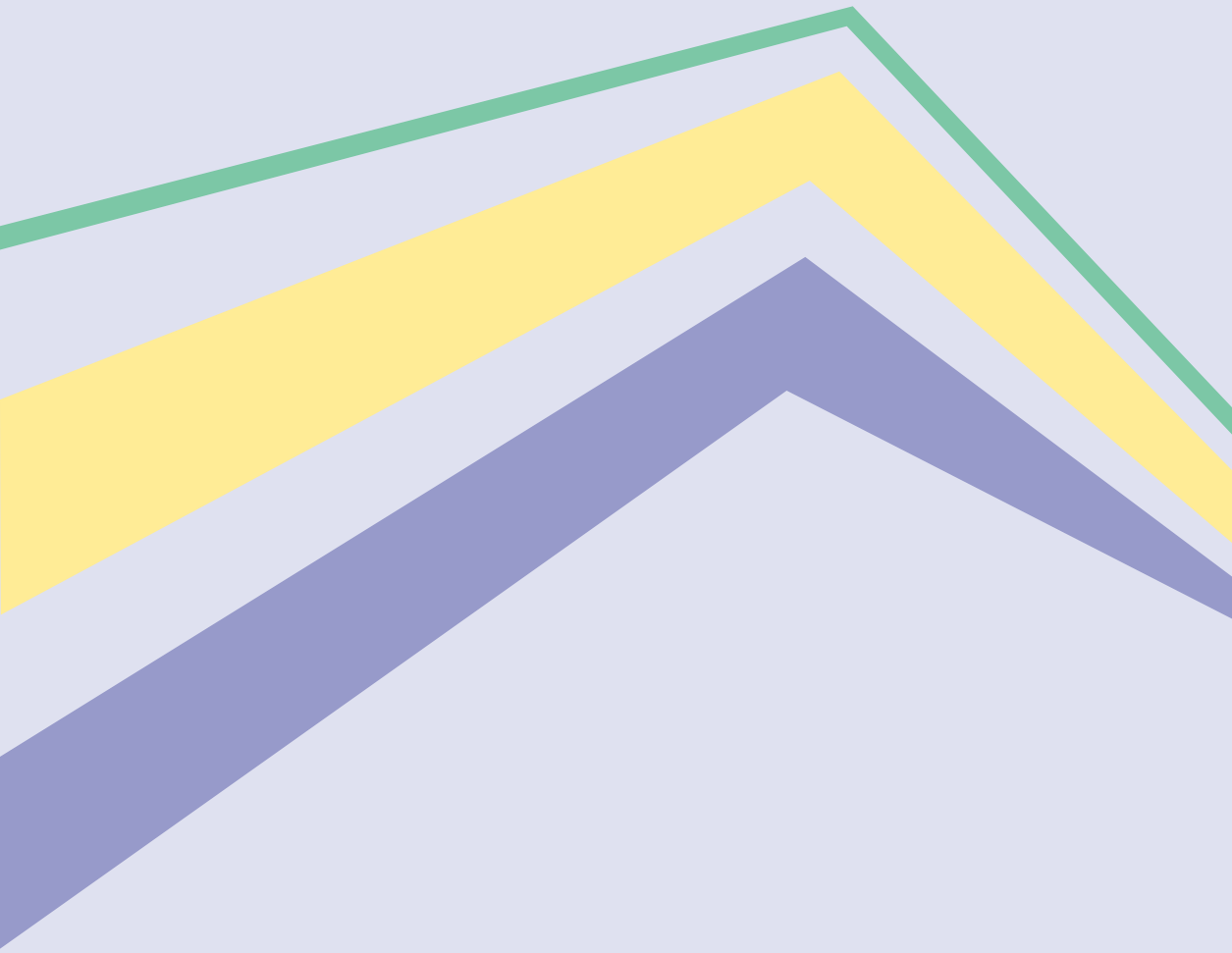
Last but not least, the definition of the terms of “taxation measures” is not clear. While the article lists what is not a taxation measure, it fails to provide guidance in whether “measures” are limited to “provisions” in legislation or treaties, or if they also include measures concerning implementation and/or collection of taxes.

Conclusions

Contracting Parties might consider taking steps towards clarifying and, perhaps, simplifying Article 21 in the existence of such ambiguities and uncertainties as to treatment of taxation measures under the ECT. Options might include:

- (i) *an amendment to the ECT,*
- (ii) *issuing a Protocol or a Declaration as per Article 1(13)(a) and (b) of the Treaty, and*
- (iii) *an interpretative note in order to clarify the object and purpose of ambiguous terms and provisions in Article 21 of the ECT as per Article 31(3)(a) of the VCLT.*

Whilst an amendment would require ratification, and would therefore appear to be politically challenging, a Protocol, Declaration and/or an interpretative note under VCLT would be most suitable in clarifying the ambiguities in the Article. This would be a crucial exercise considering that the Article might give rise to future interpretative controversies and any unanticipated consequences in which a Contracting Party's sovereign prerogative to tax is unreasonably constrained.



1. INTRODUCTION

1. INTRODUCTION

Taxation of foreign investments is a key regulatory exercise in every sovereign State. Inasmuch as it is not “designed to effect a dispossession outside the normative constraints and practices of the taxing powers”², the right to tax foreign investments is also a legitimate regulatory exercise.³ Investment treaty arbitration (ITA) tribunals often examine whether taxation measures by host States are discriminatory, confiscatory and/or tantamount to expropriation in the light of applicable standards under a vast network of international investment agreements (IIAs). Whilst it is established that *bona fide* taxation measures fall within the ambit of the legitimate regulatory powers of States⁴, State parties might negotiate to include provisions in IIAs that would exempt this key regulatory power from the scope of heightened international disciplines, and thus safeguard the right to tax from direct expansive challenges made by foreign investors.⁵

Article 21 of the Energy Charter Treaty (ECT) provides one such example. Article 21(1) reads: “[...] *nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties*”. Nevertheless, the carve-out provision is not absolute: Article 21(5) excludes expropriatory measures from the general carve out rule under Article 21(1) for “taxes”. Further, Article 21(3) subjects “Taxation Measures other than on income and capital” to the national treatment (NT) regime. Whilst, Article 21 (particularly Subparagraph 5) is praised for providing a fair balance between conflicting objectives of host States and foreign investors⁶, as the expansive discussions and *obiter* on its meaning in the recent *Yukos awards*⁷ proves, it is “barely intelligible”⁸.

Drawing on its drafting background and interpretation by arbitral tribunals, this paper aims to explore and shed light on the significance, scope and application of the “carve out” mechanism on taxation under Article 21 of the ECT. In this, it takes a comparative approach aiming to spot similarities and differences in drafting methodologies of some IIAs, Free Trade Agreements (FTAs) and the ECT. It provides a detailed analysis of the drafting background of Article 21 based

* This work is a result of the research undertaken at the Energy Charter Secretariat between September and December 2014. I am grateful to Dr. Matteo Barra and Alejandro Carballo Leyda for their guidance and comments, and to the Energy Charter Secretariat for their financial support. I also thank the members of the Legal Advisory Task Force, and former members of the Sub-Group on Taxation of Working Group II of the European Energy Charter Conference for their comments on earlier drafts and for taking part in our questionnaire. The views expressed herein do not purport to represent the views of the Energy Charter Secretariat or the Contracting Parties. All errors are the author's alone. The author can be contacted at u.e.ozgur@dundee.ac.uk, Centre for Energy, Petroleum and Mineral Law and Policy (CEPMLP), University of Dundee.

² *Renta 4 S.V.S.A. Ahorro Corporación Emergentes F.I., Ahorro Corporación Eurofondo F.I., Rovime Inversiones SICAV S.A., Quasar de Valores SICAV S.A., Orgor de Valores SICAV S.A., GBI 9000 SICAV S.A. v. The Russian Federation* (hereinafter *Quasar v. The Russian Federation*), SCC No. 24/2007, Award 2012, at para. 48; see also *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL, Award 2006 at para. 177.

³ A.R. Albrecht, ‘The Taxation of Aliens under International Law’, *Brit. YB Int’ L.*, 29 (1952), 145.

⁴ See e.g. *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award 2006 (hereinafter *Saluka v. Czech Republic*), at para. 255: “[...] States are not liable for adopting in a non-discriminatory manner bona-fide regulations that are aimed at the general welfare”; see *Methanex v USA*, UNCITRAL, Final Award 2005, para. 410: “[i]t is a principle of customary international law that, where economic injury results from a bona fide regulation within the police powers of a State, compensation is not required”; see also *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, NAFTA, Award 2002 at para. 105 and *Technicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, 29 May 2003 (hereinafter *TECMED v. Mexico*), para. 119.

⁵ Abba Kolo, ‘Tax Veto as a Special Jurisdictional and Substantive Issue in Investor-State Arbitration: Need for Reassessment’, *Suffolk Transnat’l L. Rev.*, 32 (2008), 475; see T.W. Wälde, ‘National Tax Measures Affecting Foreign Investors under the Discipline of International Investment Treaties’, *Proceedings of the Annual Meeting of the Annual Meeting (American Society of International Law)*, 102 (2008), 55-59; see also Christian Tietje and Karoline Kampermann, ‘Taxation and Investment: Constitutional Law Limitations on Tax Legislation in Context’, *International Investment Law and Comparative Public Law* (Oxford: Oxford University Press, 2010); T.W. Wälde and Abba Kolo, ‘Investor-State Disputes the Interface between Treaty-Based International Investment Protection and Fiscal Sovereignty’, *Intertax*, 35/8/9 (2007), 424.

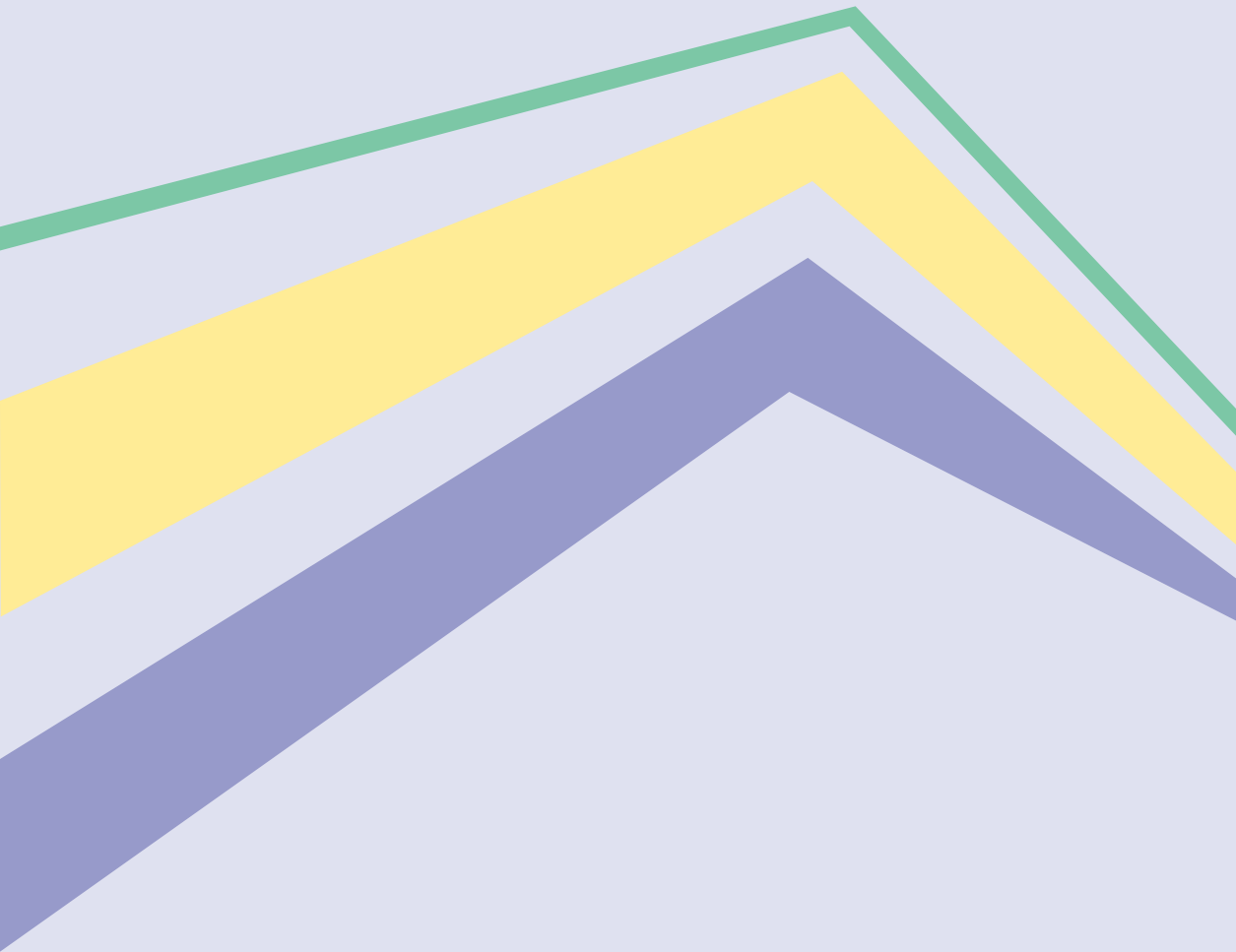
⁶ Kolo, ‘Tax Veto as a Special Jurisdictional and Substantive Issue in Investor-State Arbitration: Need for Reassessment’, (*supra* note 5) at p. 480.

⁷ *Yukos Awards* (*Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 226; *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228; *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227)

⁸ Wälde, ‘National Tax Measures Affecting Foreign Investors under the Discipline of International Investment Treaties’, (*supra* note 5) at p. 57.

on *travaux préparatoires* as well as interviews with former negotiators/delegates involved in the making of the taxation provision. The paper also focuses on the application of Article 21, and examines interpretative approaches developed by arbitral tribunals.

The paper consists of four consecutive sections. In Part 2, it discusses limits to States' sovereign prerogative to tax foreign investments under customary international law, and international treaties. It then considers carve out mechanisms on taxation in general and focuses on mechanisms under some Bilateral Investment Treaties (BITs), Double Taxation Treaties (DTTs) and FTAs. Subsequently, the paper reviews arbitral cases in which carve-out provisions in various international treaties were invoked, including *Feldman v. Mexico*, *Occidental v. Ecuador*, *EnCana v. Ecuador*, *Duke Energy v. Ecuador*, and *El Paso v. Argentina*. In Part 3, based on *travaux préparatoires* as well as on interviews with delegates involved in the negotiations, this paper examines the drafting history and purpose of Article 21 ECT, and reviews its function and formulation in comparison to similar provisions in other IIAs and/or FTAs including (but not limited to) Article 2103(6) of the North American Free Trade Agreement (NAFTA), Article 16 of the Canada Model Promotion and Protection of Investments Agreement (FIPA) of 2004, Article 21 of the 2012 US Model BIT, and some EU FTAs. In Part 3, it scrutinizes practice of Article 21 and similar provisions on taxation in other IIAs, and endeavours to put forward shortcomings in the implementation of the ECT's taxation carve out mechanism. In the second section of Part 3, it reviews the Tribunals' interpretations of Article 21 in *Plama v. Bulgaria*, and *Hulley/Yukos/Veteran v. the Russian Federation*. In Part 4, in light of the findings in Parts 2 and 3, the paper outlines the scope of the general carve out provision under Article 21(1), the definition and scope of Taxation Measures under Article 21(7), exceptions to the general carve-out rule provided under Articles 21(3) and (5), and its relation with trade and transit provisions. In Part 5, the paper concludes. It argues that Article 21 provides a fair balance between conflicting objectives of host States and foreign investors. However, its rather incautious drafting gives rise to concrete problems in its application and interpretation.



2. TAXATION OF FOREIGN INVESTMENTS UNDER INTERNATIONAL LAW

2. TAXATION OF FOREIGN INVESTMENTS UNDER INTERNATIONAL LAW

As one of the primary sources of revenue, the right to tax is a sovereign prerogative for every State. Irrespective of whether the subject of a taxation measure is a national or an alien, taxation is admitted as a permissible regulatory power, and does not *per se* constitute expropriation. As highlighted in the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (the Harvard Draft Convention):

An uncompensated taking of an alien property or a deprivation of the use or enjoyment of property of an alien which results from the execution of tax laws; from a general change in the value of currency; from the action of the competent authorities of the State in the maintenance of public order, health or morality; or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful (emphasis added).⁹

However, as in every other sovereign prerogative, the right to tax has its limits. And such limits may arise from standards of protection such as national and most favoured nation treatments (NT and MFN), fair and equitable treatment (FET), protection and security (P&S), and protection against expropriation as well as customary international law as “[i]n interpreting a treaty, account has to be taken of ‘any relevant rules of international law applicable in the relations between the parties’”.¹⁰ As held in the *Case Concerning Oil Platforms*, these include “relevant rules of general customary international law” as per Article 38 of the Statute of the International Court of Justice (ICJ).¹¹

Thus, in determining whether a taxation measure constitutes a violation of international law, one should consider *if the taxation measure falls within the limits of legitimate regulatory measures under (i) customary international law, and (ii) standards of protection provided under applicable international treaties*. Under the second check point, i.e. the international treaty, one should also consider if the subject treaty provides *an exception*, or in other words, a carve-out clause that could exclude a taxation measure from the coverage of the standards of protection. This Part follows this pattern: Drawing on early cases on the protection of alien property as well as comparably recent ITA awards, it first questions what legitimate taxation is under customary international law and contemporary international investment law. In the second sub-section, it focuses on examples of carve-out clauses in various international treaties, and subsequently, questions how divergences in the drafting of these provisions could lead to different outcomes in cases concerning taxation. Finally, the paper aims to draw conclusions for Part 4, in which it puts forward guidelines that could facilitate a deeper understanding of Article 21 of the ECT.

2.1. Limits of the Right to Tax under International Investment Law

What is legitimate taxation? Though the question appears simple enough, it has created much controversy in international law. Admittedly, taxation is a sovereign power, and is exercised irrespective of whether the subject is an alien or a national. Nevertheless, it is equally important

⁹ Article 10 of the 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens: Louis B. Sohn et al., ‘Excerpts from Draft Convention’, *Proceedings of the American Society of International Law at Its Annual Meeting (1921-1969)*, 54 (APRIL 28-30, 1960), 102-20; see J. Crawford, *State Responsibility: The General Part* (Cambridge University Press, 2013) at Ch. 1, pp.32-5.

¹⁰ Saluka, Partial Award, para. 254 quoting *Case Concerning Oil Platforms (Islamic Republic of Iran v. USA)*, Judgment, 6 November 2003, ICJ Reports (2003), paras 23 and 41.

¹¹ United Nations, *Statute of the International Court of Justice* <<http://www.icj-cij.org/documents/?p1=4&p2=2&p3=0>>. According to Article 38 of the Statute of the ICJ, international law can find its sources in “(a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; (b) international custom, as evidence of a general practice accepted as law; (c) the general principles of law recognized by civilized nations; (d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law”.

to exercise this sovereign right in accordance with international law. A handful of cases on customary practice on the taxation of aliens point out that taxation of foreign investments shall not be unfairly and unreasonably discriminatory, and confiscatory.¹² Discriminatory taxation may occur in instances where a host State treats aliens less favourably by way of exercising its sovereign right to tax. Whereas, a taxation measure that is confiscatory would occur by taking “too much” from the foreign investor¹³, and would essentially deprive it of benefiting from the economic value of its investment.¹⁴ Both discrimination and confiscation have no static meaning, but are determined on a case specific basis.¹⁵

2.1.1. Early Disputes on the Taxation of Alien Property

As early as 1905, the Permanent Court of Arbitration (PCA) confirmed that a State’s (in the case at hand, Japan) revisions of direct taxes on housing constructed on land by European nationals could be a violation of its international law commitments under its Treaties of Friendship, Navigation and Commerce (FNCs) (concluded between 1854 and 1869).¹⁶ In the early 20th century, Germany and Great Britain challenged the five per-cent tax applied by the Governor of State in Sinaloa in Mexico on alien property. According to both States, their nationals in Mexico should have been responsible for the same amount of tax levied on Mexicans under international law. Similarly, the US disputed “the [allegedly] confiscatory mining taxes imposed by the Mexican Government to the detriment of American citizens in Mexico [...]”. Whilst, the US did not question Mexico’s sovereign right to impose taxes, it “protested against a system of taxation having for its avowed object... the absolute confiscation of the larger holdings of mining claims in Mexico, in which so many American citizens [were] interested”.¹⁷ In 1922, Kügele, a German national who owned a brewery in Polish Upper Silesia, challenged a series of license fees imposed by the domestic authorities, and alleged that the increase in the license fee had ceased its business from being “remunerative”.¹⁸ In the *Ten Lepta Charge* case against the Greek Government, Hellenic Electric Railways Ltd. also claimed that the Government’s indirect imposition of additional taxes, i.e. the “ten lepta charge” on tickets, was a breach of its commitment to fix taxes to 5% under a 1925 concession¹⁹, and amounted to confiscation.

¹² Albrecht, ‘The Taxation of Aliens under International Law’, (*supra* note 3) at p. 169.

¹³ *Ibid.*, at p. 173.

¹⁴ See e.g. Yuri Bogdanov and Yulia Bogdanov v. Republic of Moldova, SCC Case No. V091/2012, Final Award, 16 April 2013 at para. 167: “[A]n excessive or unlawful taxation of an investment may of course cause harm in economic terms to that investment and involve a loss for the investor. If the investment is protected by a Bilateral Investment Treaty, and if such a taxation is held to be unfair or inequitable, this will qualify as a breach of the treaty in question”.

¹⁵ Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5 (formerly Burlington Resources Inc. and others v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (PetroEcuador)) (hereinafter Burlington), Decision on Liability 2012, para. 393; Generation Ukraine, Inc. v. Ukraine, ICSID Case No. ARB/00/9, Award, 16 September 2003, para. 20.29; Saluka, Partial Award, para. 264-5. See A. Newcombe and L. Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Wolters Kluwer Law & Business, 2009) at p. 366; see also George C Christie, ‘What Constitutes a Taking of Property under International Law’, *Brit. YB Int’l L.*, 38 (1962), 307.

¹⁶ Japanese House Taxation Arbitration, Award of the Tribunal of Arbitration Constituted in Accordance with the Protocols Signed at Tokyo on the 28th August, 1902, by Japan of the one part, and Germany, France, and Great Britain of the other part, available at http://www.pca-cpa.org/showfile.asp?fil_id=169. See Rudolf Bernhardt (ed.), *Decisions of International Courts and Tribunals and International Arbitrations: Instalment 2* (The Netherlands: North-Holland Publishing Company, 1981).

¹⁷ Albrecht, ‘The Taxation of Aliens under International Law’, (*supra* note 3) at p. 172.

¹⁸ Kügele v. Polish State, Upper Silesian Arbitral Tribunal, 5 February 1932: H. Lauterpacht, *International Law Reports: Annual Digest of Public International Law Cases 1931-1932* (Cambridge University Press, 1945) at pp. 69-70.

¹⁹ The Ten Lepta Charge Case (Hellenic Electric Railways Ltd. v. Government of Greece, 1930): Stephen M. Schwebel, *Justice in International Law: Selected Writings* (Cambridge University Press, 1994) at pp. 454-8. For a latter decision on the sovereign immunity in taxing aliens see also *Eastern Liberian Timber Corporation v. the Government of the Republic of Liberia*, where in staying the execution of the ICSID award against the Republic of Liberia, the US District Court of New York upheld Liberia’s argument in that “[...] tonnage fees, registration fees and other taxes due the government [...] are collected as taxes designed to raise revenues for the Republic of Liberia and as such, are sovereign non commercial assets under the Liberian maritime law and regulations, and thus immune from execution since they are not ‘property ... used for a commercial activity’”: US District Court, S.D. New York, December 12, 1986, 650 F. Supp. 73 (1986).

Thus, *before World War I*, the threshold in determining discriminatory and confiscatory taxation as part of State liability under international law had been vague. Whilst, the *Japanese House Tax Arbitration* reinforced that, the sovereign states right to tax is not absolute and could be limited by treaty provisions; latter controversies (between European powers and the USA, on the one side, and Mexico, on the other) established that, even if there is no treaty provision, power to tax could be confined so as to prohibit taxation that is confiscatory and/or discriminatory.²⁰

On the other hand, according to the Tribunal in the arbitration between *Kügele and the Polish State*, “[t]he increase of the license fee was not in itself capable of taking away or impairing the rights of the plaintiff... even if “taxation render[s] the [business] less remunerative or altogether unremunerative” – since, “had [the Claimant] paid the tax, he would be entitled to go on with his business.”²¹ By contrast, the Tribunal in the *Ten Lepta Charge* case adopted the view that if a government expressly committed itself not to increase taxes in a contract, it would be illegal and thus confiscatory to circumvent such a contractual commitment “merely by giving a different name to charges imposed by legislation”. After all, “[i]t is the impact of the financial burden rather than the form it takes.”²²

2.1.2. Taxation and Indirect Expropriation

After *World War II*, confiscation in the taxation of foreign investments had become an issue of common illegality. Late Professor Thomas Wälde connected this with what he described as a change in the role of States to regulate.²³ According to Wälde, direct public ownership replaced itself with “regulatory function of the State”, which he described as “the ability of the State to use its taxing, environmental, labour and social regulatory authority.”²⁴ In particular, until the collapse of the USSR in 1991, Eastern European States exercised their rights to tax in order to effectively “engineer an expropriation.”²⁵

Bigger scale nationalizations of foreign tangible property were gradually replaced by indirect taking of property by way of restricting their economic functioning through environmental and social regulation, and taxation.²⁶ Thus latter cases, in effect, reflected this shifting reality: Confiscation did not only appear as a matter of direct taking of tangible property, but, as reflected in the US Restatement Third of the Law of Foreign Relations (Third US Restatement)²⁷ and the 1961 Harvard Draft Convention, also took the form of indirect taking of the property of an alien by way of reducing the economic value of its investment via excessive taxation.²⁸ Indirect expropriation through taxation has been disputed in early cases including *Revere*

²⁰ Albrecht, ‘The Taxation of Aliens under International Law’, (*supra* note 3) at pp. 171–3.

²¹ *Kügele v. Polish State*, Upper Silesian Arbitral Tribunal, 5 February 1932; Lauterpacht, *International Law Reports: Annual Digest of Public International Law Cases 1931–1932* at pp. 69–70.

²² The *Ten Lepta Charge* Case: Schwebel, *Justice in International Law: Selected Writings* at pp. 454–8.

²³ See e.g. T.W. Wälde and P.K. Wouters, ‘State Responsibility in a Liberalised World Economy: “State, Privileged and Subnational Authorities” under the 1994 Energy Charter Treaty: An Analysis of Articles 22 and 23’, *Netherlands Yearbook of International Law*, 27/1 (1996), 143–91; Wälde, ‘National Tax Measures Affecting Foreign Investors under the Discipline of International Investment Treaties’, (*supra* note 5); Wälde and Kolo, ‘Investor–State Disputes the Interface between Treaty–Based International Investment Protection and Fiscal Sovereignty’, (*supra* note 5); T.W. Wälde and Abba Kolo, ‘Environmental Regulation, Investment Protection and ‘Regulatory Taking’ in International Law’, *International and Comparative Law Quarterly*, 50/4 (2001), 811–48; with reference to P. Bobbitt, *The Shield of Achilles: War, Peace, and the Course of History* (Knopf Doubleday Publishing Group, 2007).

²⁴ Wälde and Kolo, ‘Investor–State Disputes the Interface between Treaty–Based International Investment Protection and Fiscal Sovereignty’, (*supra* note 5)

²⁵ T.W. Wälde and Abba Kolo, ‘Confiscatory Taxation under Customary International Law and Modern Investment Treaties’, *OGEL Special OGEL Archive*, 1 (2003).

²⁶ Wälde and Kolo, ‘Investor–State Disputes the Interface between Treaty–Based International Investment Protection and Fiscal Sovereignty’, (*supra* note 5)

²⁷ Restatement of the Law (3d) of Foreign Relations Law of the United States, American Law Institute, 1987.

²⁸ *Burlington v. Ecuador*, Decision on Liability, para. 394.

*Copper & Brass Inc. v. OPIC of 1978 (Revere Copper v. OPIC)*²⁹ as well as comparably recent cases such as *Goetz v. Burundi of 1999*³⁰, *Link-Trading v. Moldova of 2002*³¹, *Feldman v. Mexico of 2002*³², *EnCana v. Ecuador of 2006*³³, *RosInvest v. The Russian Federation of 2010*, and *Burlington and Quasar of 2012*.³⁴

In *Revere Copper v. OPIC*, according to the Claimant, tax increase implemented by the Jamaican government in 1974 (i.e. “bauxite levy” for its mining bauxite business in Jamaica) violated the concession agreement of 1967, and amounted to an expropriation of its business. Whilst, the Tribunal confirmed that taxing an investment could not in itself amount to a breach under international law³⁵, it held that measures adopted by the government damaged the economic value of the investment by preventing the Claimant from “exercising effective control over the use or disposition of a substantial position of its property or from operating the property”.³⁶ According to the Tribunal, a taxation measure need not be confiscatory to constitute a breach: Depriving an investor of its right to enjoy economic value of its investment by implementing excessive taxation measures was, in itself, a breach of the Government’s contractual commitments under the investment guarantee provided by Overseas Private Investment Corporation (OPIC)³⁷:

Admittedly, Parliament could at any time legislate with respect to taxes and thus override contracts with private parties. It could not, however, deprive such parties of compensation, if the circumstances justified the payment of compensation under international law principles.³⁸

Similarly, in *Goetz v. Burundi*, the Tribunal ruled that prospective (not retrospective) withdrawal of tax and customs exemptions³⁹ (established with the “free-zone regime”) was, in effect, an indirect expropriation of the property rights of the Claimants under the Belgium-Burundi BIT:

[Burundi] had violated its duty under the Treaty to refrain from adopting measures similar to depriving an investor of or restricting its property rights. [It] would thus be found to be liable of a breach of international law if it did not either provide adequate and fair compensation within four months of the notice of the decision or grant a new free-zone certificate.⁴⁰

²⁹ *Revere Copper & Brass Inc. v. OPIC*, AAA Award of August 24, 1978, 17 I.L.M. 1321 (1978) (hereinafter *Revere Copper*): R.D. Bishop, J. Crawford, and W.M. Reisman, *Foreign Investment Disputes: Cases, Materials, and Commentary* (Kluwer Law International, 2005) at p. 555.

³⁰ Antoine Goetz et consorts v. République du Burundi, ICSID Case No. ARB/95/3, Award (Embodying the Parties’ Settlement Agreement) 1999 (hereinafter *Goetz*): James Crawford and Karen Lee (eds.), *ICSID Reports: Volume 6* (Cambridge: CUP, May 2004) at pp. 3–10.

³¹ *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova*, UNCITRAL, Final Award, 18 April 2002.

³² Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1 (also known as *Marvin Feldman v. Mexico*), Award 2002 (hereinafter *Feldman v. Mexico*).

³³ *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL (formerly *EnCana Corporation v. Government of the Republic of Ecuador*), Award 2006 (hereinafter *EnCana v. Ecuador*).

³⁴ In most instances, confiscation and indirect expropriation have been used interchangeably. For a divergent understanding on the interchangeability of confiscation and expropriation, however, see *Revere Copper v. OPIC*, Award, pp. 45–60. “The majority of the Tribunal held that, although the effects of the tax – Bauxite Levy – were not confiscatory, the tax was nonetheless expropriatory because it amounted to a repudiation of the contractual commitment to tax stability that had deprived the investor of effective control over its investment”: As discussed in *Burlington*, Decision on Liability, para. 403, ft. 657.

³⁵ A recent and instructive consideration was also put forward by Arbitrators Landau, Brower and Paulsson. They suggested: “The questions that arise for the present Tribunal concern the bona fides of measures taken by the Respondent. Were these actions taken as part of the ordinary process of assessing and collecting taxes, or were they part of an expropriatory pattern? All taxation of course has the effect of a taking of the taxpayer’s money; but it is nonsense to say that it is therefore compensable. The tax is the payment of a debt established by law in favour of the public treasury (“the price we pay for civilization”, in Holmes’s famous expression). But 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 powers, those measures are expropriatory and fall within Article 6 of the BIT. And it is then for the Tribunal to consider whether such expropriation has been properly compensated”. *Quasar v. The Russian Federation*, Award, para. 48.

³⁶ *Revere Copper v. OPIC*, Award, p. 55.

³⁷ *Revere Copper v. OPIC*, Award, pp. 46–7. Wälde and Kolo, ‘Confiscatory Taxation under Customary International Law and Modern Investment Treaties’, (; Bishop, Crawford, and Reisman, *Foreign Investment Disputes: Cases, Materials, and Commentary* at p. 555.

³⁸ *Ibid.*

³⁹ Wälde and Kolo, ‘Confiscatory Taxation under Customary International Law and Modern Investment Treaties’, (*supra* note 25)

⁴⁰ *Goetz v. Burundi*: Crawford and Lee (eds.), *ICSID Reports: Volume 6*.

The above cited decisions illustrate that indirect involvement of a State in depriving an alien from enjoying the use of its property may also involve confiscation, and thus may result to be indirect or creeping expropriation. Perhaps, however, the most instructive consideration of taxation measures amounting to creeping expropriation was put forward by the Tribunal in *Feldman v. Mexico*. The Tribunal held that it is in the “very nature” of a taxation measure to be indirect, and that even if such a measure is designed to have the effect of an expropriation this would be an indirect expropriation. The Tribunal further opined that, if “the measures are implemented over a period of time, they could also be characterized as “creeping”, which [...] is not distinct in nature from, and is subsumed by, the terms ‘indirect’ expropriation or ‘tantamount to expropriation’.”⁴¹

According to the Tribunal, customary international law confirms that taxation measures could amount to indirect or creeping expropriation, however, the line between legitimate taxation and an indirect taking shall be drawn. Based on the Restatement (Second) on the Foreign Relations Law of the US, the Tribunal held:

A State is responsible as for an expropriation of property [...] when it subjects alien property to taxation [...] that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the State's territory... A State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation [...] that is commonly accepted as within the police power of States, if it is not discriminatory...⁴²

The Tribunal then described the ways in which “[States] may force a company out of business or significantly reduce the economic benefits of its business”. According to the Tribunal, confiscatory taxation could have resulted through “denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes”. While such actions would be illegitimate under international law, the Tribunal held that, “[a]t the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like”. In the Tribunal’s view, “[r]easonable governmental regulation [as such] cannot be achieved if any business that is adversely affected may seek compensation, and [...] that customary international law recognizes this”.⁴³

Along the similar lines, the Tribunal in *Link-Trading v. Moldova* held that “[a]s a general matter, fiscal measures only become expropriatory when they are found to be an abusive taking” (emphasis added). According to the Tribunal an “abusive taking” arises when:

[I]t is demonstrated that the State has acted unfairly or inequitably towards the investment, where it has adopted measures that are arbitrary or discriminatory in character or in their manner of implementation, or where the measures taken violate an obligation undertaken by the State in regard to the investment.⁴⁴

In its conclusion as to whether the Claimant suffered of an indirect expropriation, the Tribunal dismissed the allegations in that an average increase of 44% in its merchandise prizes would adversely affect the Claimant’s competitiveness in the market, and would, in effect, amount to an indirect expropriation. According to the Tribunal:

⁴¹ *Feldman v. Mexico*, Award, para 101.

⁴² *Feldman v. Mexico*, Award, para 105.

⁴³ *Feldman v. Mexico*, Award, para 103.

⁴⁴ *Link-Trading v. Moldova*, Final Award, para. 64.

While one might suppose that the new tax measures contributed to Claimant's losses that is not enough to constitute expropriation. Otherwise, the concept would be unlimited, since most tax measures have a cost impact on taxpayers. To prove expropriation, Claimant must show that as a direct consequence of the measures complained of Claimant was deprived of its investment. Claimant has not carried its burden of proof of this causal link.

In *EnCana v. Ecuador*, however, the Tribunal took a more conservative approach as to the limits of States' sovereign right to tax: According to some, it seems to have favoured an archaic approach that was first articulated in *the Kügele v. the Polish State* case of 1932, in which it was ruled that general taxation cannot constitute expropriation.⁴⁵

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.

According to the Tribunal, "[o]nly if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised".⁴⁶ However, this was not the issue in the case at hand: The Tribunal held that "the denial of VAT refunds in the amount of 10% of transactions associated with oil production and export did not deny EnCana 'in whole or significant part' the benefits of its investment".⁴⁷

Whilst there seems to be some inconsistency in determining how much would be "too much" of a taking from a foreign investor, tribunals commonly apply the test of "requirement for a substantial deprivation".⁴⁸ As put forward by Newcombe and Paradell, this requirement opts for a deprivation that is "severe, fundamental or substantial and not ephemeral". However, despite the conceptual commonality, certain factors might still impede consistency in its application. For instance, while the Tribunal in *EnCana v. Ecuador* ruled that a deprivation of 10% would not amount to expropriation, there is no numerical clarity in that whether a deprivation of 60 or 70% would be tantamount to expropriation. In addition, how broad the definition of an investment is understood by a tribunal could be determinative in a deprivation analysis. If, for instance, an investor is denied the VAT return, which (according to a tribunal) comprises 10% of the investment, the investor may not benefit from the applicable protection against expropriation provision. Moreover, legitimate and *bona fide* exercise of general taxation could be considered as a police power, which would not incur any responsibility for the host State.⁴⁹

⁴⁵ Wälde and Kolo, 'Confiscatory Taxation under Customary International Law and Modern Investment Treaties', (*supra* note 25).

⁴⁶ This reasoning was also adopted by the Tribunal in *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. The Government of Mongolia*, UNCITRAL (Paushok v. Mongolia), Award on Jurisdiction and Admissibility, 28 April 2011.

⁴⁷ *EnCana v. Ecuador*, Award, para 177. Similarly see *Señor Tza Yap Shum v. The Republic of Peru*, Award (Spanish), ICSID Case No. ARB/07/6, para 181 in which the Tribunal cites the reasoning of the Tribunal in *EnCana v. Ecuador*.

⁴⁸ This test is also named as "effects test" in arbitral decisions. See for example *Burlington v. Ecuador*, Decision on Liability, para. 395: "The most important factor to distinguish permissible from confiscatory taxation is the effect of the tax. The effects required for a tax to be deemed confiscatory do not appear to be different from those required to assess the existence of an indirect expropriation. In other words, confiscatory taxation constitutes an expropriation without compensation and is unlawful. The Parties have also attached importance to the effects of the tax. Burlington alleged that Law 42 was a measure tantamount to expropriation because it resulted in a substantial deprivation. Ecuador has in turn submitted that a tax measure may be tantamount to expropriation only if it causes the effects required for any indirect expropriation". Also see *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL, Interim Award, 26 June 2000, para. 102: "The Tribunal noted that "under international law, expropriation requires a 'substantial deprivation'; Occidental Exploration and Production Company v. The Republic of Ecuador, LCIA Case No. UN3467, Final Award, 1 July 2004, para. 89: The Tribunal referred to "substantial deprivation" under international law [...]; *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. The United Mexican States*, ICSID Case No. ARB (AF)/04/5, Award, 21 November 2007, para. 240: The tribunal noted that "expropriation occurs if the interference is substantial and deprives the investor of all or most of the benefits of the investment".

⁴⁹ Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* at pp. 344–58, paras. 7.16 and 7.24.

While the test for a “substantial deprivation” is an established rule in determining whether a taxation measure amounts to expropriation, it is also essential to note that the test applies if the subject measure meets the prerequisite to qualify as a “taxation measure”. Such scenarios have been most recently dealt with in disputes concerning the former Yukos shareholders, i.e. *RosInvest, Quasar, and Hulley/Yukos/Veteran v. the Russian Federation*.⁵⁰

In *RosInvest v. The Russian Federation*, the Claimant, RosInvestCo Ltd (a company incorporated in the UK), challenged, among others, the tax liabilities imposed on Yukos by the Russian Federation under the UK – USSR BIT of 1989. After reviewing the implementation of Russian tax law, the tax assessments on Yukos and the conduct of its auction, the Tribunal concluded that the Russian Federation’s acts were not *bona fide*, and were thus confiscatory.⁵¹ According to the Tribunal, therefore, measures taken by the Russian Federation could not be characterized as tax measures, and thus would not fall in the coverage of a test for a “substantial deprivation”:

It [is] undisputed [...] that States have a wide latitude in imposing and enforcing taxation laws even if resulting in substantial deprivation without compensation. The only question is whether Respondent’s measures can be justified as falling within this discretion. In this regard, the Tribunal refers to its considerations above with respect to the application of Russian tax law, the tax assessment, and the auctions which resulted in the conclusion that Respondent’s actions towards Yukos cannot be justified by its authority to apply and enforce its tax laws (emphasis added).⁵²

In *Quasar v. The Russian Federation*, under the Spain – USSR BIT of 1991, the Claimants similarly alleged that the tax claims brought against Yukos were a pretext to seize Yukos’ assets. The Tribunal concurred with the *RosInvest v. the Russian Federation* decision in that “States have a wide latitude in imposing and enforcing taxation laws even if resulting in substantial deprivation without compensation”. However, according to the Tribunal, this shall not lead to “any confused idea that they have a discretion as to whether or not to comply with an investment treaty”. *In obiter*, the Tribunal discussed that simply labelling a measure as taxation would not put such a measure in the scope of the test for a substantial deprivation:

Yet there is a world of difference between incidental detriment, even of a substantial nature, and purposeful dispossession. It is no answer for a state to say that its courts have used the word “taxation”- any more than the word “bankruptcy” - in describing judgments by which they effect the dispossession of foreign investors. If that were enough, investment protection through international law would likely become an illusion, as states would quickly learn to avoid responsibility by dressing up all adverse measures, perhaps expropriation first of all, as taxation. When agreeing to the jurisdiction of international tribunals, states perforce accept that those jurisdictions will exercise their judgment, and not be stumped by the use of labels (emphasis added).⁵³

2.1.3. Taxation and Discrimination

Fiscal discrimination had been the chief impediment imposed by host States on aliens before the development of customary international law. During feudal times in France and England, aliens were subject to excessive taxation and special levies in return for permits to reside and conduct business. Such a discriminatory treatment of aliens has changed gradually, first, with the introduction of certain privileges under treaties that enabled reciprocal treatment of aliens in the same manner as nationals. Second, with the development of international law in the field, a more stable and uniform bases for fiscal rights of aliens was established. This was done, first, through exemption of alien merchants from taxation based on a series of treaties of commerce, and second, through introduction of MFN and NT provisions in international treaties. A third development came to existence after World War I with the rise of nationalism

⁵⁰ Non-ECT disputes will be examined herein. For an analysis of *Hulley/Yukos/Veteran v. The Russian Federation* see Parts 3 and 4.

⁵¹ *RosInvest v. The Russian Federation*, Final Award, paras. 558-81.

⁵² *RosInvestCo UK Ltd. v. The Russian Federation*, SCC Case No. V079/2005 (hereinafter *RosInvest v. the Russian Federation*), Final Award 2010, para. 580.

⁵³ *Quasar v. The Russian Federation*, Award, para. 180.

when host States dismantled privileges granted in pre-war capitulation treaties, and subjected aliens the same taxes as nationals.⁵⁴

In contemporary ITA practice, “discriminatory taxation” could be challenged under NT, MFN or FET provisions as well as protection against expropriation standards. In *Occidental v. Ecuador*, for example, among others, the Claimant disputed that the Respondent breached its obligation when it entitled a “number of companies involved in the export of other goods, particularly flowers, mining and seafood products [...] to receive VAT refund and continuously enjoy this benefit”. By contrast, the Respondent argued that the term “in like situations” [provided in Article II of the US-Ecuador BIT] would require all companies in the same sector [...] to be treated alike and this happens in respect of all oil producers”. In the end, the Tribunal upheld the Claimant’s argument, and ruled that the Respondent breached its obligation of non-discrimination under the NT provision. It distinguished itself from the narrow interpretation of the NT provision in GATT/WTO, and, *in obiter*, held:

In fact, “in like situations” cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken.

In *Paushok v. Mongolia*, similarly, the Claimants alleged that the windfall profits tax violated NT and MFN provisions in the Mongolia-Russian Federation BIT of 1995 on the basis that the Respondent discriminated against the Claimants in favour of (i) Mongolian companies active in the mining and extraction of natural resources such as crude oil (cross-sectoral discrimination) and copper (discrimination between gold and copper) and (ii) Canadian owned Boroo Gold.⁵⁵ Boroo Gold was not affected by the windfall profits tax since it had concluded a stabilization agreement with the Mongolian government protecting it from the negative changes in the tax legislation. The Tribunal distinguished itself from the decision of the Tribunal in *Occidental v. Ecuador* on the basis that (i) the NT clause in the US-Ecuador BIT referred to “in like situations”, which was not available in the NT provisions of the Mongolia-Russian Federation BIT, and (ii) the subject matter of the dispute in *Occidental v. Ecuador* related to the general application of the VAT legislation, whereas the windfall profits tax law in Mongolia dealt specifically with two minerals, i.e. gold and copper. In the absence of an applicable principle, the Tribunal, by analogy to the GATT/WTO practice, referred to “competitive and substitutable products”, and concluded that “the Claimant have not succeeded in demonstrating that [there] was an abusive or irrational decision and that it constituted discriminatory treatment.”⁵⁶

In *Cargill v. Mexico*⁵⁷, among others, the Claimant argued that Mexico breached Article 1102 of NAFTA when it imposed Ley del Impuesto Especial Sobre Producción y Servicios (Law on the Special Tax on Production and Services) (IEPS Tax) on US high fructose corn syrup suppliers (HFCS) but not on the domestic sugar producers. Having considered the conditions under Article 1102 (namely “like circumstances’ with domestic investors or their investments, and that the treatment accorded to the investor or the investment be less favourable than the treatment accorded to domestic investors or their investments”⁵⁸), the Tribunal held that “as a result of the IEPS Tax, the treatment received by suppliers of HFCS to the Mexican soft drinks industry was less favourable than the treatment received by suppliers of cane sugar. HFCS

⁵⁴ Albrecht, *The Taxation of Aliens under International Law*, (*supra* note 3).

⁵⁵ *Paushok v. Mongolia*, Award on Jurisdiction and Admissibility, para. 258.

⁵⁶ *Paushok v. Mongolia*, Award on Jurisdiction and Admissibility, paras. 313–17.

⁵⁷ *Cargill, Incorporated v. United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award, 18 September 2009.

⁵⁸ *Cargill v. Mexico*, Award, para. 189.

suppliers could no longer compete as a result of the IEPS Tax, whereas cane sugar suppliers were not affected”.⁵⁹ It concluded:

[T]he discrimination was based on nationality both in intent and effect. The IEPS Tax was taken avowedly to bring pressure on the United States government. By its very design, then, it was directed at United States producers of HFCS because only in that way would pressure be brought to bear on the United States government. The import permit requirement, which was intended by the Mexican government to be a substitute for the IEPS Tax, was even more directly targeted at United States producers, even though it may have affected other nationals as well. The whole history of this case, as set out by both Claimant and Respondent, indicates that it is about measures directed at United States producers and suppliers of HFCS.⁶⁰

2.1.4. Taxation and Legitimate Expectations

The doctrine of legitimate expectations is a fairly recent phenomenon in ITA, and as a self-standing principle, it has mostly been available through FET claims.⁶¹ As put forward by the Tribunal in *TECMED v. Mexico*, it requires a host State [...] to act in a **consistent** manner, free from ambiguity and totally **transparently** in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments [...] to be able to plan its investment and comply with such regulations” (emphasis added).⁶² The doctrine applies to “taxation measures”, and has been invoked by investors in a handful of cases.⁶³

An often-required principle in the successful invocation of the doctrine is “stability”. Herein, one should distinguish “stability” from contractual stability in that, as a principle under international law, stability would not require “the circumstances prevailing at the time the investment is made remain totally unchanged” unless there is an explicit commitment by a host State to stabilize or even freeze legislation with regard to taxation. The Tribunal in *Paushok v. Mongolia* confirms that an explicit commitment is essential if an investor argues that “modification of taxation levels” would harm its legitimate expectations to obtain a reasonable return when it made its investment:

[F]oreign investors are acutely aware that significant modification of taxation levels represents a serious risk, especially when investing in a country at an early stage of economic and institutional development. In many instances, they will obtain the appropriate guarantees in that regard in the form of, for example, stability agreements, which limit or prohibit the possibility of tax increases.⁶⁴

According to the Tribunal, however, this was not the case: Despite its attempts to obtain such a guarantee, the foreign investor failed to secure a stability agreement. In the absence of such a stability agreement, the Tribunal ruled that “claimants have not succeeded in establishing that they had legitimate expectations that they would not be exposed to significant tax increases in the future”.⁶⁵

⁵⁹ *Cargill v. Mexico*, Award, para. 219.

⁶⁰ *Cargill v. Mexico*, Award, para. 220.

⁶¹ T.W. Wälde, ‘Separate Opinion in *International Thunderbird Gaming Corporation v. United Mexican States*’, (1 December 2005).

⁶² *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ‘Award’, (ICSID Case No. ARB (AF)/00/2, 29 May 2003) at para. 154.

⁶³ For an insightful review see Michele Potestà, ‘Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept’, *ICSID Review*, 28/1 (2013), 88–122; see also Uğur Erman Özgür, ‘In Search of Consistency and Fairness in Investor-State Arbitration: An ‘Institutional’ Approach to Interpreting the Doctrine of Legitimate Expectations’, *Transnational Dispute Management (TDM)*, Special Issue on Investor-State Dispute Settlement System, ed. Jean Kalicki & Anna Joubin-Bret, Vol. 11/Issue 1 (January 2014).

⁶⁴ *Paushok v. Mongolia*, Award on Jurisdiction and Admissibility, paras. 301–2.

⁶⁵ *Paushok v. Mongolia*, Award on Jurisdiction and Admissibility, para. 302.

2.1.5. Preliminary Remarks: What is Legitimate Taxation?

Having reviewed both early cases on taxation and contemporary ITA practice, one may more clearly describe what legitimate taxation is. However, putting forward an exhaustive list of situations in which a taxation measure could be discriminatory and/or confiscatory would be a challenging exercise. After all, as emphasized in various instances above, tribunals consider specific factual background of a dispute in determining whether a taxation measure is, for example, expropriatory.

An instructive list of elements in which a taxation measure might amount to expropriation was furthered in the Political Declaration of Contracting Parties in the OECD's MAI⁶⁶, and some of these correspond to decisions by international courts and tribunals reviewed above. Under the light of these elements, and general principles and practice of international law, one could therefore conclude that:

1. The right to tax is a sovereign prerogative. The imposition of taxes to foreign investments, and, in this vein, introduction of new taxation measures do not *per se* constitute expropriation.
2. Whilst, States have a wide latitude of discretion in imposing and enforcing tax laws, taxes shall be imposed in good faith. Taxation measures shall not be confiscate, prevent, or unreasonably interfere with, nor unduly delay effective enjoyment of a foreign investor's property or its removal from the State's territory.
3. Taxation measures may not be directly expropriatory, however they may have the equivalent effect of an expropriation, or, in other words, they may amount to "creeping expropriation".
4. Either in direct or indirect forms, for a taxation measure to amount to expropriation, the measure shall cause a substantial deprivation that is severe, fundamental or substantial. There is no common numerical threshold in this respect. Tribunals determine the effect of a taxation measure based on factual background of a dispute.
5. Taxation measures might also discriminate between foreign investors and nationals. Foreign investors could invoke NT and MFN provisions in challenging a discriminatory taxation.
6. In determining whether a taxation measure is discriminatory, tribunals conduct their analyses based on the language of the subject treaty and factual background of the dispute. If the treaty does not provide terms such as "in like situations or circumstances", tribunals usually draw analogies from GATT/WTO practice giving effect to the term "competitive or substitutable products". However, there is no established practice in this respect.

⁶⁶ OECD Multilateral Investment Agreement, Draft Consolidated Text, DAFFE/MAI(98)7/REV1, 22 April 1998, Article VIII, p. 86, ft. 3:

Interpretative Note: When considering the issue of whether a taxation measure effects an expropriation, the following elements should be borne in mind:

- a) The imposition of taxes does not generally constitute expropriation. The introduction of a new taxation measure, taxation by more than one jurisdiction in respect to an investment, or a claim of excessive burden imposed by a taxation measure are not in themselves indicative of an expropriation.
- b) A taxation measure will not be considered to constitute expropriation where it is generally within the bounds of internationally recognised tax policies and practices. When considering whether a taxation measure satisfies this principle, an analysis should include whether and to what extent taxation measures of a similar type and level are used around the world. Further, taxation measures aimed at preventing the avoidance or evasion of taxes should not generally be considered to be expropriatory.
- c) While expropriation may be constituted even by measures applying generally (e.g., to all taxpayers), such a general application is in practice less likely to suggest an expropriation than more specific measures aimed at particular nationalities or individual taxpayers. A taxation measure would not be expropriatory if it was in force and was transparent when the investment was undertaken.
- d) Taxation measures may constitute an outright expropriation, or while not directly expropriatory they may have the equivalent effect of an expropriation (so-called "creeping expropriation"). Where a taxation measure by itself does not constitute expropriation it would be extremely unlikely to be an element of a creeping expropriation.

7. Unless there is an explicit commitment by states to stabilize tax levels or legislation (e.g. in a stability agreement or domestic laws or regulations), foreign investors may not be able to challenge imposition of higher tax levels after the investment is made.

2.2. Taxation Carve Out Provisions in International Investment Agreements: Overview⁶⁷

While assessing State liability under international law, a second check-point requires arbitral tribunals to consider whether the applicable treaty includes an exception provision with regard to tax or taxation measures. Such exception or “carve-out” provisions⁶⁸ are common in investment treaties, particularly if the treaty is concluded between States that are keen to safeguard their regulatory space on issues of public interest at the inter-governmental level.⁶⁹ Carve-out mechanisms enable States in keeping taxation out from the coverage of heightened international rules or disciplines, and thus very often, limit arbitrability of disputes arising from taxation measures under investment treaties.⁷⁰

Carve-out provisions may include cross references to double taxation treaties (DTTs), in which case the aim is to avoid the overlap between the investment treaty and DTT. Along the lines of OECD’s Model Tax Convention on Income and Capital, a good number of DTTs have subjected disputes of taxation on income and capital to a non-binding and voluntary mutual agreement procedure between the competent tax authorities of contracting parties.⁷¹ At the same time, in some IIAs, taxation carve-out provisions disabled arbitration of disputes on taxation (generally on measures other than on income and capital) under treaty standards of protection such as FET, NT, MFN and expropriation. As stipulated above, these limitations to arbitrability apply notwithstanding that taxation measures taken by a host State comply with customary international law and standards of protection under the relevant investment treaty. In addition, taxation carve-outs might also include exceptions which, in the end, remove the general limitation to arbitrability.

Established drafting styles of taxation carve-outs in IIAs include (1) *unconditional limitations* that would completely exclude taxation measures from the scope of any kind of differential treatment and/or dispute settlement mechanism therein; and (2) *conditional limitations* that would bar application of standards of protection and/or dispute resolution clauses subject to certain exclusions.⁷²

2.2.1. Unconditional Limitations

Part V of the Association of Southeast Asian Nations’ (ASEAN’s) Agreement on the Promotion and Protection of Investments (ASEAN Investment Agreement) of 1987 unconditionally (in other words without any exceptions) carved out “taxation in the territory of the Contracting

⁶⁷ See Annex I – Taxation Carve-Out or Exception provisions in International Treaties: Examples

⁶⁸ Exceptions or carve-outs shall be distinguished from reservations. An exception or a carve out is not “a unilateral statement [...] made by a State, when signing, ratifying, accepting, approving or acceding to a treaty, whereby it purports to exclude or to modify the legal effect of certain provisions of the treaty in their application to that State”: Article 2(1)(d) of the Vienna Convention on the Law of the Treaties concluded at Vienna on 23 May 1969 (VCLT); Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* at pp. 482-3.

⁶⁹ J.W. Salacuse, *The Law of Investment Treaties* (OUP Oxford, 2010) at p. 341.

⁷⁰ William W. Park, ‘Arbitrability and Tax’, in Loukas A. Mistelis and Stavros L. Brekoulakis (eds.), *Arbitrability: International and Comparative Perspectives* (The Hague: Kluwer Law International 2009).

⁷¹ Z.D. Altman, *Dispute Resolution under Tax Treaties* (IBFD Publications, 2005) at p. 1-2, ft. 3. See OECD Model Tax Convention on Income and Capital (28 January 2003), Article 25.

⁷² Newcombe and Paradell distinguishes two models as “express exception” and “qualified exception” models: Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* at p. 507.

Parties” from the scope of the Treaty. It provided that matters of taxation “shall be [exclusively] governed by [DTTs] between Contracting Parties and the domestic laws of each Contracting Party”.⁷³ Likewise, Article 5(2) of the Argentina-New Zealand BIT of 1999 on Exceptions *unconditionally* subjects “matters of taxation in the territory of either Contracting Party” to “the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties.”⁷⁴ In the Moscow Convention on Protection of the Rights of the Investor, parties *unconditionally* excluded protection of investors against changes in legislation with regard to taxation.⁷⁵

In addition, States may insert exception provisions within expropriation, NT or MFN clauses, which, once again, *unconditionally* carve out taxation measures that fall within the ambit of DTTs and/or municipal tax legislation: For example, Article 4(4) of the Ethiopia – Luxembourg BIT of 2006 provides that NT and MFN provisions shall not be applicable to tax matters.⁷⁶ Likewise, Article 4(3)(b) of the Spain – Mexico BIT of 2006 carves out “any international agreement relating wholly or principally to taxation or any domestic legislation or provision fully or partially relating to taxation” from the scope of the NT and MFN protections.⁷⁷ Along similar lines, Article 3(4) of the Germany-Afghanistan BIT of 2005 carves-out advantages accorded to investors of third States “by virtue of a double taxation agreement or other agreements regarding matters of taxation” from the scope of national and MFN treatments.⁷⁸ Article 10 of the China-Mexico BIT of 2008 also excludes “any rights and obligations of a Contracting Party resulting from an international agreement or arrangement or any domestic legislation relating wholly or mainly to taxation”. It provides that “in the event of any inconsistency between this Agreement and any other tax-related international agreement, or arrangement, the latter shall prevail”.⁷⁹

2.2.2. Conditional Limitations

The dominant approach adopted in taxation carve-out provisions is *conditional*. In other words, provisions on taxation measures very often provide exclusions to general taxation carve-out rules. OECD’s Multilateral Investment Agreement (MIA) provides one such example: Paragraph 1 of Article XIII on Taxation carves out taxation measures from the scope of the Agreement subject to exceptions provided between Paragraphs 2 and 5. Paragraph 2, for instance, excludes expropriation provision from the general carve-out rule in Paragraph 1. Paragraph 3 excludes the Agreement’s rules with respect to transparency from the general carve out rule. Paragraph 4 limits investor-state and state-state arbitration of taxation disputes to exclusions to the general carve-out rule in Paragraphs 2 and 3, i.e. expropriation and transparency. Paragraph 5 defines what Competent Tax Authority and Taxation Measures are.⁸⁰

In like manner, Article 16 of the Canada Model Promotion and Protection of Investments Agreement (FIPA) of 2004 carves out taxation measures to the extent that the taxation measure is not tantamount to expropriation. In this, it obliges parties to refer to “taxation authorities of the Parties [which shall], no later than six months after being notified by an investor [...], jointly

⁷³ Part V of the Association of Southeast Asian Nations’ (ASEAN’s) Agreement on the Promotion and Protection of Investments of 1987.

⁷⁴ Article 5(2) of Argentina–New Zealand BIT of 1999.

⁷⁵ Article 5 of the Moscow Convention on Protection of the Rights of the Investor of 1997. Parties to the convention include Armenia (with reservation), Byelorussia, Kazakhstan, Kyrgyzstan, Moldova and Tajikistan. Russia had signed the Convention, however revoked its signature in 2007.

⁷⁶ Article 4 of Ethiopia–Luxembourg BIT of 2006.

⁷⁷ Article 4(3)(b) of the Spain – Mexico BIT of 2006 translated by the author from its Spanish original.

⁷⁸ Article 3(4) of the Germany–Afghanistan BIT of 2005.

⁷⁹ Article 10 of the China–Mexico BIT of 2008.

⁸⁰ Article VIII of the OECD Model Investment Agreement of 1998.

determine [whether] the measure in question” is an expropriation or not.⁸¹ Likewise, the US Model BIT of 2012 excludes expropriatory taxation from the general taxation carve-out rule under Article 21 provided that the investor “has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measure involves an expropriation; and [...] within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.”⁸² A similar provision exists in the North American Free Trade Agreement (NAFTA): Article 2103 carves out taxation measures from the scope of the treaty except in matters of expropriation under Article 1100 provided that, before commencing arbitration, “parties refer to tax authorities of host and home States for a joint determination as to whether or not the [taxation] measure is an expropriation.”⁸³

The ASEAN Comprehensive Investment Agreement (CIA) of 2009 follows similar lines. Article 4(a) of the CIA carves out taxation measures from the scope of the Agreement except for Articles 13 (Transfers) and 14 (Expropriation and Compensation). While, the Agreement does not embed a joint consultation mechanism in Article 4, it elaborates a consultation mechanism in Article 36 on the Conduct of Arbitration. Article 36(6) gives power to “the disputing Member State and the non-disputing Member State, including representatives of their tax administrations” to consult whether the subject measure is a “taxation measure”. Article 36(7) further empowers the disputing and non-disputing Member States to hold consultation to determine whether “the taxation measure in question has an effect equivalent to expropriation or nationalisation.”⁸⁴

Whereas, the EU has no established investment agreement practice as yet⁸⁵, it regulates any potential conflict between DTTs or similar arrangements with regard to taxation and FTA provisions such as NT and MFN through “Tax Carve-Out” provisions. Current EU policy in the drafting of FTAs is to give effect to provisions such as NT and MFN on taxation measures in so far as such application is necessary under the agreement at hand. The EU – South Korea FTA of 2011 follows these lines. At the same time, however, it leaves some leeway to parties “in the application of the relevant provisions of their fiscal legislation” when “distinguishing [...] between taxpayers who are not in the same situation, in particular with regard to their place of residence or with regard to the place where their capital is invested”⁸⁶ Similarly, in Article 296 of the Colombia-EU-Peru FTA of 2013, parties carve out the application of the provisions of the Agreement in so far as there is inconsistency between the Agreement and any tax convention including DTTs or other international taxation agreement or arrangement. As in the North American practice, it requires parties to refer to competent authorities “for determining whether any inconsistency exists between [the] Agreement and any such convention.”⁸⁷

On the other hand, a former generation of FTAs such as the European Free Trade Association (EFTA) – Southern African Customs Union (SACU) FTA of 2008 is less flexible compared to the

⁸¹ Article 16 of the Canada Model Promotion and Protection of Investments Agreement (FIPA) of 2004.

⁸² Article 21 of the US Model bilateral investment treaty (BIT) of 2012.

⁸³ Article 2103 of the North American Free Trade Agreement (NAFTA).

⁸⁴ Articles 4(a), and 36 (6) and (7) of ASEAN Comprehensive Investment Agreement (CIA) of 2009.

⁸⁵ While the Treaty on the Functioning of the European Union (TFEU or the Treaty of Lisbon) gives exclusive competence to the EU in regulating matters related to foreign direct investment (Article 207(1) of the TFEU), yet, there is no EU common policy in drafting a model investment agreement. The EU seems to pursue a common investment protection and promotion policy through its bilateral and multilateral FTA practice. See e.g. Canada-EU Trade and Investment Agreement negotiations and US-EU Transatlantic Trade and Investment Partnership Agreement negotiations available at http://ec.europa.eu/internal_market/capital/third-countries/bilateral_relations/index_en.htm, date of access: 22 December 2014.

⁸⁶ Article 15.7 of the EU – South Korea FTA of 2011.

⁸⁷ Article 296 of the Colombia-EU-Peru FTA of 2013.

current EU practice in that they carved out applicability of the MFN provision in the Agreement, if a dispute at hand associates to “tax advantages which South Africa and the Member States of the European Union are providing or may provide in the future on the basis of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation”. Article 98 of the EFTA – SACU FTA on “Tax Carve-Out” provides exceptions with regard to “double taxation or other tax arrangements, or domestic fiscal legislation” (Paragraph 2) and distinguishes between “[...] taxpayers who are not in the same situation, in particular with regard to their place of residence, or with regard to the place where their capital is invested” (i.e. NT) (Paragraph 3).⁸⁸ A similar provision exists in the Cotonou Agreement of 2000 (between the African, Caribbean and Pacific Group of States and the European Community and its Member States): Article 52 on “Tax Carve-Out” limits the application of the NT and MFN provisions to tax advantages agreed under DTTs, other taxation arrangements and domestic fiscal legislation.⁸⁹

2.3. Taxation Carve-Outs in Contemporary ITA Practice

As discussed above, taxation carve-out provisions are particular instruments in limiting application of treaty provisions in disputes concerning States’ right to tax foreign investments. There might be variations between certain drafting styles: In the case of Europe, carve-outs have usually been drafted to overcome possible contradictions between bilateral tax arrangements and/or DTTs in order to limit the application of the subject treaty if and when the case at hand concerns a taxation measure. In the North and South American examples, a joint veto system is common: As is the case in Article 21 of the US Model BIT, Article 16 of the Canada Model FIPA and Article 2103 of NAFTA, parties to a dispute might be obliged to exhaust a joint tax consultation procedure for the determination of whether the taxation measure is expropriatory.

As elaborated below, cases in which taxation carve-out provisions have been applied, tribunals commonly address issues such as the meaning of tax and/or taxation measure, and whether joint tax consultation should be a bar to arbitration of disputes based on certain facts of disputes. While, it is herein acknowledged that international investment law does not operate on the basis of the doctrine of precedence, it is equally important to note that tribunals have “a duty to seek to contribute to the harmonious development of investment law, and thereby to meet the legitimate expectations of the community of States and investors towards establishing certainty in the rule of law”.⁹⁰ Thus, the arbitral practice will be reviewed with the aim to assess how specific situations shall be treated under Article 21 of the ECT under Part 4.

2.3.1. Feldman v. Mexico

Article 2103 of NAFTA on Taxation provides a general carve-out for the exclusion of taxation measures from the coverage of the Treaty: “Except as set out in this Article, nothing in this Agreement shall apply to taxation measures”. This general exception or carve-out is followed by exceptions with regard to NT and MFN provisions. Article 2103(4)(b) makes Articles 1102 and 1103 applicable to “all taxation measures, other than those on income, [and] capital gains [...]”. However, extension of any rights provided under bilateral tax arrangements or DTTs through NT and MFN provisions is also carved out with Articles 2103(2) and 2103(4)(c). Concerning expropriatory taxation, Article 2103(6) provides that Article 1110 on Expropriation

⁸⁸ Article 98 of the European Free Trade Association (EFTA) – Southern African Customs Union (SACU) FTA of 2008.

⁸⁹ Article 52 of the Cotonou Agreement of 2000 between the African, Caribbean and Pacific Group of States and the European Community and its Member States.

⁹⁰ *Duke Energy v. Ecuador*, Award, para 117. See Gabrielle Kaufmann-Kohler, ‘Arbitral Precedent: Dream, Necessity or Excuse?’, *Arbitration International*, 23/3 (2007), 357-78.

and Compensation shall apply to taxation measures provided that “[t]he investor [...] refer[s] the issue of whether the measure is not an expropriation for a determination to the appropriate competent authorities [...]”.

In *Feldman v. Mexico*, Article 2103 of NAFTA was subject to Respondent State’s, Mexico’s, contentions in that regulatory measures challenged by the Claimant fell within the scope of the taxation carve-out under Article 2103: “The Respondent has objected that the Claimant has in effect added a new element to the case, which, among other things, should have been submitted to the Competent Tax Authorities under Article 2103(6) for a determination as to whether it should be excluded from consideration as an expropriation”.⁹¹ According to the Tribunal, reference to expropriation under Article 2103 was a confirmation by State Parties that “[...] tax regulatory activity may be expropriatory under Article 1110, albeit with significant limitations”.⁹² While in its final award, the Tribunal did not find the Respondent’s taxation activities to be expropriatory, in its earlier decision on jurisdiction, it held that six month consultation period is not a minimum but a maximum one, and thus the joint tax consultation mechanism did not bar arbitrability of the expropriation claim. Having considered that the six-month consultation period under Article 2103(6) had passed, the Tribunal concluded that the expropriation claim was well within its jurisdiction.

2.3.2. Occidental v. Ecuador

In *Occidental v. Ecuador*, the dispute between the parties centred on whether the terms of the formula with regard to the Claimant’s participation in oil production included a Value Added Tax (VAT) reimbursement, and if not, whether the Claimant was entitled to VAT refunds under the tax laws of Ecuador.⁹³ As a jurisdictional issue, the Tribunal considered the carve-out in Article X of the US-Ecuador BIT of 1993: According to the Respondent, the dispute concerned VAT and non-reimbursement of VAT, and therefore was in the scope of the carve-out provision since they were clearly matters of taxation excluded from the dispute settlement under Article X of the BIT.⁹⁴ It further contended that standards of protection (no less favourable treatment, FET, NT) invoked by the Claimant under Article II of the BIT were also subject to the exception provided in the carve-out provision. The Claimant opposed that the carve-out only applied to matters of direct taxation, According to *Occidental*, it was indirect taxation that was disputed, and therefore the carve-out did not apply.⁹⁵

It is important to distinguish the carve-out set forth under Article X of the US-Ecuador BIT. The general taxation carve-out is different to the usual Model US BIT drafting style. It is somewhat broader. With respect to tax policies of Parties, it provides that “[...] each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party”. It further provides:

Nevertheless, the provisions of this Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only with respect to the following:

- (a) expropriation, pursuant to Article III;
- (b) transfers, pursuant to Article IV; or

⁹¹ *Feldman v. Mexico*, Award, para 101.

⁹² *Feldman v. Mexico*, Award, para. 109.

⁹³ *Occidental v. Ecuador*, Award, para. 29.

⁹⁴ *Occidental v. Ecuador*, Award, para. 65.

⁹⁵ *Occidental v. Ecuador*, Award, para. 66-7.

(c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VI(J)(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.⁹⁶

According to the Tribunal, reference to “fairness and equity” “imposes an obligation on the host State that is not different from the obligation of [FET] embodied in Article II, even though admittedly the language of Article X is less mandatory”. Furthermore, the “nevertheless proviso at the beginning of Paragraph 2 does not derogate this legal effect in that, with regard to taxation measures, the host State could pursue an unfair or inequitable treatment. According to the Tribunal, “[i]t only means that such obligation is concerned with the three categories of tax matters therein listed, that is, expropriation, transfers and the observance and enforcement of an investment agreement or authorization.”⁹⁷

Having determined that the carve-out included an exception with respect to the FET standard, the Tribunal then turned to analysing facts of the dispute in the context of the remaining three exceptions to the general carve-out rule listed in Article X(2). Concerning Subparagraph (c), the Tribunal considered the Modified Participation Contract between the Claimant and Ecuador as an investment agreement. *In obiter*, it discussed that “a tax matter associated with an investment agreement [had] been submitted to it for its consideration”. According to the Tribunal, the Claimant’s position that “there [was] a dispute concerning the observance and enforcement of the Contract” was plausible, “which [brought] the tax dispute squarely within the exceptions of Article X, and hence within the jurisdiction of the Tribunal.”⁹⁸ The Tribunal concluded that the dispute was subject to the dispute resolution provisions of the BIT, and the standards of treatment stipulated under Article II (in particular FET) “acquire[d] its [...] full meaning.”⁹⁹

The Tribunal also considered the expropriation claim as an issue of admissibility since Ecuador raised that there was no expropriation involved in the case as the “specific ground for submitting a matter of taxation to dispute resolution under [...] Article X [was] not available”. *Prima facie*, the Tribunal held that “there [had] been no deprivation of the use or reasonably expected economic benefit of the investment let alone measures affecting a significant part of the investment”, and ruled that the claim concerning expropriation was inadmissible.¹⁰⁰ Whilst, the Tribunal provides some reference as to the conditions of a direct or indirect expropriation, it provides no guidance as to the substance of the exceptions in the carve-out with respect to expropriation.¹⁰¹

2.3.3. *EnCana v. Ecuador*

In EnCana v. Ecuador, a similar issue arose when the Claimant alleged that “[...] the dispute concerns the relationship between the participation factors and VAT liability, and therefore falls partly within, and partly, outside the scope” of the taxation carve-out under Article XII of the

⁹⁶ US-Ecuador BIT, Article X(2)

⁹⁷ *Occidental v. Ecuador*, Award, para. 70-5.

⁹⁸ *Occidental v. Ecuador*, Award, para. 72.

⁹⁹ *Occidental v. Ecuador*, Award, paras. 73-5.

¹⁰⁰ *Occidental v. Ecuador*, Award, paras. 80-92.

¹⁰¹ The award was subsequently challenged by Ecuador before the High Court of Justice, Queen’s Bench Division and UK Supreme Court of Appeal on the basis of “substantive jurisdiction” and “serious irregularity” in the award as per Sections 67 and 68 of the 1996 English Arbitration Act. Both challenges were rejected by the High Court of Justice which seems to have followed the reasoning of the Arbitral Tribunal. The decision was later upheld by the Supreme Court of Appeal. See *Republic of Ecuador v. Occidental Exploration and Production Company*, [2006] 1 Lloyd’s Rep. 773, [2006] EWHC 345, 2006 WL 690585 (QBD (Comm. Ct.)), (2 March 2006) and *Republic of Ecuador v. Occidental Exploration & Production Company*, [2007] EWCA Civ. 656 (4 July 2007).

Canada-Ecuador BIT of 1997. By contrast, in the Respondent's view "the participation factors had no relevance whatsoever to VAT liability" which depends on nothing but the tax laws of Ecuador". Accordingly, the Respondent contended that, Article XII was not applicable to taxation measures under the carve-out provision, and therefore the Tribunal lacked jurisdiction.¹⁰² Similar to NAFTA, Article XII of the Canada-Ecuador BIT carves out taxation measures from the coverage of the Agreement subject to certain exclusions. According to paragraph 3, "a claim by an investor that a tax measure of a Contracting Party is in breach of an agreement between the central government authorities of a Contracting Party and the investor" shall be covered by the BIT unless, within six months, taxation authorities jointly determine that "the measure does not contravene such agreement". An analogous joint tax consultation procedure is required for disputes related to expropriatory taxation under paragraph 4. The investor may submit its dispute to dispute resolution if State Parties to the BIT fail to exhaust joint tax determinations as per paragraphs 3 and 4.¹⁰³

The question of the extent to which matters concerning VAT liability fall within the scope of Article XII was a preliminary one. In interpreting the carve-out provision, the Tribunal in *EnCana* first considered what the scope of the term "taxation measure" was. Having noted that "taxation measure" was not defined in the BIT, it first emphasized the requirement of the rule of law in taking taxation measures:

It is in the nature of a tax that it is imposed by law. Tax authorities are not robber barons writ large, and an arbitrary demand unsupported by any provision of the law of the host State would not qualify for exemption under Article XII. [...] a taxation law is one which imposes a liability on classes of persons to pay money to the State for public purposes.¹⁰⁴

The Tribunal then defined the scope of the term "taxation measure": In its view, there was no reason to limit the term "taxation" to direct taxation, and, so, the term covered indirect taxes such as VAT. The Tribunal also saw no reason why one should limit the scope of the term "measure" to actual provisions of the law which impose a tax:

All those aspects of the tax regime which go to determine how much tax is payable or refundable are part of the notion of 'taxation measures'. Thus tax deductions, allowances or rebates are caught by the term.¹⁰⁵

In this, it distinguished the legal operation and economic effect of the term "taxation measure". The Tribunal opined that a measure was a taxation measure if it is part of the legal regime for the imposition of the tax since "the economic impacts or effects of tax measures may be unclear and debatable". Accordingly, the Tribunal listed VAT measures that fell in the scope of carve-out under Article XII:

In the case of the VAT, the Tribunal does not accept that the system of intermediate manufacturer or producer, is any less a taxation measure at each stage of the process. A law imposing an obligation on a supplier to charge VAT is a taxation measure; likewise a law imposing an obligation to account for VAT received, a law entitling the supplier to offset VAT paid to those from whom it has purchased goods and services, as well as law regulating the availability of refunds of VAT resulting from an imbalance between an individual's input and output VAT.¹⁰⁶

The Tribunal, thereafter, considered specific facts of the case: The Claimant alleged that the resolutions of tax authorities (namely SRI – Servicio de Rentas Enternas) in refusing to allow a

¹⁰² *EnCana v. Ecuador*, Award, para. 134.

¹⁰³ Article XII of the Canada-Ecuador BIT of 1997.

¹⁰⁴ *EnCana v. Ecuador*, Award, para. 142(1).

¹⁰⁵ *EnCana v. Ecuador*, Award, para. 142(2) and (3).

¹⁰⁶ *EnCana v. Ecuador*, Award, para. 142(4).

VAT rebate was inconsistent with the applicable Andean Community Law. According to the Tribunal, however, whether such a taxation measure was lawful under Ecuadorian law was not for the Tribunal to decide. The role of the Tribunal was limited to determining whether such a measure was a taxation measure, and if it was exempt as per Article XII of the BIT. On the other hand, even if SRI was unlawful in allowing the VAT rebate, the measure would not cease to be a taxation measure for the purposes of Article XII(1). However, drawing on the International Law Commission's Articles on State Responsibility, the Tribunal also noted that had there been a retrospective change in law to cover some measures by taxation law which was not covered at the time, and that latter labelling of such measures as taxation measures would not "attract immunity from scrutiny under Article XII(1)".¹⁰⁷

2.3.4. Duke Energy v. Ecuador

In *Duke Energy v. Ecuador*, among others (late and inappropriate implementation of Payment Trusts; non-payment interest on late payments; wrongful imposition of fines and penalties; failure to entertain the Claimants' suits under local arbitration), the Tribunal addressed the alleged "disregard of customs duties application" invoked under both the Power Purchase Agreements (PPAs) concluded by and between INECEL (the State owned entity) and Electroquil, and – like the *Occidental v. Ecuador* case – the US-Ecuador BIT of 1997.¹⁰⁸ The Claimants argued, and the Respondent opposed, that the Arbitration Agreement in respective PPAs extended the Tribunal's jurisdiction over claims including matters of Payment Trusts, interest on late payments, and customs duties, and, in any case, these claims were also subject to its jurisdiction pursuant to the BIT.

In this vein, the Tribunal assessed whether the BIT could in fact be invoked. A jurisdictional issue that the Tribunal faced was whether the "customs duties" claims could be considered in the scope of BIT protection by way of application of Article X of the BIT, which included a taxation carve-out and relevant exceptions. According to the Respondent, customs duties were related to tax matters, and therefore, were outside the scope of the BIT pursuant to Article X(2)(c).¹⁰⁹ By contrast, the Claimants contended that the customs duties claim did not involve a matter of taxation as described in Article X(2). According to the Claimants, had the Tribunal determined that the claim was a matter of taxation, it would, in any case, fall within the exceptions listed in Article X(2) since the PPAs [were] investment agreements¹¹⁰, which was also the conclusion reached by the *Continental v. Ecuador* Tribunal based on similar factual basis.

The Tribunal, however, was not in agreement with the Claimants' arguments. It approached the jurisdictional question in a two-tiered way: First, it assessed whether the claim for customs duties is a matter of taxation within the meaning of Article X. While the Tribunal noted that the BIT did not define the term "matters of taxation", it considered the definition put forward by the *EnCana v. Ecuador* Tribunal as instructive. The Tribunal held that:

From their title and even more from their purpose, Ley No. 30 and Ley Organica de Aduanas must be deemed to constitute taxation legislation. Indeed, as stated by the *EnCana* tribunal, '[a] measure providing relief from taxation is a taxation measure just as much as a measure imposing the tax in the first place.'

Consequently, the Tribunal concluded that the "customs duties" must be deemed as a matter of taxation in the context of the carve-out provision in Article X. As a second issue, the Tribunal

¹⁰⁷ *EnCana v. Ecuador*, Award, paras. 146-9.

¹⁰⁸ *Duke Energy v. Ecuador*, Award, para. 99.

¹⁰⁹ *Duke Energy v. Ecuador*, Award, para. 151.

¹¹⁰ *Duke Energy v. Ecuador*, Award, para. 152.

questioned whether the customs duties qualified for an exemption under Article X(2)(c) since, according to the Claimants, “it relate[d] to Ecuador’s obligation under the PPAs to reimburse Claimants and because PPAs are investment agreements”. In this vein, the Tribunal considered whether “(a) the PPAs are indeed investment agreements, as referred to in Article VI(1)(a) or (b) of the BIT, and (b) whether the observance and enforcement of the terms of an investment agreement concerning matters of taxation is at issue in this dispute”.¹¹¹

Based on the definition by Justice Aikens, the Tribunal held that “an investment agreement has to be one that ‘is between a State Party and a national or company of the other State Party’”. Thus, considering the fact that the PPAs were entered into by INECEL – a state-owned entity – and Electroquil, which was not owned by foreign investors at the time of subscription of Agreements, the PPAs could not be recognized as investment agreements as per the definition adopted by the Tribunal.

According to the Tribunal, in fact, the *Occidental v. Ecuador* award leads to an opposite conclusion to that of the Claimants: Whilst, in *Occidental v. Ecuador*, the Tribunal identified the concession contract as an investment agreement (since it had been signed between a foreign investor and Petroecuador, a State-owned corporation), same methodology would not apply here as the PPAs were not concession contracts, but “contracts for the installation of certain equipment and the sale and purchase of electricity to INECEL”.¹¹² And, even if the PPAs were concession agreements, the PPAs would not qualify as investment agreements since “Duke Energy did not sign the PPAs nor did it acquire any obligations under their terms”.¹¹³ Accordingly, the Tribunal concluded that “the PPAs cannot be deemed investment agreements for the purposes of Article VI(1)(a)”, and therefore, could not be considered within the context of the exception to the general carve-out rule under Article X(2)(c) of the BIT. Thus, the taxation carve-out applied fully, and the Tribunal lacked jurisdiction to decide over the customs duties claim.¹¹⁴

2.3.5. El Paso v. Argentina

In *El Paso v. Argentina*, the Tribunal noted that, in the context of expropriation claims, the Claimant also challenged the tax measures enacted from 2002 onward by the Government of Argentina. As part of its claim under the heading “Failure to mitigate impact of Law No 25,561”, the Claimant alleged that:

[W]ith the devaluation of the peso and the inflation deriving there from – that reached 118% in 2002 – , the non-recognition of inflation for tax depreciation purposes was unreasonable and confiscatory. As a result, there has been an expropriation: [...] [T]he policy of the Government ‘artificially diluted the amount of depreciation that the CAPEX [sic] and COSTANERA are allowed to claim for tax purposes, thus resulting in confiscatory taxation and a taking of revenues.’¹¹⁵

Under its claim on “Restrictions on deduction for losses from Law No 25,561”, *El Paso* further argued that:

The [Government of Argentina] unreasonably limited the tax deductions of the Argentine Companies in light of the significant losses caused by the devaluation of the Peso.¹¹⁶

¹¹¹ *Duke Energy v. Ecuador*, Award, para. 174-81.

¹¹² *Occidental v. Ecuador*, Award, paras. 184-5.

¹¹³ *Occidental v. Ecuador*, Award, paras. 185-6.

¹¹⁴ *Occidental v. Ecuador*, Award, paras. 187-9.

¹¹⁵ *El Paso v. Argentina*, Award, paras. 281-4.

¹¹⁶ *El Paso v. Argentina*, Award, para. 284.

According to El Paso, as a foreign investor, it had a right to certain tax deductions:

While it is fair and reasonable for an investor to expect that no inflation adjustment be used in a low inflation environment, it is also reasonable that the same investor can expect that inflation will be recognized for tax depreciation purposes in the context of high inflation such as occurred in 2002.¹¹⁷

The Respondent, on the other hand, argued that, under international law, the BIT could only be violated if there are taxes with confiscatory effect. According to Argentina, “[t]he creation of export duties on oil and gas within the context of the crisis is a reasonable governmental regulation”, and “[t]he regulations issued in connection with income tax [...] are also a part of Argentina’s freedom to act in the broader public interest through new or modified regimes”. Thus, Argentina contended there was no expropriation, and therefore the tax measures taken by the Government would not fall under the exceptions listed in Article XII of the BIT. It argued that general carve-out was applicable in the case, and the Tribunal lacked jurisdiction on the export withholdings claim, which, according to Argentina, formed 93% of the claims.¹¹⁸

It is useful to note that, in its earlier Decision on Jurisdiction, the Tribunal concluded that:

[I]t has jurisdiction over tax matters, but only insofar as the tax measures complained of are linked with: (a) expropriation, pursuant to Article IV; (b) transfers, pursuant to Article V; or (c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VII(1)(a) or (b). In other words, the only claims that the Tribunal can consider at the merits stage are the tax claims based on the existence of an expropriation and on the violation of an investment agreement or authorization. Everything else is beyond the competence of the Tribunal.¹¹⁹

Having found that El Paso did not file any claim related to transfers under Article V or an investment agreement or authorization under Article VII(1)(a) or (b), the Tribunal pursued into assessing whether tax measures challenged by the Claimant would qualify as an expropriation, and thus, could be considered under the expropriation exception stipulated in Article X(2) of the BIT. Giving due regard to States’ sovereign right to tax aliens in its territory, the Tribunal analysed the facts of the case in the context of applicable provisions of the BIT and earlier awards on taxation measures. Citing the *EnCana v. Ecuador* award, the Tribunal first determined that “the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change [...] during the period of the investment”.¹²⁰

In obiter, the Tribunal considered that introduction of export duties on oil and gas were “a reasonable governmental regulation within the context of the [2001 Argentina] crisis”. It therefore held that measures with regard to taxing of the unexpected income resulting from the devaluation of the Argentine peso and the increase in the international price of oil were not tantamount to expropriation. In addition, the Tribunal found that the tax measures had only limited impact on the property rights of the Claimant since “export withholdings imposed in May 2004 cannot have caused a forced sale constituting an expropriation of El Paso’s shares in the Argentinian companies [...]”. Hence, according to the Tribunal, taxation measures implemented by the Government of Argentina did not amount to expropriation. They were “reasonable and did not result in the neutralisation of the property rights of the Claimant”.¹²¹

¹¹⁷ El Paso v. Argentina, Award, para. 285.

¹¹⁸ El Paso v. Argentina, Award, paras. 286-8.

¹¹⁹ El Paso v. Argentina, Decision on Jurisdiction, para. 112.

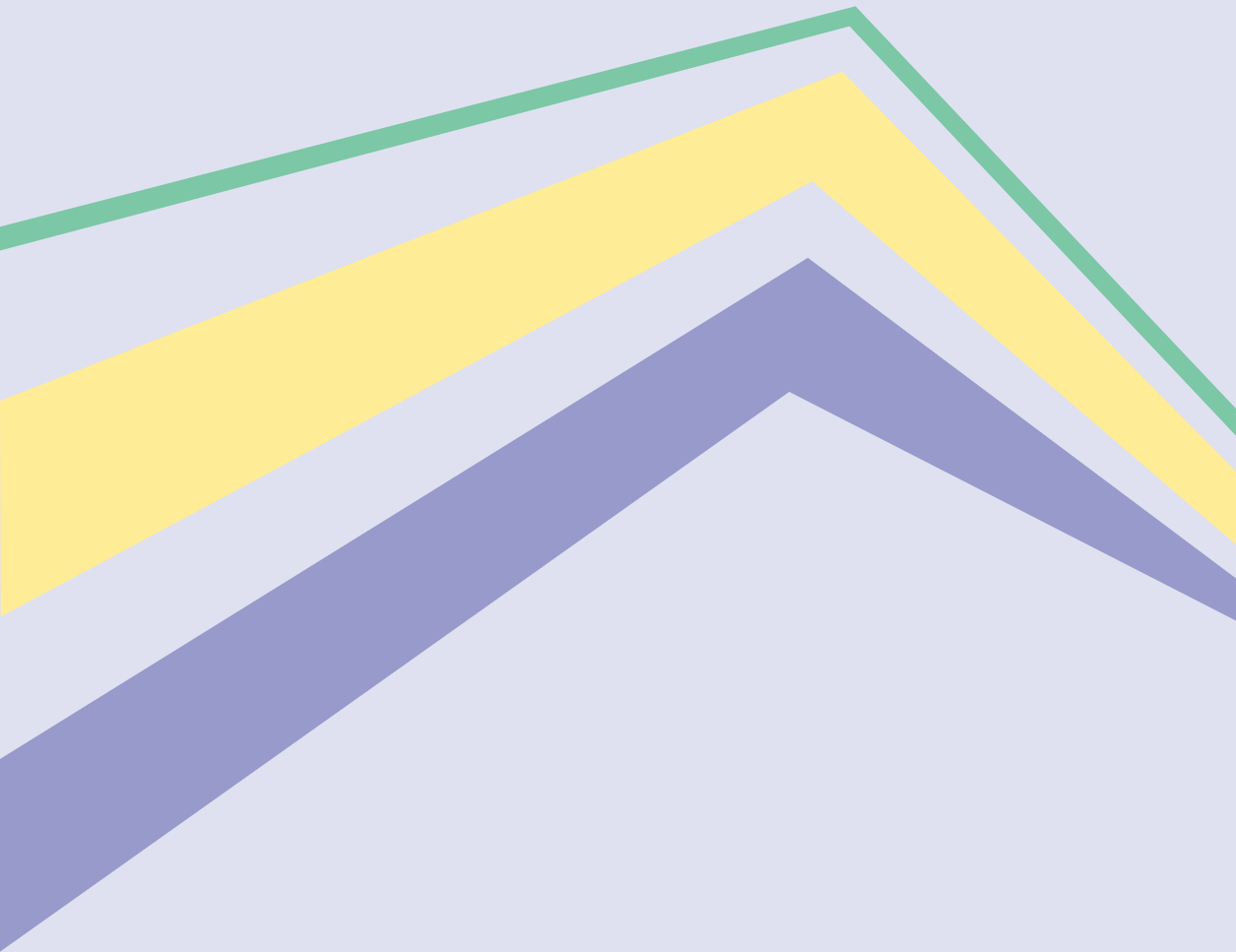
¹²⁰ El Paso v. Argentina, Award, para. 294.

¹²¹ El Paso v. Argentina, Award, paras. 297-99.

2.4. Preliminary Remarks

Having reviewed some specific textual differences in carve-out provisions in some IIAs, one could put forward some common elements in their application, despite their case specific applications:

1. Tribunals concur in that tax regulatory activity may be expropriatory subject to limitations.
2. A joint tax consultation or veto mechanism (or in other words a referral mechanism) is common in the majority of conditional carve-out provisions. The procedure is limited to a certain period (usually 6 months), and tribunals do not consider this limitation as a bar to arbitrability of investor-State disputes.
3. There is no clarity in that if the joint consultation tax mechanism is a procedure that must be exhausted before proceeding into arbitration of disputes. While, drawing on the specific text of the applicable treaty, some tribunals consider the consultation mechanism as a jurisdictional prerequisite, they also agree in that it shall not bar investors from submitting their disputes to arbitration.
4. Some carve-out provisions define what tax or taxation measures are, whereas some others remain silent in defining certain terms. In the absence of definitions embedded in treaties, tribunals refer to general principles of international law, and the superiority of the rule of law in the imposition of tax measures. If not defined in the applicable treaty or in any other source of international law (which could be read into the treaty), they note that the term "taxation measures" includes taxes on income and capital, customs duties as well as indirect taxes such as VATs. The term "measures" does not only refer to provisions embedded in domestic taxation laws and regulations or treaties. It also includes any measure taken to enforce or collect taxes.



3. TAXATION CARVE-OUT MECHANISM UNDER THE ECT: ARTICLE 21

3. TAXATION CARVE-OUT MECHANISM UNDER THE ECT: ARTICLE 21

3.1. Article 21 of the Energy Charter Treaty on Taxation: Drafting Background

Having considered the limits to States' sovereign right to tax under international law, and having reviewed the major drafting styles of taxation carve-out provisions in investment agreements, one may now turn to analysing the methodology adopted in the drafting of Article 21 on Taxation. Before further analysis, however, one should also take note that the ECT comprises both BIT and FTA features. Its content is comprehensive in that the ECT also obliges Contracting Parties to facilitate trade and transit of energy materials and products, and promotes energy efficiency policies through the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA). Thus it provides multilateral rules on trade and transit on sector specific basis, with cross references to the General Agreement on Tariffs and Trade (GATT) (see e.g. Article 29), in addition to investment promotion and protection provisions in Article 26 and Part III.

A review of the *travaux préparatoires* proves the difficulty in establishing consensus among States in drafting a multi-tasked carve-out provision that would also suit the purpose of the ECT. In the Sub-Group on Taxation of Working Group II (WG II) of the European Energy Charter Conference (EEC Conference), key issues considered by delegates were whether transit provisions and trade related investment measures (TRIMs) should apply to taxation measures, and whether taxation measures should be subject to ITA provisions articulated under Article 26 and Part III of the ECT. Negotiations on the draft Article 21 on Taxation of the ECT were fierce, and were not concluded until the last minute, i.e. until the adoption of the Final Act of the EEC Conference on 30 November 1994.

3.1.1. Initial Records of Negotiations

The very first texts of the provision limited the content of the carve-out clause to limit bilateral arrangements (i.e. DTTs) or domestic legislation on taxation from the scope of the ECT. The text proposed by the Chairman of the WG II on 12 September 1991 was formulated to carve out the "exten[sion] [of the provisions of the ECT] to the investors of any other Contracting Party the benefit of any treatment, preference or privilege resulting from [...] any international agreement or arrangement or any municipal legislation relating wholly or mainly to taxation". The draft text aimed to overcome potential extension of more beneficial treatments provided under DTTs or other bilateral tax arrangements and domestic legislation through the MFN treatment in the ECT. However, later on, it was proposed to draft Article 21 (formerly Article 20) to include a more detailed set of carve-outs with regard to challenging:

- Domestic legislation on taxation (through the national treatment [NT or discrimination] provision);
- Advantages and privileges granted "by virtue of its membership to or its association with any existing of future Customs or Economic Union or a Free Trade Area or similar international agreement, or any agreement and any equivalent arrangement entered into in order to avoid double taxation or to facilitate cross-border traffic"¹²²;
- Trade related taxation measures on Energy Materials and Products;
- Transit related taxation measures on Energy Materials and Products.

¹²² USA alternative Text, BA 10, March 19, 1992, Annex 5.

- Under the mandate of the German delegation's proposal, direct taxation along the lines of the OECD Model Tax Convention's clause on non-discrimination.¹²³

It was also proposed to exclude expropriatory taxation from the coverage of the general carve-out rule under Article 21 provided that parties to a dispute exhaust certain remedies prior to filing an investor-State or State-State arbitration claim (such as referral to competent tax authorities). This proposal was first articulated in the US' alternative text on 10 June 1992.¹²⁴ This initial text was, however, criticized for speaking of plural "authorities", and for requiring referral to competent authorities "at the earlier of the time when amicable settlement procedures under Article [26(1)] or [27(1)] begin, or the time the issue is submitted to arbitration or dispute resolution". During negotiations, Craig Bamberger voiced substantial concerns in that such a text might affect access to ITA. In his report he argued:

"First, since referral 'is required' at a time certain, failure to refer in accordance with this paragraph appears to be a bar to arbitration, and failure to have done so at the time require is a potential defect. The risks are aggravated by the lack of clear definition in Article [21] of when an issue has arisen under Article [13] that meets the characteristics of the first sentence of paragraph (b); for example, 'taxation measure' is identified only by illustration in paragraph [(7)(a)]".¹²⁵

In their response, three members of the Taxation Sub-Group "opposed any change in the referral provisions, insisting that they accurately reflected the intention of the Taxation Sub-Group". One member further noted:

There was agreement in the tax-group that issues of allegedly discriminatory taxes must first be referred to the competent tax authorities of the countries involved in the dispute. By-passing this procedure would therefore seem inappropriate to us.¹²⁶

Following a joint meeting of the Legal and Taxation Sub-Groups held on 22 June 1993, the Taxation Sub-Group redrafted the referral provision and eliminated the provision stating that "referral is 'required' at a time certain, calling for referral by the investor or Contracting Party to the 'relevant' competent tax authority rather than to 'the competent tax authorities', and inserting a provision obliging the deciding tribunals to make a referral to 'the relevant competent tax authorities' if the investor or Contracting Party has failed to make a referral". According to Bamberger "[t]his was a purposeful and quick redrafting exercise by the Taxation Sub-Group members, aimed at completing their work, not a reflection on possible scenarios for implementation".¹²⁷ This final text was circulated as the Text for Adoption (TfA) on 14 September 1994.

3.1.2. Negotiations on the Text for Adoption: Post-14 September 1994

While the general framework as to the substance of Article 21 in the TfA, remained mostly untouched; after 14 September 1994, disagreement continued on certain crucial matters such as restricting taxation issues concerning TRIMS (currently Article 5 of the ECT), and MFN and NT

¹²³ BA-15, August, 12, 1992, Proposal by Germany: "Inclusion of the non-discrimination clause based on the OECD Model Double Taxation Convention [concerning taxes on estates, inheritances and gifts or substantially similar taxes] was not supported by the UK and a number of other Member States on the grounds that it would be inconsistent with the approach of Member States making [DTIs] and that most Member States for whom the matter was important already have relevant [DTIs].

¹²⁴ The USA proposal read: "The issue of whether such tax is discriminatory shall be referred for resolution to the competent authorities under a tax convention between the relevant Parties. If the competent authorities under the tax convention do not agree to consider the issue, or having agreed to consider the issue, fail to resolve it within a reasonable period of time, or if there is no tax convention between the relevant parties, the issue of whether such tax is discriminatory shall resolved together with all other issues of the expropriation under Article ____ of Part IV (Investment Promotion and Protection) basing such resolution on the concepts of the nondiscrimination provision of the OECD or UN Model Income Tax Treaty", USA proposal, RMDOC-5, June 10, 1992. It is useful to note that draft article was mostly mandated by delegates from the USA, Canada, Australia, the UK, Japan and Germany.

¹²⁵ BA-15, August, 12, 1992.

¹²⁶ Ibid.

¹²⁷ Interview with Craig Bamberger, available in file with the ECS.

protections provided through the ITA mechanism (currently) under Article 26 and Part III. For instance, upon the Chairman's proposal to include an exclusion to the general carve out rule on TRIMS, Canada noted that it was not prepared to accept extension of obligations in the tax area beyond those already imposed by the GATT.¹²⁸ Along the similar lines, the US delegation also noted that the USA did not agree to amend Article 21(2)(a) to cover TRIMS. It opined "[c]hoosing TRIMS under Article 21(2)(a) amounts to an extension of the obligations regarding taxation in the Energy Charter in the guise of a legal clarification".¹²⁹ According to Canada and the USA, such exception would subject TRIMs to ITA, unlike the treatment of TRIMs under the GATT.¹³⁰ Eventually, a reference to Article 5 on TRIMS was not included in Article 21.

Another major disagreement arose from different positions of delegations on the potential enforcement of the provisions of other bilateral taxation agreements and arrangements through NT and MFN provisions. By virtue of the last sentence of Article 10(1) [which read: "[i]n no case shall such investments be accorded treatment less favorable than that required by international law, **including treaty obligations**" (emphasis added)], Canada argued that the treaty provided protection for measures that fall within the scope of double taxation treaties and other agreements described under draft paragraph 6(a)(ii) of Article 21¹³¹, which "could be read to effectively import the provisions of the tax treaties of Contracting Parties within the scope of the ECT, and permit enforcement of tax treaty obligations under the ECT's dispute settlement procedures in Articles 26 and 27".¹³² On similar grounds, Canada later on suggested that "it would be much preferable to leave disputes arising in the tax area exclusively within the realm of State-to-State dispute resolution, for reasons similar to those that led the Taxation Sub-Group to draft Article 21(4) in connection with expropriation claims in tax area". Canada, therefore, proposed to introduce the following proviso at the end of Paragraph (3):

"The obligations under Part III by virtue of this paragraph shall not be enforceable under Article 26".

Thereafter, the US delegation, in support of the Canadian proposal, extended this carve-out with the following proposal:

"The obligations under Part III by virtue of this paragraph shall not be enforceable under Article 26. The dispute settlement provisions of this Treaty shall not apply to obligations under provisions relating to taxes of any convention for the avoidance of double taxation or any other international agreement or arrangement by which the Contracting Party is bound".

This stage of negotiations marks the inception of some contrasting views between US-Canada-UK block and Germany. US-Canada-UK backed the position that taxation measures should not be subject to ITA under Article 26 and Part III. Canada submitted that "[it] never envisioned that tax disputes (other than those pertaining to expropriation, explicitly addressed in [Paragraph (5)] of Art. 21) would be subject to [ITA] under the ECT". It further noted that additional sentence at the end of Paragraph (3) in its proposal was a mere clarification of the intent of Taxation Sub-Group (which according to Canada was to exclude Article 26 from the reach of investors on matters related to taxation).¹³³ Nevertheless, a draft of the Article that included a proviso restricting resort to NT and MFN protection under Article 26 and Part III on

¹²⁸ Text for Adoption, Canada comments, October 5, 1994.

¹²⁹ Text for Adoption, USA comments, October 5, 1994.

¹³⁰ Interview with Craig Bamberger, available in file with the ECS.

¹³¹ Article 21(6)(ii) of the TFA provided: "[...] any provision relating to taxes of any convention for the avoidance of double taxation or any other international agreement or arrangement by which the Contracting Party is bound".

¹³² Text for Adoption, Canada comments, October 26, 1994.

¹³³ Text for Adoption, Canada, USA, the UK comments, November 3-25, 1994.

ITA on matters of taxation was circulated in Sub-Group on Taxation on 8 November 1994. In Paragraph (3) the last sentence read:

“[...] provided that a breach of an obligation under those provisions with respect to such a Taxation Measure shall not be subject to Article 26”.

Germany opposed this text: By contrast, it was of the view that all discussions were “based on the assumption that Article 26 applies to Article 21”. According to Germany, amending the text of Article 21 to exclude ITA would deteriorate investors’ position, particularly in Russia, where indirect taxation measures raise important issues.¹³⁴ Craig Bamberger, Chairman of the Legal Group, supported the view of Germany in his analysis of 4 November 1994: According to Bamberger, amending the article as proposed by the USA and thus denying access to ITA provisions of the ECT was not in compliance with the actual intentions of the Contracting Parties. The taxation carve-out mechanism creates obligations for Contracting Parties which shall be subject to adjudication under the ECT.¹³⁵ On the other hand, EEC Conference Secretariat could not produce any document that proved the contrary: Leif Ervik, from the Secretariat, noted that “[t]he files on negotiations on this Article neither confirms nor denies that [ITA] was meant to be excluded”.¹³⁶

In a note dated 29 November 2014, Lise Weis from the EEC Conference Secretariat, noted:

“Craig Bamberger continues to believe that the Taxation Article is one of the major flaws in the ECT. [...] The main issue is that a government is allowed to breach a contract with a private investor under the provisions of Article 10(1) with respect to taxation. Craig Bamberger is certain that this was never intended”.¹³⁷

The very same date, a note by the Legal Sub-Group read:

“If a decision were taken on policy grounds to delete the proviso at the end of Paragraph (3), the only other necessary drafting change would be to change the coma at the end of sub-paragraph (3)(b) to a period”.¹³⁸

3.1.3. Final Text

In the Final Act of EEC Conference of 30 November 2014, Article 21 read:

“[...]”

(3) Article 10(2) and (7) 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:

(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.

[...]”

As it appears from the Final Act, the “policy decision” was taken, and the comma at the end of Sub-paragraph (3)(b) was changed to a period. This decision was not taken through consensus and/or consultations with stakeholders. As confirmed by Bamberger, the German proposal was adopted, mainly, for two reasons: First, the EEC Conference Secretariat neglected from keeping the EU Presidency, then held by Germany, abreast of the Taxation Sub-Group’s discussions.

¹³⁴ Text for Adoption, Germany comments, November 23, 1994.

¹³⁵ Note by the Chairman of the Legal Sub-Group, November 4, 1994.

¹³⁶ Note by Leif Ervik of the EEC Conference Secretariat to Ann Fisher (USA), Alain Castonguay (Canada) and Peter Wardle (UK), November 18, 1994.

¹³⁷ Personal note of Lise Weis, November 29, 1994.

¹³⁸ Report of the Taxation Sub-Group, November 29, 1994.

Second, as noted elsewhere, Leif Ervik, Chairman of Taxation Sub-Group, could not find any decisive evidence that the proviso reflected the original intention of the negotiators.¹³⁹

3.2. Article 21 in Practice

The dearth of the cases is apparent: Whilst taxation is an issue of utmost controversy in the energy sector, the *publicly available* awards concluded under the auspices of the ECT are limited. This part, therefore, draws on two disputes, namely *Plama v. Bulgaria* and *Hulley/Yukos/Veteran v. the Russian Federation*, which, in operative parts, include references to the rather complex formulation of Article 21 of the ECT.

3.2.1. Plama v. Bulgaria

In *Plama v. Bulgaria*, the Claimant argued that “Bulgaria ha[d] failed to create stable, equitable, favourable and transparent conditions for [its] investment in Nova Plama [the former State-owned joint stock company that was privatized in 1996] in violation of its obligations under the ECT.¹⁴⁰ In addition to its claims with regard to liability for environmental damages, allegedly unlawful actions of Syndics, privatization of Varna Port, and negotiations with the State-owned Biochim Bank in restructuring its debt; Nova Plama invoked Articles 10 of the ECT on the basis that Bulgaria refused to assist Nova Plama “in finding a solution to the problem of ‘paper profits’ [which – allegedly – arose out of Bulgaria’s failure to adopt legislation for artificial profits] and by failing to amend its laws in a timely way regarding the taxation of the paper profit which resulted from the discounted liabilities under the Recovery Plan [...]”. According to the Claimant, the Respondent also violated Article 13 on expropriation when its negligent actions “resulted in the deprivation of Nova Plama’s right to use and enjoyment of the economic benefits of its investment.”¹⁴¹ The Respondent, referred to Article 21(1) of the ECT, and argued that Contracting States to the Treaty “do not accept an obligation under Article 10(1) of the ECT regarding [FET] with respect to tax”.¹⁴²

In its decision, the Tribunal considered the “paper profit” claim in the scope of Article 10(1) and the FET standard, noting that “the Claimant [...] was or should have been aware of the taxation treatment that would be accorded to debt reduction by Bulgarian law. It could not have had any legitimate expectation that it would be treated otherwise”. The Tribunal assessed the factual record and the tax laws of Bulgaria, and found “no evidence that Bulgaria violated its obligations under the ECT [...] towards Claimant with respect to paper profits issue [...]”. In obiter, the Tribunal also discussed the applicability of Article 21 on Taxation in the dispute. According to the Tribunal:

“Article 21 of the ECT specifically excludes from the scope of the ECT’s protections taxation measures of a Contracting State, with certain exceptions, one of which is that, if a tax constitutes or is alleged to constitute an expropriation or is discriminatory, **the Investor must refer the issue to the competent tax authority, which Claimant did not do**” (emphasis added).¹⁴³

Thus, according to the Tribunal, if an investor challenges a measure of taxation under the ECT’s expropriation and/or discrimination provisions, it must exhaust the referral mechanism before proceeding to arbitration. It could be argued that the Tribunal therefore deemed the referral mechanism as a bar to arbitration. On another point, although the Claimant invoked Article 13

¹³⁹ Interview with Craig Bamberger, available in file with the ECS.

¹⁴⁰ *Plama v. Bulgaria*, Award, paras. 149–51.

¹⁴¹ *Plama v. Bulgaria*, Award, paras. 256–9.

¹⁴² *Plama v. Bulgaria*, Award, para. 260.

¹⁴³ *Plama v. Bulgaria*, Award, para. 266.

on expropriation, the Tribunal seems to have limited its analysis to the legitimate expectations doctrine under Article 10(1) on the FET standard. However, as also noted by the Tribunal, Article 21(1) carves out taxation measures from the scope of the ECT subject to certain conditions. The FET standard is not amongst these exceptions. In other words, if a tribunal determines that a taxation measure is being challenged by an investor under the ECT, it would have no jurisdiction for an FET claim as per Article 21(1). The Tribunal in *Plama v. Bulgaria*, however, chose not to address (i) what a taxation measure is in the context of the dispute and (ii) if the measure at hand breaches Article 13 of the ECT. It seems from the award that the Tribunal *per se* admitted the measures by the Respondent on “paper profit” as taxation measures without any reasoning. The award does not involve any further discussion on the scope of Article 21.

3.2.2. *Hulley/Yukos/Veteran v. The Russian Federation*

In *Hulley/Yukos/Veteran v. The Russian Federation* (Yukos cases), a central issue in the disputes was the tax optimization scheme and tax re-assessments imposed on Yukos, a joint stock company that was established in 1993, and was subsequently privatized in 1995. By the end of 2000 Yukos was the largest of all nine major companies in the Russian Federation and, in a similar fashion, was operating based on vertical integration, transfer pricing and use of low-tax regions, i.e. ZATOs (Zakrytoe Administrativno-Territorial'noe Obrazovaniye – Closed Administrative Territorial Unit), to mitigate tax burdens. Yukos was typical in this sense, as it was using ZATOs or the low-tax regions as part of its tax optimization strategy. Whether the actions of Yukos (to minimize its tax burdens) lawful or not was a disputed issue in the case. In examining the Tax Optimization Scheme, the Tribunal questioned if “Yukos [was] merely taking advantage of the legislative arrangements in place to minimize its taxes, or was there an element of abuse in its scheme”. It also questioned whether “the Russian Federation [was] merely enforcing its tax laws, or rather it [was] carrying out a punitive campaign against Yukos and its principal beneficial owners”. “Were the other Russian oil companies subjected to the same tax enforcement actions by the Russian Federation, or was Yukos discriminated against and specifically targeted by the Russian Federation?”¹⁴⁴

In this context, an objection raised by the Respondent was that the Tribunal lacked jurisdiction over claims with respect to taxation measures other than those based on expropriatory taxes as per the taxation provisions under Article 21 of the ECT. The Claimants, on the other hand, argued that Article 21 does not apply to actions - including expropriations - carried out under the guise of taxation.¹⁴⁵ The Yukos shareholders alleged that the Respondent’s actions were not *bona fide* taxation measures, but were rather a tool to achieve a purpose that had nothing to do with taxation.¹⁴⁶

Claimants also took the view that the ECT would still apply with regard to the expropriation standard under Article 13 of the ECT, due to the claw-back provision in Article 21(5) of the ECT, which, they argued, must have the same scope as Article 21(1) of the ECT. On another point, Claimants asserted that referring any questions which regard to taxation measures to the Russian Federation’s tax authorities as per the claw back provision in Article 21(5) would be an exercise in *futility*.¹⁴⁷

¹⁴⁴ Yukos cases, Final Award, paragraphs 272–6.

¹⁴⁵ Yukos cases, Final Award, paragraph 1375.

¹⁴⁶ Yukos cases, Final Award, paragraph 1379.

¹⁴⁷ Yukos cases, Final Award, paragraphs 1380–84.

Respondents argued that the Tribunal lacked jurisdiction due to the taxation carve-out provision in Article 21(1) of the ECT, which has a number of functions, such as preserving States' sovereignty in fiscal matters. To achieve these functions, taxation carve-outs would typically be "broad, covering all aspects of the tax regime". In response to the Claimant's argument that Article 21(1) ECT is inapplicable since the measures by the Respondent were taken under the guise of taxation, the Respondent referred to the ECtHR Yukos Judgment in support of its claim that the tax assessments pursued a legitimate aim. In any event, it claimed that the question of legality can have no impact on the qualification of an act as a "taxation measure" and suggested that measures "in apparent reliance" to taxation legislation, even if abusive, must be covered by a taxation carve-out.

The Respondent argued that, if the Tribunal were to find that both the carve-out and the claw-back provisions apply, the Tribunal would be required to make a referral to the "Competent Tax Authorities". This is because "[t]he referral mechanism . . . forms part of the ECT Contracting Parties' consent to submit themselves to international arbitration pursuant to Article 26 ECT, and it precludes any ruling the Tribunal whether a tax constitutes an expropriation. . . without having made referral to the tax authorities".¹⁴⁸

Based on its earlier findings on the totality of the evidence, the Tribunal concluded that the carve-out did not apply, and that it had jurisdiction under Article 13 of the ECT even assuming that the carve-out in Article 21(1) did apply. According to the Tribunal, as per the general rule of interpretation under Article 31 of the VCLT, any measures falling under the taxation carve-out of Article 21(1) of the ECT are also covered by the scope of the expropriation claw-back in article 21(5) of the ECT. The Tribunal agreed with the Claimants in that, the contrary "would lead to a gaping hole in the ECT where investors would stand completely unprotected from expropriatory taxation".¹⁴⁹

With regard to the referral mechanism articulated under Article 21(5)(b), the Tribunal acknowledged that the assistance by competent tax authorities was designed to assist tribunals in distinguishing normal and abusive taxes. In the dispute at hand, according to the Tribunal, there would be no possibility that the relevant authorities would in fact be able to come to some timely and meaningful conclusion about the disputes, and therefore an exercise of referral would clearly have been futile at the outset of this arbitration.¹⁵⁰ In the second part of its reasoning, the Tribunal concluded that Article 21 carve-out did not apply to the Russian Federation's measures because they were not, on the whole, *a bona fide* exercise of tax powers. According to the Tribunal, simply labelling a measure as taxation would not subject a taxation action to an exemption under the carve-out in Article 21(1).¹⁵¹

Thus, in a nutshell, the Tribunal found that:

1. Whether it is explicitly provided within the carve-out provision or not, Contracting Parties to the ECT shall take measures in good faith irrespective of whether they are labelled as taxation measures or not.
2. The referral mechanism in Article 21(5) is not binding in matters of expropriatory taxation, and shall not be a bar to arbitrability, particularly where the relevant authorities would not be able to come to some timely and meaningful conclusion about the disputes. In this, it

¹⁴⁸ Yukos cases, Final Award, paragraphs 1385-1400.

¹⁴⁹ Yukos cases, Final Award, paragraph 1413.

¹⁵⁰ Yukos cases, Final Award, paragraphs 1417-29.

¹⁵¹ Yukos cases, Final Award, paragraphs 1430-5.

diverged from the conclusion of the *Plama v. Bulgaria* Tribunal, which deemed the referral mechanism compulsory before proceeding to arbitration under Article 26 of the ECT.

3.3. Preliminary Remarks

As the above review proves, the majority of modern IIAs commonly exclude taxation from the application of the NT and MFN provisions. As Professor Walde put it, “[t]his gives the contracting parties flexibility in implementing other tax conventions even though that might result in discriminatory treatment between investors of the contracting States with those of the tax convention.”¹⁵² Nevertheless, some tax carve-out provisions, including Article 21 of the ECT, go beyond exclusion of taxation measures from the coverage of NT and MFN provisions: They additionally provide comprehensive and, in most cases, complex exceptions within exceptions that provide a leeway for investors if their investments are subject to expropriatory and/or discriminatory taxation.

As far as Article 21 is concerned, it is clear that the USA and Canada were the driving forces behind the drafting of Article 21 on Taxation from the outset of negotiations. Although, at first, negotiations very bluntly focused on exclusion of bilateral and/or regional taxation agreements/arrangements, and domestic legislation from the scope of the treatment under the ECT [following the EU drafting style as reflected in its FTAs - exemplified above], the Article on taxation later on included references to trade related measures under the GATT in Article 29 of the ECT as well as a referral mechanism that all require involvement of Competent Tax Authorities [in resolving expropriation and discrimination disputes arising from taxation measures]. Unsurprisingly, the latter provision on the referral mechanism in matters of expropriatory or discriminatory taxation, i.e. Article 21(5)(b), seems to mimic the process that needs to be followed as per Article 21 on Taxation of the US Model BIT of 2012 and Article 16 on Taxation Measures of the Canada Model FIPA of 2004.¹⁵³

As Craig Bamberger very well elaborated, contrary to similar limitations to carve out in the Canada Model FIPA and the US Model BIT, Paragraph (5)(b) provides that:

Whenever there is a question under Article 13 of whether a tax constitutes an expropriation or discriminatory treatment, Paragraph [(5)] of Article 21 on Taxation requires that the issue be referred to the Competent Tax Authorities. Arbitral bodies are constituted for State-State or investor-State dispute settlement must take into account any conclusions arrived at within six months by the competent authorities as to whether the tax is discriminatory, and may take into account any other conclusions on the two kinds of questions (emphasis added).¹⁵⁴

Thus Paragraph (5)(b)(iii) makes a distinction between the conclusions of Competent Tax Authorities with regard to expropriation and discrimination: While tribunals must take into account conclusions reached by the Competent Tax Authorities within six months on matters of discriminatory taxation, they are not equally responsible to consider conclusions of Competent Tax Authorities on matters of expropriatory taxation. A tribunal may or may not take into account any conclusion reached by a Competent Tax Authority on matters of expropriatory taxation.¹⁵⁵

¹⁵² Walde and Kolo, ‘Confiscatory Taxation under Customary International Law and Modern Investment Treaties’, (*supra* note 25).

¹⁵³ While Article 21 also looks similar to Article 2103(6) of the North American Free Trade Agreement (NAFTA), it is clear that the six month referral deadline is not mentioned in Article 2103(6), whereas both Article 21 of the US Model BIT of 2012 and Canada Model FIPA of 2004 include an application timeline similar to that of Article 21 of the ECT.

¹⁵⁴ Note by the General Counsel of the International Energy Agency: Investment Protection Provisions of the ECT, November 18, 1994, OECD Doc DAFFE/INV/IME(94)28

¹⁵⁵ This appears to contrast the provision in the Canada Model FIPA, which mandates that the referral mechanism is binding “with jurisdiction over the claim or the dispute”: see Article 16(6) of the Canada Model FIPA of 2004.

Does this, however, mean that a tribunal has the discretion to not to refer (if and when the parties fail to refer) a dispute on expropriatory taxation to Competent Tax Authorities when it believes that, under the principle of good faith, “a referral cannot be required if following the referral procedure would clearly be futile under the circumstances of a specific case”¹⁵⁶? Although this is an issue that will further be elaborated in the following part, i.e. Part 4, it appears from the *travaux préparatoires* that such a scenario was never considered during the work of the Taxation Sub-Group. Upon review of the negotiations, however, one could conclude that intention of the referral mechanism is not to create an additional jurisdictional hurdle, and thus bar arbitration of expropriatory and/or discriminatory taxation.

Another issue that deserves particular attention is that until 7 July 1993, the claw back provision on expropriation and discrimination read:

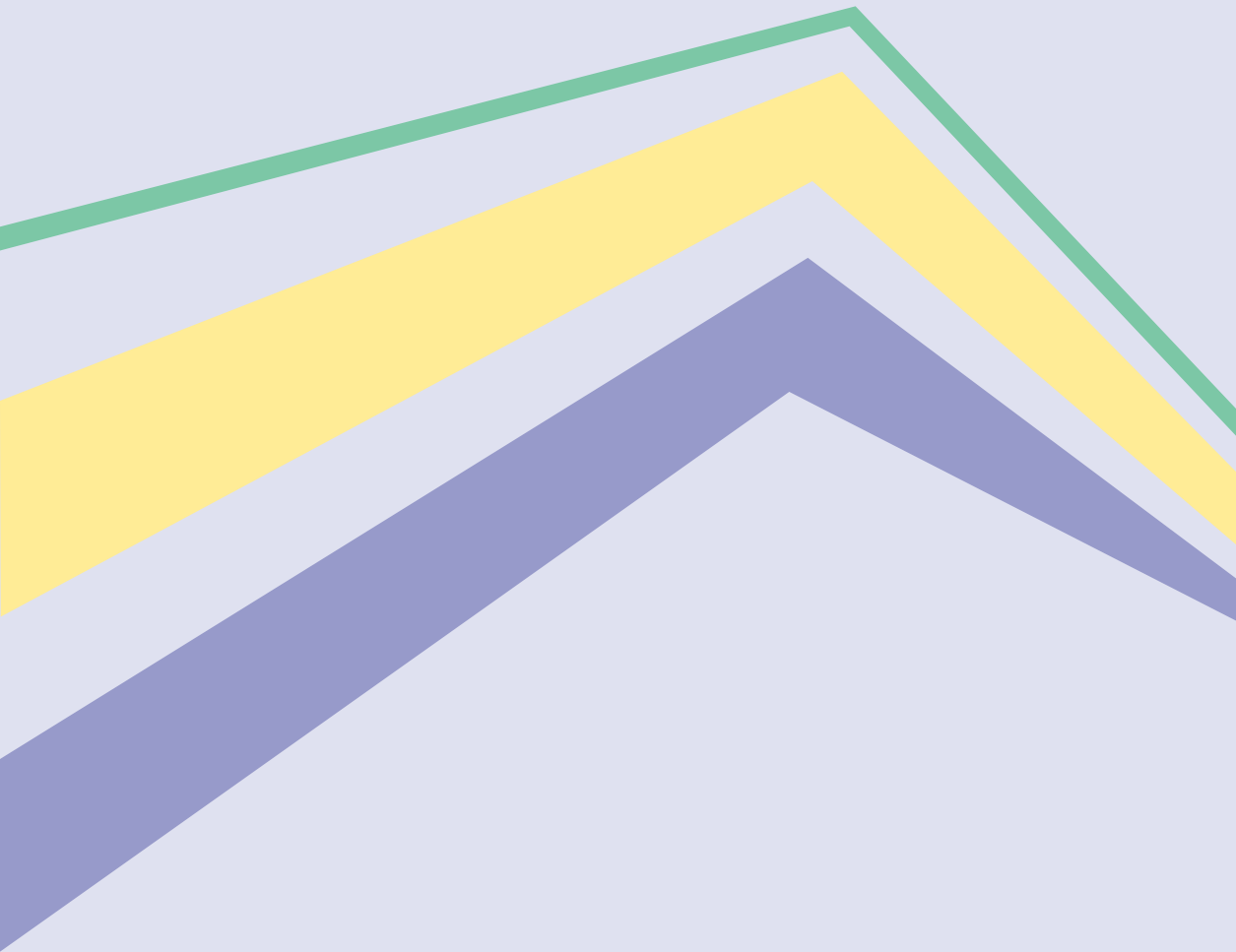
- (a) Notwithstanding paragraphs (1) and (3), Article 15 [the then expropriation provision] shall apply to taxation measures.
- (b) Whenever an issue arises under Article 15, to the extent it pertains to whether a taxation measure constitutes an expropriation or nationalization or whether [...]

The current drafting of the same article however does not refer to “taxation measures” but refers to “taxes”- this approach was first reflected in the draft Article circulated on 7 July 1993, and the same approach was kept in the final text of the treaty. As provided earlier, Article 21(5) (a) reads: “Article 13 shall apply to taxes.” It is not clear whether delegates aimed to achieve anything with such change. The record does not provide any guidance as to what the word “taxes” reflects that the text “taxation measures” does not.^{157/158}

¹⁵⁶ Yukos Universal Ltd. v The Russian Federation, Final Award, PCA Case No. AA 227, 18 July 2014 at para. 1424.

¹⁵⁷ See the discussion in the Yukos Interim Awards between 574-8: Claimants argued, and Respondent contended that “In support of its position, Claimant contends that while different words (“tax” and “Taxation Measures”) are used in the English version of Article 21 of the ECT, the fact that they refer to the same concept is demonstrated by the French, German and Italian versions of Article 21. In those versions, all equally authentic, the words “tax” and “Taxation Measure” are used interchangeably. The interpretation of Article 21, avers Claimant, should thus be reconciled with the non-English versions. 576. Furthermore, Claimant submits, Respondent’s interpretation of Article 21(5) would result in a huge loophole for States wishing to expropriate assets of investors “under the guise” of Taxation Measures. Claimant asserts that such an interpretation would defeat the object and purpose of the Treaty, as it would destabilize the investment climate in host States. 577. Finally, Claimant argues that it cannot be required to submit its claims to the local Russian authorities before proceeding to international arbitration, since such a recourse would be entirely futile. 578. In respect of the different language versions of the Treaty, Respondent answers that the non-English versions of Article 21 should not be given much weight, because Article 21 was negotiated in English. Citing several authorities, Respondent submits that where multiple language versions of a treaty are being compared for the interpretation of a particular provision, the version in which the provision was negotiated should be given primacy.”

¹⁵⁸ Yukos awards: “In any event, the Tribunal, having found that the interpretation of Article 21 of the ECT according to the general rule of interpretation under Article 31 of the VCLT results in a meaning that is neither ambiguous nor obscure and does not lead to a result which is manifestly absurd or unreasonable, does not need to call in aid any other rule of interpretation. Finally, the Tribunal does not find much helpful guidance in the *travaux préparatoires* of the ECT. Respondent claims that the replacement of “Taxation Measures” with “taxes” in a draft of Article 21(5) of the ECT circulated in June 1993 could not have been incidental. However, if this replacement had been motivated by the intention of the negotiators to limit the scope of the claw-back provision in Article 21(5) of the ECT compared to the scope of the carve-out in Article 21(1) of ECT, the Tribunal would expect such a motivation to have found some additional expression in the record” (emphasis added): Hullely/ Yukos/Veteran v The Russian Federation, Final Award at para. 1415.

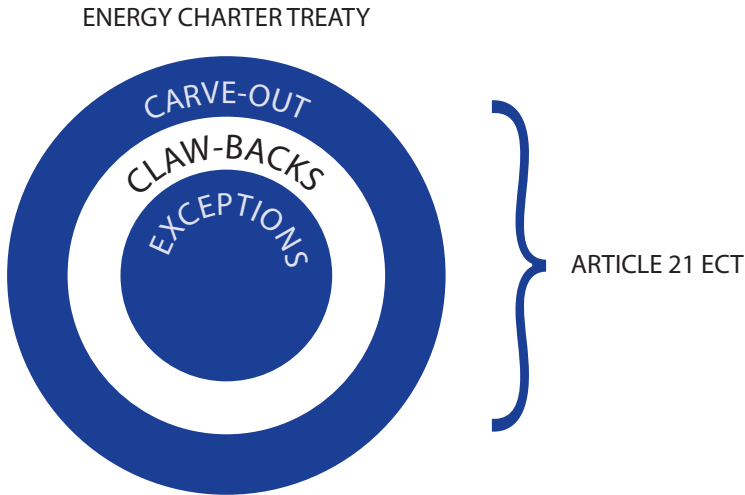


4. UNDERSTANDING ARTICLE 21

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Understanding Article 21 is a challenging task: The Article is comprised of a multi-layered exceptions mechanism, which, according to some, evokes “the Russian nested doll, or *matryoshka*” by providing “exceptions within exceptions” (see Figure 1).¹⁵⁹

Figure 1: A Simplified Look at the Carve-Out Mechanism in Article 21 of the ECT¹⁶⁰



The text of Article 21 is complex, and therefore is prone to give rise to interpretative controversies. As discussed earlier, findings of the Tribunals in *Plama v. Bulgaria* and *the Yukos* cases diverge given the differences in the factual background of both disputes as well as different interpretative approaches by the Tribunals. Thus, as provided in VCLT Article 31, one should question the ordinary meaning and purpose, as well as scope, of Article 21 on Taxation giving due regard to supplementary means of interpretation, i.e. preparatory work, as per VCLT Article 32 in addition to case law on the treatment of taxation measures and carve-out provisions. In this, this part aims to put forward guidelines for Contracting Parties regarding the scope and meaning of this barely intelligible Article.

4.1. General Rule: the Taxation Carve Out

According to VCLT Article 31, the starting point in treaty interpretation shall be the text of the Treaty itself.¹⁶¹ Article 21(1) of the ECT provides the general rule. It carves out “Taxation Measures” from the scope of the ECT:

“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”.

¹⁵⁹ Park, ‘Arbitrability and Tax’, at p. 189.

¹⁶⁰ See Annex II for a detailed look at the carve-out mechanism in Article 21 of the ECT.

¹⁶¹ M.E. Villiger, *Commentary on the 1969 Vienna Convention on the Law of Treaties* (Martinus Nijhoff Publishers, 2009) at p. 421. At the same time, however, one should note that “[w]hilst methodology laid out in this general framework is commonly referenced by tribunals, it is equally hard to mention that tribunals commonly apply these provisions” T.W. Wälde, ‘Interpreting Investment Treaties: Experiences and Examples’, in Christina Binder et al. (eds.), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford: OUP, 2009).

The carve-out is typical in the sense that it does not subject Contracting Parties to obligations in addition to what is dictated under customary international law and internationally accepted principles. While, in this vein, the provision is somewhat similar to the US and Canadian Model IIAs, it does not give effect to application of the FET standard to taxation measures unlike Article X of the US-Ecuador BIT.¹⁶² There is no exception incorporated in the general carve-out provision, however, there are exceptions to the general rule in the subsequent sections of the Article (which will be elaborated in more detail below).

Article 21(1) refers to “Taxation Measures”. According to Paragraph 7, “[t]he term ‘Taxation Measures’ 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”.

Sub-paragraph (b) of Paragraph (7) further “regard[s] taxes on income and capital” as:

“[...] 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”.

What is the ordinary meaning of the term “Taxation Measures”?

As outlined in Part 2 above, the ordinary meaning, and purpose and scope of “tax matters”, “tax policies”, “taxes” or “Taxation Measures” have been frequently discussed by tribunals: In *Occidental v. Ecuador*, the Tribunal held that VAT refunds associated with an investment agreement are within the scope of “tax matters” under Article X(1) of the US-Ecuador BIT. In *EnCana v. Ecuador*, having noted that the term “taxation measure” was not defined in the Canada-Ecuador BIT, the Tribunal held that the term “taxation” covered both direct and indirect taxes (such as VAT), and defined the term “taxation measure” as a measure that is part of the legal regime for the imposition of the tax. In *Duke Energy v. Ecuador*, the Tribunal considered the term “tax matters” in the carve-out in Article X of the US-Ecuador BIT as including “customs duties”. The Tribunal also agreed with the Tribunal in *EnCana v. Ecuador* in that “[a] measure providing relief from taxation is a taxation measure just as much as a measure imposing the tax in the first place”.¹⁶³

Article 21(1) refers to “Taxation Measures”, and this, as elaborated under Paragraph 7(a), includes any *provision* relating to taxes of the domestic law of the Contracting Party and of DTTs, or of any other international agreement or arrangement by which the Contracting Party is bound.

¹⁶² See above discussion on Article X of the US-Ecuador BIT and the *Occidental v. Ecuador* Award in Part 2.3.1.2. See also Annex I for the Taxation Carve-Out provisions in the US-Ecuador BIT and the US Model BIT 2012.

¹⁶³ *Duke Energy v. Ecuador*, Award, para. 174-81.

What does the term “Taxation Measures” include?

In the *Yukos* cases, among others, the meaning and scope of Taxation Measures was disputed: According to the Respondent, the ordinary meaning of Article 21 confirms that “Taxation Measures include not only tax laws and regulations [...] but also measures relating to taxes, including the imposition, administration, collection and enforcement of taxes”. According to the Russian Federation, the use of “includes” rather than “means” in Paragraph 7 as well as the reference in Paragraphs 3 and 6 to “any Taxation Measure aimed at ensuring the effective collection of taxes” also confirm that the term “Taxation Measures” was intended to have “broad and inclusive scope”. In his witness statement, Professor Daniel Berman and Mr. Stephen Knipler (a former delegate of Australia involved in the drafting of Article 21 in WG II) supported the position of the Russian Federation in that “the definition of ‘Taxation Measures’ in the ECT should be interpreted to include any law, regulation, procedure, requirement or practice related to the imposition, administration, or enforcement of taxation”. By contrast, the *Yukos* shareholders argued that the term “provisions” had to be distinguished: According to them, the term “[...] is an actual “provision” relating to taxes, be it found in domestic law or in a tax treaty, nothing else”. The Claimants contended that the scope of “Taxation Measure” could not be extended to cover measures with regard to enforcement of taxes. In its decision on Article 21, the Tribunal noted that “[...] the term ‘Taxation Measures’, used in Article 21(1), is defined in Article 21(7)(a) to mean ‘provisions’ of domestic tax law and tax treaties [...]”. The decision, however, does not include a discussion as to what Contracting Parties meant with the term “provisions”.¹⁶⁵

On the other hand, it appears from the two publicly available decisions on Article 21 of the ECT – i.e. *Plama v. Bulgaria* and the *Yukos* cases – that Tribunals consider “Taxation Measures” as including measures with respect to the imposition, administration, collection and enforcement of taxes: In *Plama v. Bulgaria*, the Tribunal considered that any measure to modify Bulgaria’s tax law to eliminate the tax consequences was in the scope of Article 21(1). In the *Yukos* cases, the Tribunal considered not only provisions in the Russian Tax Laws but also “any actions that are taken under the guise of taxation” in the context of Article 21(1). Moreover, in a non-ECT award, the Tribunal in *EnCana v. Ecuador* saw no reason why one should limit the scope of “taxation measures” to actual provisions of the law which impose a tax.¹⁶⁶

¹⁶⁴ *Yukos* cases, Award on Jurisdiction, Para 71 – Respondent’s Skeleton arguments.

¹⁶⁵ *Yukos* Cases, Award, para. 1411.

¹⁶⁶ *EnCana* award, para. 142(2) and (3). See the discussion in Part 2.2.1.3 above.

Are Taxation Measures limited to certain “Provisions” as elaborated in Article 21(7)?

It is unclear whether the scope of “Taxation Measures” is limited to “provisions” in domestic laws, and DTTs and other bilateral agreements and arrangements, or whether they also include measures aimed at ensuring the effective collection of taxes. Grammatically, the word “provision” is defined as a clause or a division “of a legal or formal statement; a legal or formal statement providing for some particular matter; a clause in such a statement which makes an express stipulation or condition; or a proviso”. In Black’s Law Dictionary, due regard is also given to “an article or clause in a document”. The literal meaning of the term “provision” thus does not involve any activity related to enforcement or implementation of “a provision”. According to VCLT Article 32, one might make use of the *travaux préparatoires* if “the interpretation according to article 31 [...] [l]eaves the meaning ambiguous or obscure”.¹⁶⁷ However, the *travaux préparatoires* provide no useful guidance. Whilst one could note the linguistic endeavours in drafting Subparagraph 7¹⁶⁸, the record of the WG II meetings does not provide what the original intentions of the Contracting Parties could be.

In the absence of a meaningful guidance in the literal meaning of the term “provision” and preparatory work, one might consider the ECT in its entirety in finding the real intentions of the Contracting Parties. This would indeed be in accordance with the teleological method of interpretation, which would emphasize the object and purpose of the ECT in all materials available, and would not distinguish between primary and secondary sources of interpretation.¹⁶⁹ An issue, in this context, would be if it is the piece of legislation that matters in achieving the objectives outlined in the Treaty, or whether enforcement mechanisms also matter in as much as the piece of legislation or the “provision” as described in Paragraph (5) of Article 21 in instituting the rule of law in energy sector investments. While, one could argue that this would be a broad reading of Paragraph (5), as discussed by the Tribunal in the *Yukos cases*¹⁷⁰, such an approach would also be in line with the fundamental aim of the ECT.¹⁷¹

4.2. Exceptions to the Taxation Carve-Out

As discussed earlier, the ECT is a multilateral and multipurpose treaty. It covers matters related to trade and transit of energy materials and products in addition to protection and promotion of energy investments under Article 26 and Part III. In line with the Treaty’s multipurpose scope, Article 21 has been drafted to provide certain exceptions to the general carve-out rule with cross references to Article 7 on Transit of Energy Materials and Products, MFN and NT standards embodied in Article 10 of the Treaty, Article 29 on Interim Provisions on Trade-Related Matters, and, last but not least, Article 13 on Expropriation. This Part will focus on these specific exception provisions (which will be referred to as “claw-back” provisions along the lines of the decision by the Tribunal in the *Yukos cases*¹⁷²), and further “exceptions to claw-backs”. It will, consequently, aim to provide a guidance as to their scope and applicability.

¹⁶⁷ VCLT Article 32.

¹⁶⁸ See the comments by the Norwegian delegate, Ole Kirvaag, of September, 22, 1992 in BA 15 – foot 12 August 1992: “Para 6.1 [the then Paragraph 7] may be improved by some changes” by inserting “the provisions relating to taxes of [...]” and “the provisions of [...]” in subparagraphs (a) and (b) respectively”.

¹⁶⁹ Villiger, *Commentary on the 1969 Vienna Convention on the Law of Treaties*, (supra note 161) page. 444.

¹⁷⁰ “The Tribunal agrees with Claimants that such an interpretation would lead to ‘a gaping hole in the ECT where investors would stand completely unprotected from expropriatory taxation’. Such an interpretation would defeat **the object and purpose of the claw-back of the ECT itself**” (emphasis added): The *Yukos Cases*, Final Award, para. 1413.

¹⁷¹ “The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thus minimising the risks associated with energy-related investments and trade”. The Energy Charter Treaty and Related Documents at 14, available at http://www.encharter.org/fileadmin/user_upload/document/EN.pdf

¹⁷² *Yukos cases*, Final Award, para. 1375.

Herein, it is also useful to discuss the scope of “Taxation Measures”: As mentioned earlier, Paragraph (1) refers to “Taxation Measures”. However, references to “Taxation Measures” in subsequent clauses are somewhat different: Paragraphs (2), (3) and (4) provide claw-backs with respect to “Taxation Measures other than on income and capital” (emphasis added). As illustrated in the preparatory work, exclusion of taxation measures on income and capital aim to avoid a potential overlap of two inter-governmental regimes, i.e. DTTs and other agreements and/or arrangements on taxation, and the ECT provisions. Taxation measures relating to income and capital fall within the ambit of direct taxes¹⁷³, and according to one former delegate, the real intention behind the exclusion of direct taxation measures from the coverage of the ECT was to avoid duplication of matters of NT and MFN for tax matters that were already dealt with under bilateral tax treaties (including DTTs and other agreements and arrangements). These treaties and arrangements are the preferred avenue in matters of taxation of income and capital since “they [are] based on accepted [...] international tax standards that [are] reflected in the OECD Model Tax Convention [on Income and Capital]”.¹⁷⁴ However, as appears from the OECD’s Model Tax Convention, bilateral tax arrangements usually do not include provisions with respect to protection against expropriatory taxation, and Paragraph (5) of Article 21 serves one such purpose.

What are Indirect Taxes and Taxes on Income and Capital in the Energy Sector?

In the energy sector, one could come across to different forms of taxation. A host State might issue indirect forms of taxes such as excise duties on energy goods and products, royalties on domestic production of fossil fuels. A State might also impose tax levy on income taxes on the profit of energy companies.¹⁷⁵ Such types of direct taxation may include special forms of taxation such as taxation of windfall, or in other words, excessive profits.¹⁷⁶

4.2.1. Treatment of Taxation Measures related to Trade and Transit of Energy Materials and Products

Paragraph (2) of Article 21 provides the very first exception to the general carve-out provision in Paragraph (1):

“(2) Article 7(3) 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).”

The claw-back, thus, comprises a double exception mechanism. First, it excludes Article 7(3) from the coverage of the general carve-out in Paragraph (1), and thus it brings Taxation Measures other than those on income and capital back in the coverage of the ECT. Thus, it enables the

¹⁷³ “[...] Direct taxes are paid by the person or organization taxed, as in the case of income taxes or capital gains taxes. Indirect taxes involve shifting the payment from the taxed entity to someone else, usually to the final consumers of goods. These include taxes on manufacturers, wholesalers, and retailers, which are shifted (through increased prices) partially or wholly to the final consumers. Excise duties, sales taxes, and value-added taxes are examples [...]”: Anonymous, ‘Taxes and Taxation’, in Craig Calhoun (ed.), *Dictionary of the Social Sciences* (Oxford: Oxford University Press 2002).

¹⁷⁴ Interview with Stephen Knipler, available in file with the ECS.

¹⁷⁵ S.C. Bhattacharyya, *Energy Economics: Concepts, Issues, Markets and Governance* (Springer, 2011) at p. 310.

¹⁷⁶ See A Kolo, ‘Fat Cats And Windfall Taxes in the Natural Resources Industry Legal and Political Analysis in the Light of Modern Investment Treaties’, *Transnational Dispute Management* (TDM), 9/1 (2012).

application of the NT standard provided within Article 7(3)¹⁷⁷ regarding “Taxation Measures other than those on income and capital”. In subparagraph (a), the provision then provides an “exception to the claw-back”¹⁷⁸ and once again exempts “any advantage accorded by the Parties to the ECT as per the tax provisions of any convention, agreement or arrangement [...]” in the treatment of Taxation Measures other than those on income and capital. This “exception to the claw-back” is further elaborated with a cross reference to Paragraph (7)(a)(ii), which refers to “convention[s] for the avoidance of double taxation or [...] any other international agreement or arrangement by which the Contracting Party is bound”. Thus, irrespective of whether they are related to income and capital, or not, the NT provision in Article 7(3) (and the method provided in Article 7(7) for the resolution of disputes on the Transit of Energy Material and Products) does not apply to Taxation Measures that are in the scope of a DTT or any other bilateral arrangement or agreement on taxation entered into by a Contracting Party.

A second exception to the claw-back is provided in Paragraph (2)(b). While, Paragraph (2) excludes Taxation Measures other than on income and capital from the coverage of the general taxation carve-out provision, Subparagraph (b), once again, subjects “any Taxation Measure aimed at ensuring the effective collection of taxes” to the general carve-out in Paragraph (1) provided that the Taxation Measure does not “arbitrarily discriminate[] against Energy Materials and Products originating in or destined for the Area of another Contracting Party or arbitrarily restricts” the NT benefit provided in Article 7(3).

Another exception to the general carve-out rule under Paragraph (1) is with respect to Trade of Energy Materials and Products. Paragraph (4) reads:

“(4) Article 29(2) to (6) shall apply to Taxation Measures other than those on income or on capital”.

The provision makes cross reference to Article 29 on the Interim Provisions on Trade-Related Matters. With this, it claws-back General Agreement on Trade and Tariffs’ (GATT’s) provisions on NT and MFN in as far as they concern Taxation Measures, other than those on income, or on capital, relating to trade in Energy Materials and Products. As per Article 29(2)(a) of the Treaty, Article 21(4) allowed the interim incorporation of trade related indirect Taxation Measures on Energy Materials and Products in as far as the measure at hand involved a State that was not a party to the GATT. Following adoption of the Trade Amendment to the ECT, GATT/WTO rules were extended to trade of Energy Materials and Products among non-WTO and WTO member States through the ECT-trade regime. Hence, Article 21(4) of the ECT, enables GATT/WTO rules when a dispute concerns Taxation Measures (that are not on income and capital) in the trade of Energy Materials and Products.

4.2.2. Treatment of Taxation Measures under Article 10 ECT

A third exception to the general carve-out is with respect to NT and MFN provisions articulated in Article 10 of the Treaty. Paragraph 3 of Article 21 claws-back Article 10(2) on MFN and Article 10(7) on NT in disputes regarding Taxation Measures other than those on income and capital. The Paragraph also provides “exceptions to the claw-back”. Articles 10(2) and (7) shall not apply to:

- (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

¹⁷⁷ Article 7(3) of the ECT reads: “Each Contracting Party undertakes that its provisions relating to transport of Energy Materials and Products and the use of Energy Transport Facilities shall treat Energy Materials and Products in Transit in no less favourable a manner than its provisions treat such materials and products originating in or destined for its own Area, unless an existing international agreement provides otherwise”.

¹⁷⁸ Park, ‘Arbitrability and Tax’ (*supra* note 70).

(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.

The exceptions, thus, mimic those exceptions to the claw-back stipulated under Paragraph (3) on the transit of Energy Materials and Products. Along the same lines, Subparagraph (a) refers to Paragraph (7)(a)(ii) in describing “advantages accorded [in] tax provisions of any convention, agreement or arrangement”. At the same time, however, Subparagraph (a) diverges from Article 21(2)(a) in that it limits the scope of the exception mentioned above to the MFN provision. Thus, Article 10(7) on NT applies in cases where a Taxation Measure of a Contracting Party other than those on income and capital is challenged.

In addition, similar to the exception provided in Article 21(2)(b), Subparagraph (b) excludes any Taxation Measure that aims to ensure the effective collection of taxes provided that the Measure does not discriminate against a foreign investor or arbitrarily restricts its rights.

4.2.3. Treatment of Expropriatory and Discriminatory Taxation under Article 13 ECT

A fourth exception to the general carve-out provision is related to expropriatory and/or discriminatory taxation under Article 13 of the ECT. Paragraph (5)(a) sets the framework for this claw-back: “Article 13 shall apply to taxes”. Paragraph 5(b) then continues with the specific procedure that shall be followed, if a foreign investor claims that it has been subject to expropriatory and/or discriminatory taxation:

[5] (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 nondiscrimination 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 Co-operation 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.

The provision (like analogous provisions in other IIAs – e.g. US and Canada Model IIAs) is frequently invoked by respondent States in defence to foreign investors’ expropriation claims against taxation measures. As reviewed in Part II, the “joint tax consultation” provisions might be regarded as procedural prerequisites before proceeding to arbitration under dispute resolution articles of respective IIAs. While Paragraph (5) is similar to other IIAs reviewed above, it is also – somewhat – flexible in that tribunals may not treat it as a “tax veto” mechanism, but a mechanism established to assist tribunals in assessing what expropriatory/discriminatory taxation is.

4.2.3.1. Referral to Competent Tax Authorities

The joint tax consultation mechanism under Article 21 comprises a procedure of two alternatives: If a foreign investor or a Contracting Party claims that the tax is expropriatory or discriminatory; it shall refer the dispute to the Competent Tax Authority, which, in Paragraph 7(c) is defined as “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”. The Competent Tax Authority, then, shall determine whether the disputed tax is an expropriation or discriminatory. In the alternative, if the parties fail to refer the dispute to the Competent Tax Authority, bodies called upon to settle disputes under Articles 26(2)(c) or 27(2), i.e. ad-hoc or institutional arbitral tribunals shall refer the dispute to the relevant Competent Tax Authority.

The *timeline* for determining whether a tax is expropriatory and/or discriminatory is limited: Under Paragraph (5)(b)(ii), the Competent Tax Authorities, either after referral by the parties or by the dispute settlement bodies, “shall strive to resolve the issues so referred within six months”. The provision also distinguishes between *applicable law* for discriminatory and expropriatory taxations. Where discriminatory taxation is concerned, Competent Tax Authorities are required to apply the non-discrimination provision in the DTT or any other the relevant tax convention entered into between two Contracting Parties, in other words, host and home States to the foreign investor. If there is no such convention, Competent Tax Authorities shall apply the non-discrimination principles articulated under Article 24 of the OECD’s Model Tax Convention on Income and Capital.¹⁷⁹ Applicable law for expropriation, however, is not carved out from the scope of the treaty, and therefore Article 13 of the ECT on Expropriation remains applicable in disputes relating to “taxes”.

A further difference as to the determination of discriminatory and expropriatory taxes is provided under Paragraph (5)(b)(iii): Where expropriatory taxation is concerned, dispute settlement bodies “may” take into account conclusions reached by the Competent Tax Authorities. On the other hand, conclusions reached by Competent Tax Authorities on discriminatory taxation claims within six months “shall” be taken into account by dispute settlement bodies. Nevertheless, if the Competent Tax Authority fails to reach a conclusion within six months, the dispute settlement body “may” still consider such determination.¹⁸⁰ As discussed in Part 3.3 above, this means that tribunals must take into account conclusions reached by the Competent Tax Authorities within six months on matters of discriminatory taxation. However, they are not equally responsible to consider conclusions of Competent Tax Authorities on matters of expropriatory taxation.

4.2.3.2. Interim Analysis on the Claw-Back Provision in Article 21(5)

As in the case of the general carve-out provision in Paragraph (1), particular texts used in Paragraph (5) create some ambiguities regarding the meaning and scope of the provision. One such ambiguity arises from the use of the term “taxes” and not “Taxation Measures” in Paragraph (5). As discussed before, Article 21(1) and subsequent provisions refer to the term “Taxation Measures”, which is defined in Paragraph (7). This divergence has caused controversy between the Yukos shareholders and the Russian Federation. According to the Respondent, the term

¹⁷⁹ See Article 24 of the OECD MTC.

¹⁸⁰ See Part 3.3 above. Thus Paragraph (5)(b)(iii) makes a distinction between the conclusions of Competent Tax Authorities with regard to expropriation and discrimination: While tribunals must take into account conclusions reached by the Competent Tax Authorities within six months on matters of discriminatory taxation, they are not equally responsible to consider conclusions of Competent Tax Authorities on matters of expropriatory taxation. A tribunal may or may-not take into account any conclusion reached by a Competent Tax Authority on matters of expropriatory taxation.

“taxes” is narrower than “Taxation Measures”, and thus the claw-back provision does not apply to claims of expropriation in relation to a category that the Russian Federation defines as “Taxation Measures other than taxes”.¹⁸¹ On the other hand, the Claimants argued that the term “taxes” in the claw-back provision has the same scope as the general carve-out provision under Article 21(1), and that the Respondent’s interpretation of “taxes” and “Taxation Measures” would lead to “a gaping hole in the ECT where investors would stand completely unprotected from expropriatory taxation”.¹⁸²

Whilst, the ECT defines what a “Taxation Measure” is, it is silent as to the meaning of the term “taxes”, except that it lists what it does not include.¹⁸³ As mandated by VCLT Article 31, the term “taxes” should therefore be interpreted “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”. One might employ a textual approach in order to reveal the literal meaning of “taxes”: In the Oxford Law Dictionary, the term “tax” (or “taxes” in plural) is defined as:

[a] compulsory contribution to the State’s funds. It is levied either directly on the taxpayer by means of income tax, capital gains tax, inheritance tax, and corporation tax; or indirectly through tax on purchases of goods and services (see value-added tax) and through various kinds of duty, e.g. road tax, stamp duty, and duties on betting and gaming.”

Black’s Law Dictionary defines a “tax” as “any contribution imposed by government upon individuals, for the use and service of the State, whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name”.¹⁸⁴ One could therefore understand a “tax” as a “contribution” that is imposed by States: It is only a charge or payment, and does not involve any activity of enforcement. This literal meaning of the term “taxes”, thus, does not provide any guidance as to whether, for instance, a specific mining resource tax would in itself feature measures with regard to its enforcement and imposition.

Is the term “tax” in Article 21(5) broader than “Taxation Measures”?

According to the Tribunal in the *Yukos* cases, “the ordinary meaning of “tax” [...] cannot be narrower than the meaning of “Taxation Measure” used in Article 21(1)”. The Tribunal upheld the Claimant’s arguments in that a wide carve-out and a narrow claw-back, as the Respondent submitted, would only make “charges and payments” subject to Article 13 on expropriation, but not “collection and enforcement” activities, which “would lead to a gaping hole in the ECT where investors would stand completely unprotected from expropriatory taxation”. According to the Tribunal, such an interpretation does not reflect “the object and purpose of the claw-back and of the ECT itself”. In this case of ambiguity between the two treaty provisions, what mattered to the Tribunal was the “object and purpose of the treaty” and not only the literal meaning of two texts, as the literal meaning of the texts seemed to have suggested that “taxes” do not cover activities of collection and enforcement. In this, the Tribunal seems to have followed the teleological method (as articulated in 1935 Harvard Draft on the Law of Treaties) by considering the object and purpose of the ECT altogether.

One might reach a similar conclusion (as in the example above) by undertaking the subjective method of interpretation: Under VCLT Article 32, by taking into account the real intentions of the drafters, and also by recourse to the ECT’s *travaux préparatoires* as a supplementary method of interpretation, it is also possible to conclude that the term “taxes” is not narrower than “Taxation Measures”. Although, *the travaux préparatoires* is silent on the issue, interviews

¹⁸¹ Interim Award on Jurisdiction and Admissibility, para. 572.

¹⁸² Final Award, paras. 1381-2.

¹⁸³ Article 21(7)(d): “For the avoidance of doubt, the terms “tax provisions” and “taxes” do not include customs duties”.

¹⁸⁴ H. Campbell Black and B.A. Garner, ‘Black’s Law Dictionary’, (CLAITORS PUB DIVISION, 2014).

with former delegates suggest that the deletion of “Taxation Measures” and insertion of “taxes” in Paragraph (5) is not coincidental but a purposeful drafting manoeuvre in an attempt to better reflect scenarios in which a government unilaterally brought in a measure that while described as a tax measure, was not a genuine tax measure and amounted to expropriation. The term “taxes”, as suggested by one delegate, focuses on a measure that is a tax in itself rather than just a specific provision that was part of a tax measure, which would also be covered by Paragraph (5).¹⁸⁵ Thus the real intention of the parties was not to restrict the scope of claw-back to a narrower protection against expropriation standard, but to address possible scenarios that might not be covered with the term “Taxation Measures”.

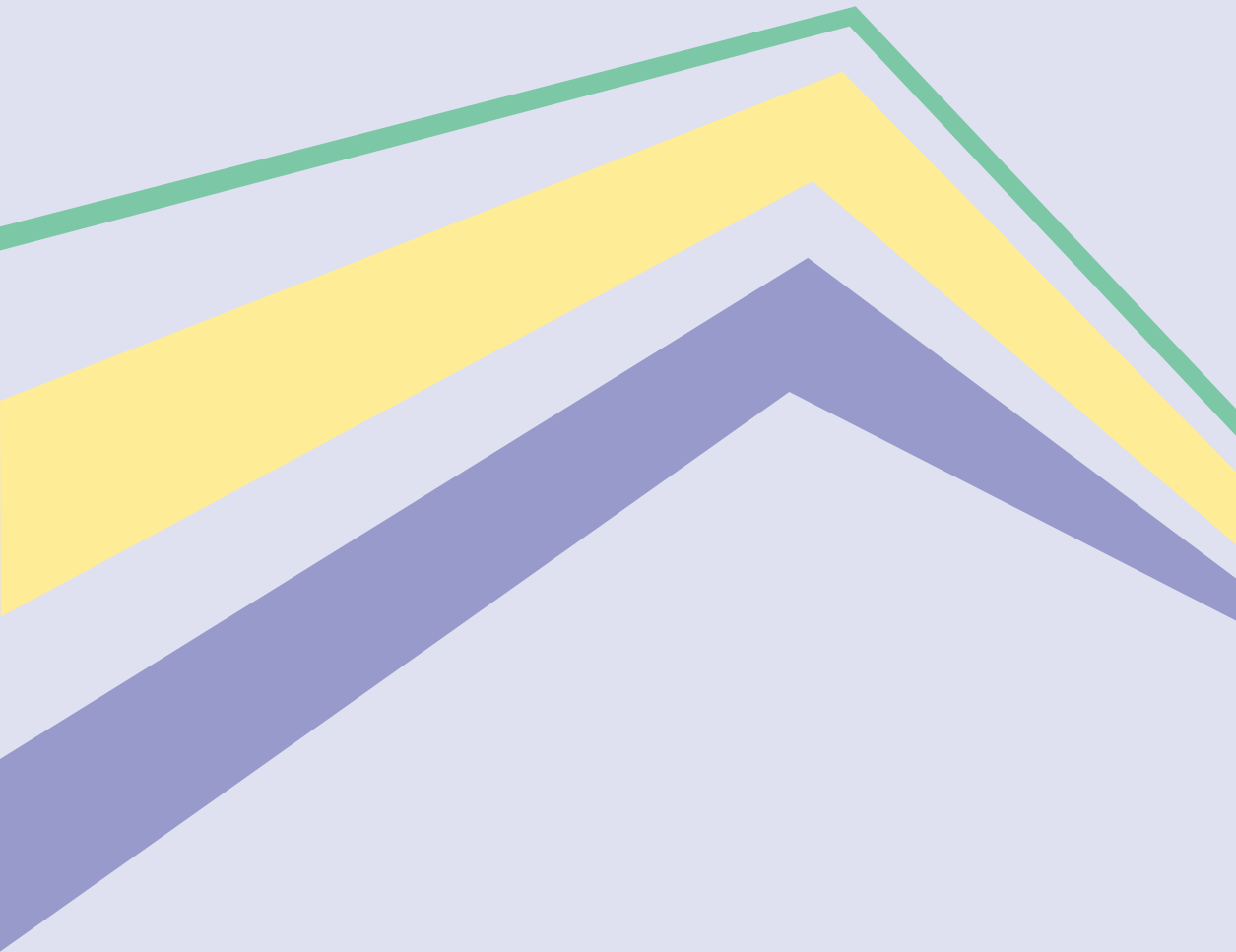
A second ambiguity in the text of the expropriation carve-out arises from the issue of whether the JTCM is compulsory or not. As set out above, Paragraph (5) distinguishes between the use of “may” and “shall” when it refers to the parties’ or dispute settlement bodies’ obligations to refer the dispute to the relevant Competent Tax Authorities. Whilst, as per the literal meaning of “shall”, one must exhaust the JTCM before submitting the dispute to arbitration, considering real intentions of the Contracting Parties [elaborated in the preparatory work either as part of treaty interpretation under VCLT Article 31 as per the subjective method, or as part of supplementary means of interpretation under VCLT Article 32 as per the textual and contextual methods], the JTCM appears not be a bar to investor-State arbitration under Article 26 and Part III of the ECT. As discussed above in Part I, intentions of Contracting Parties have never been to “create an additional jurisdictional hurdle, and thus bar arbitration of expropriatory and/or discriminatory taxation”. This is well reflected in Paragraph 5(b)(iv), which provides that the involvement of the Competent Tax Authorities shall not “lead to a delay of the proceedings under Articles 26 and 27”.

Is the referral mechanism in Article 21(5) compulsory?

As illustrated by the Tribunal in the Yukos cases, if it is clear that there would be no possibility that the relevant authorities “would in fact be able to come to some timely and meaningful conclusion about the disputes”, exhaustion of the JTCM cannot be expected from the parties or dispute settlement bodies.¹⁸⁶

¹⁸⁵ Interview with Stephen Knipler, available in file with the ECS.

¹⁸⁶ Yukos cases, Final Award, paragraphs 1417-29.



5. CONCLUSIONS AND RECOMMENDATIONS

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This paper aimed at putting forward a guideline with regard to taxation of foreign investments under international law. In context, it reviewed taxation exception or carve-out provisions in IIAs with particular focus on the treatment of taxation measures under the ECT. Drawing on insights articulated in Parts 2 and 3, it then presented an understanding of Article 21 of the ECT in Part 4.

As suggested in various instances throughout the paper, Article 21 is barely intelligible; not only because of the complexity of treatment of taxation measures under international law, but also because of the multi-layered, unclear, and incautious drafting of the Article. As noted by Craig Bamberger in 1996, Article 21 was chiefly negotiated by Finance Ministries that essentially aimed at limiting application of ECT provisions in matters of taxation where MFN provisions of their BITs were applicable. The final draft was submitted by WG II a couple of days before the Treaty was finalised, and therefore the Article did not receive any meaningful review by the Conference. According to Bamberger, particularly Subparagraph (1) could have “unanticipated limiting effects on rights and obligations under other provisions of the Treaty”.¹⁸⁷

After two decades of practice, however, one could also argue that Article 21 has created interpretative ambiguities more than it gave rise to unanticipated limiting effects. Whilst, the scope of the analysis on the practice of Article 21 is regrettably limited to two publicly available arbitral awards, it appears that arbitral tribunals approach the text of Article from different perspectives. The paper has revealed that whereas the Tribunal in *Plama v Bulgaria* considered the joint tax consultation mechanism as a jurisdictional prerequisite, the Tribunal in *the Yukos cases* considered that the consultation procedure might be a futile exercise if a host State has not acted in good faith in treating a foreign investment. Although, there exists a nuance between the treatments of discriminatory and expropriatory taxations (in that the joint tax consultation mechanism seems to have been drafted to be compulsory for matters of discriminatory taxation in Article 21), current arbitral practice does not seem to have distinguished one from the other. To the contrary, in various instances, tribunals have ruled that the procedure of consultation to Competent Tax Authorities shall not create a bar to arbitrating investment disputes.

Both the arbitral practice and the review of the preparatory work also reveal that meanings of certain terms in the text are puzzling. For instance, some delegates have noted that the term “taxes” is clearly broader than the term “taxation measures”, and that this was a purposeful drafting exercise (see interviews with Stephen Knipler and Joachim Karl). However there is no proof in the record of preparatory work in this vein (which also is an issue raised by the Tribunal in *the Yukos cases*). Furthermore, as suggested above, definition of the term “taxation measures” is not clear. While the Article lists what is not a taxation measure, it fails to provide guidance as to whether “measures” are limited to “provisions” in legislation or treaties, or if they also include measures concerning implementation and/or collection of taxes.

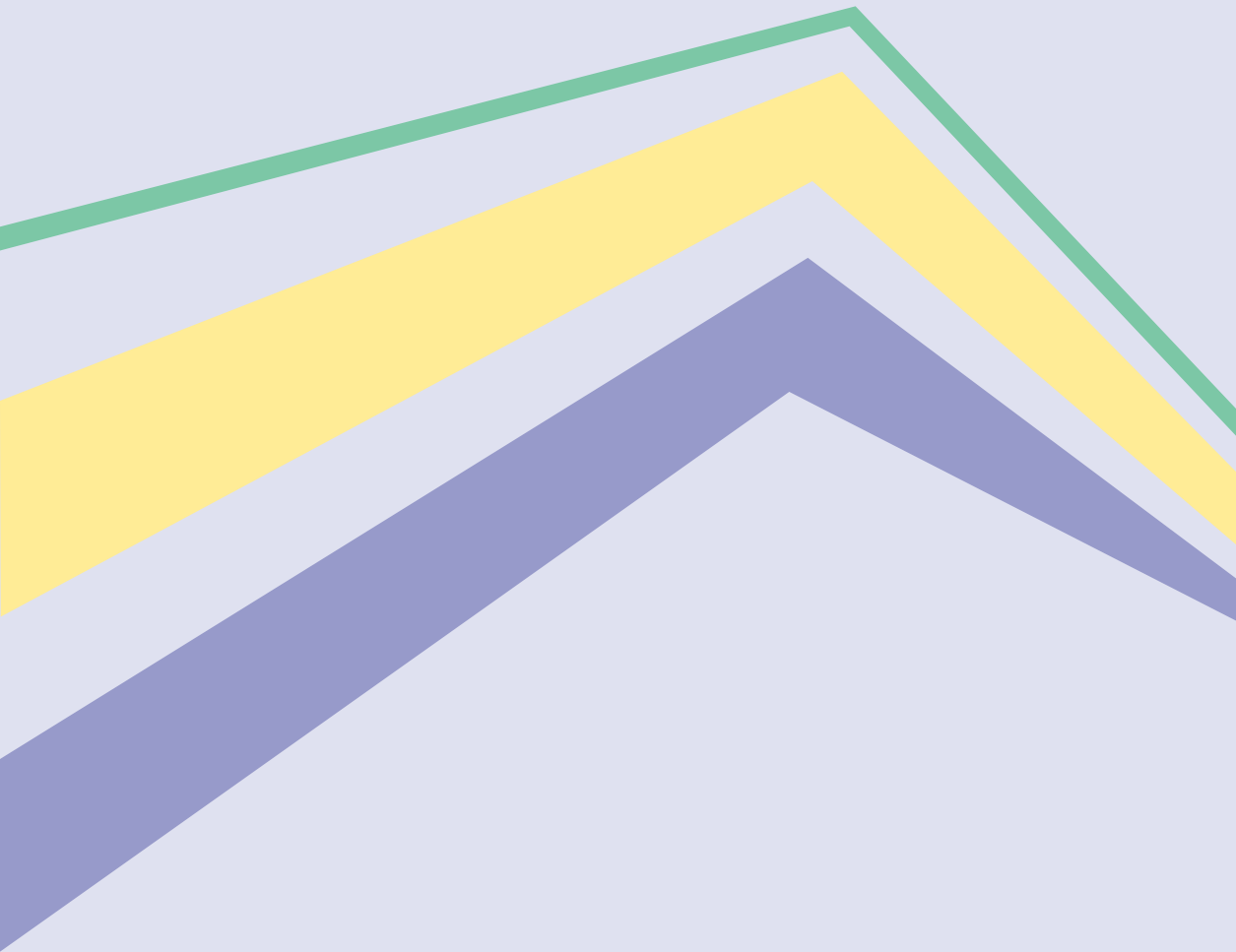
In the existence of such ambiguities and uncertainties as to treatment of taxation measures under the ECT, Contracting Parties might consider taking steps towards clarifying and, perhaps, simplifying Article 21. Options might include (i) an amendment to the ECT, (ii) issuing a Protocol

¹⁸⁷ C. S. Bamberger, ‘An Overview of the Energy Charter Treaty’, in T.W. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (Kluwer Law International, 1996) at 24.

or a Declaration as per Article 1(13)(a) and (b) of the Treaty¹⁸⁸, and (iii) an interpretative note in order to clarify the object and purpose of ambiguous terms and provisions in Article 21 of the ECT as per Article 31(3)(a) of the VCLT.¹⁸⁹ Whilst an amendment would require ratification, and would therefore appear to be politically challenging; a Protocol, a Declaration and/or an interpretative note under VCLT would be most suitable in clarifying the ambiguities in the Article. This would be a crucial exercise considering that the Article might give rise to future interpretative controversies and any unanticipated consequences in which a Contracting Party's sovereign prerogative to tax is unreasonably constrained.

¹⁸⁸ Article 1(13)(a) and (b) of the ECT defines Protocol and Declaration: "(a) 'Energy Charter Protocol' or 'Protocol' means a treaty, the negotiation of which is authorized and the text of which is adopted by the Charter Conference, which is entered into by two or more Contracting Parties in order to complement, supplement, extend or amplify the provisions of this Treaty with respect to any specific sector or category of activity within the scope of this Treaty, or to areas of co-operation pursuant to Title III of the Charter. (b) 'Energy Charter Declaration' or 'Declaration' means a non-binding instrument, the negotiation of which is authorized and the text of which is approved by the Charter Conference, which is entered into by two or more Contracting Parties to complement or supplement the provisions of this Treaty".

¹⁸⁹ Article 31 of the VCLT on Interpretation of Treaties (General Rule of Interpretation) gives effect to interpretative notes or agreements: "3. There shall be taken into account, together with the context: (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [...]"

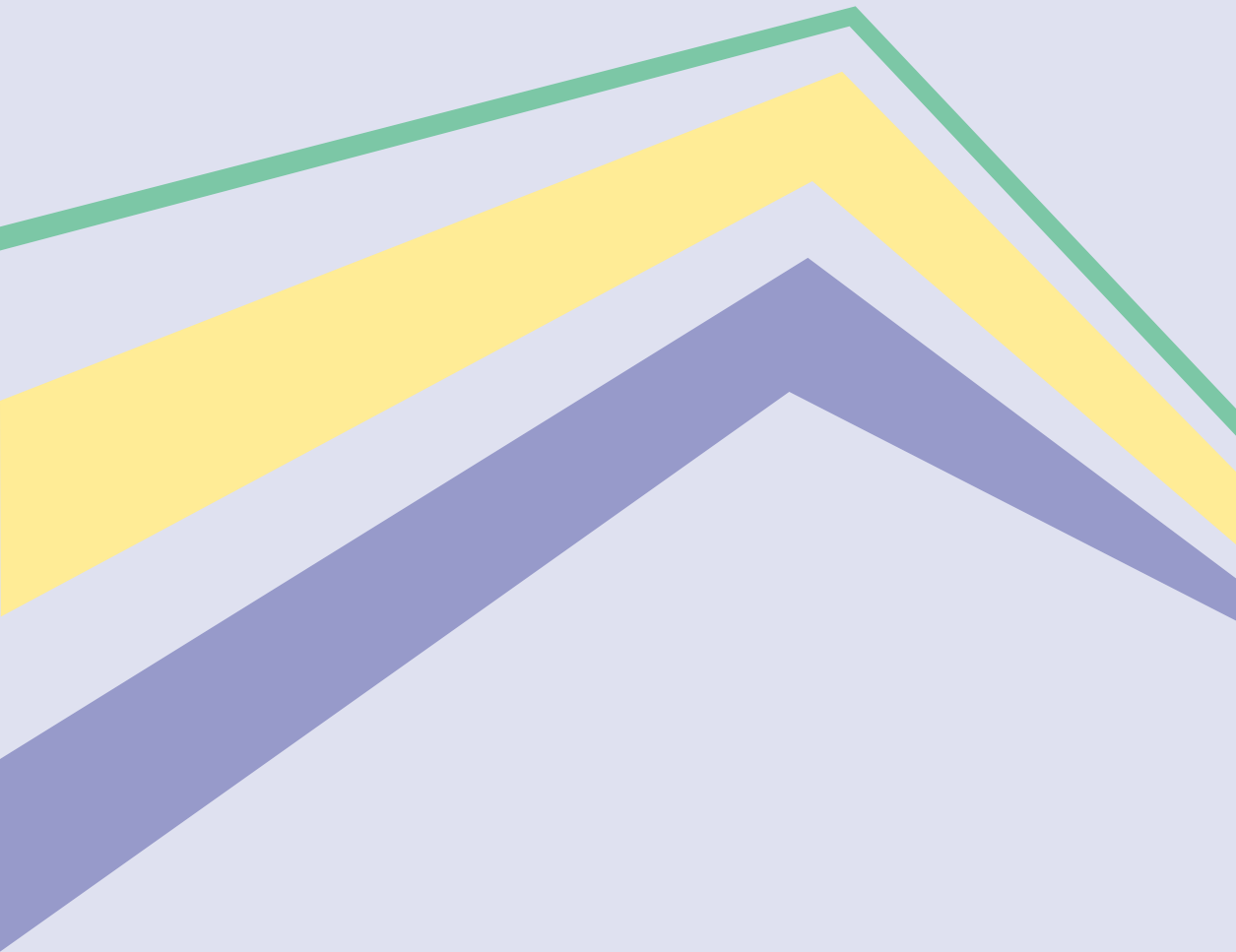


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**ANNEX I:
TAX EXCEPTION OR CARVE-OUT PROVISIONS IN
INTERNATIONAL AGREEMENTS: EXAMPLES**

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AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
Argentina-New Zealand BIT (1999)	<p>Article 5 [...]</p> <p>(2) The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties.</p>
ASEAN Agreement on the Promotion and Protection of Investments of (1987)	<p>Part V</p> <p>The Provision of this Agreement shall not apply to matters of taxation in the territory of the Contracting Parties. Such matters shall be governed by Avoidance of Double Taxation between Contracting Parties and the domestic laws of each Contracting Party.</p>
ASEAN Comprehensive Investment Agreement (CIA) (2009)	<p>4. This Agreement shall not apply to: (a) any taxation measures, except for Articles 13 (Transfers) and 14 (Expropriation and Compensation); [...]</p> <p>Article 36 [...]</p> <p>6. Where an investment dispute relate to a measure which may be a taxation measure, the disputing Member State and the non-disputing Member State, including representatives of their tax administrations, shall hold consultations to determine whether the measure in question is a taxation measure.</p> <p>7. Where a disputing investor claims that the disputing Member State has breached Article 14 (Expropriation and Compensation) by the adoption or enforcement of a taxation measure, the disputing Member State and the non-disputing Member State shall, upon request from the disputing Member State, hold consultations with a view to determining whether the taxation measure in question has an effect equivalent to expropriation or nationalisation.</p>

AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
Canada Model Promotion and Protection of Investments Agreement (FIPA) (2004)	<p>Article 16 - Taxation Measures</p> <p>1. Except as set out in this Article, nothing in this Agreement shall apply to taxation measures. For further certainty, nothing in this Agreement shall affect the rights and obligations of the Parties under any tax convention. In the event of any inconsistency between the provisions of this Agreement and any such convention, the provisions of that convention shall apply to the extent of the inconsistency.</p> <p>2. Nothing in this Agreement shall be construed to require a Party to furnish or allow access to information the disclosure of which would be contrary to the Party's law protecting information concerning the taxation affairs of a taxpayer.</p> <p>3. A claim by an investor that a tax measure of a Party is in breach of an agreement between a Party and the investor concerning an investment shall be considered a claim for breach of this Agreement unless the taxation authorities of the Parties, no later than six months after being notified by the investor of its intention to submit the claim to arbitration, jointly determine that the measure does not contravene such agreement. The investor shall refer the issue of whether a taxation measure does not contravene an agreement for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).</p> <p>4. The provisions of Article 13 shall apply to taxation measures unless the taxation authorities of the Parties, no later than six months after being notified by an investor that the investor disputes a taxation measure, jointly determine that the measure in question is not an expropriation. The investor shall refer the issue of whether a taxation measure is an expropriation for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).</p> <p>5. An investor may submit a claim relating to taxation measures covered by this Agreement to arbitration under Section C only if the taxation authorities of the Parties fail to reach the joint determinations specified in paragraph 3 and paragraph 4 of this Article within six months of being notified in accordance with the provisions of this Article.</p> <p>6. If, in connection with a claim by an investor of a Party or a dispute between the Parties, an issue arises as to whether a measure of a Party is a taxation measure, a Party may refer the issue to the taxation authorities of the Parties. The taxation authorities shall decide the issue, and their decision shall bind any Tribunal formed pursuant to Section C or arbitral panel formed pursuant to Section D, as the case may be, with jurisdiction over the claim or the dispute. A Tribunal or arbitral panel seized of a claim or a dispute in which the issue arises may not proceed pending receipt of the decision of the taxation authorities. If the taxation authorities have not decided the issue within six months of the referral, the Tribunal or arbitral panel shall decide the issue in place of the taxation authorities.</p> <p>7. The taxation authorities referred to in this Article shall be the following until notice in writing to the contrary is provided to the other Party:</p> <p>(a) for Canada: the Assistant Deputy Minister, Tax Policy, of the Department of Finance Canada;</p> <p>(b) for _____:</p>

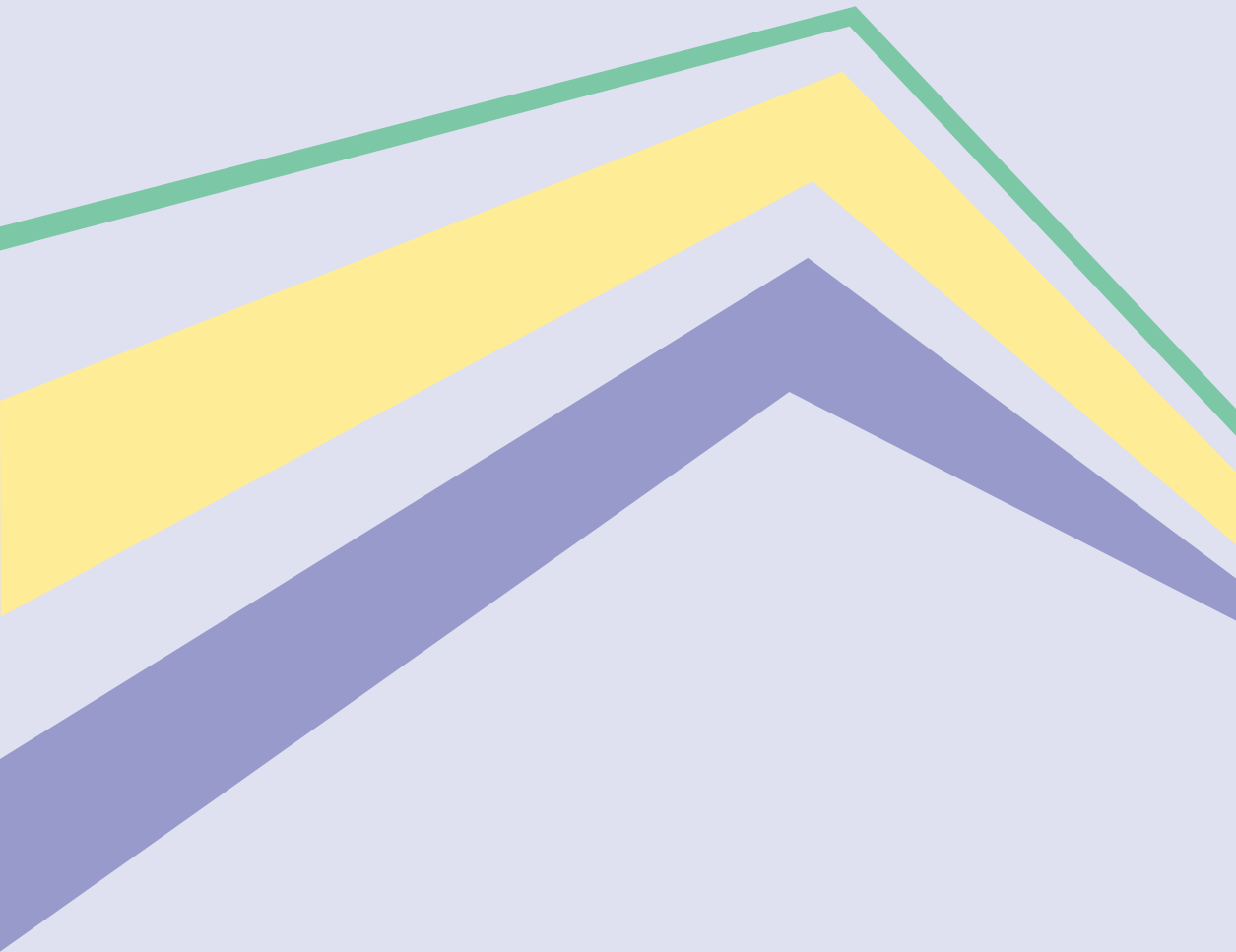
AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
<p>Colombia-EU-Peru FTA (2013)</p>	<p>Article 296 – Taxation</p> <ol style="list-style-type: none"> 1. This Agreement shall only apply to taxation measures to the extent such application is necessary to give effect to the provisions of this Agreement. 2. Nothing in this Agreement shall affect the rights and obligations of any Party under any tax convention [For the purposes of this article, "tax convention" shall be understood as a convention for the avoidance of double taxation or other international taxation agreement or arrangement] between a Member State of the European Union and a signatory Andean Country. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency. In the case of tax conventions between a Member State of the European Union and a signatory Andean Country, the competent authorities under that convention shall have sole responsibility for determining whether any inconsistency exists between this Agreement and that convention. 3. Nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing any measure which: <ol style="list-style-type: none"> (a) aims at ensuring the effective and equitable imposition and collection of direct taxes; (b) distinguishes in the application of the relevant provisions of domestic fiscal legislation, including those aimed at ensuring the imposition and collection of duties, between tax payers who are not in the same situation, in particular with regard to their place of residence or with regard to the place where their capital is invested; (c) aims at preventing the avoidance or evasion of taxes pursuant to tax provisions of conventions to avoid double taxation or other tax agreements, or domestic fiscal legislation; or (d) is incompatible with any MFN obligation established under this Agreement, provided that the difference in treatment results from a tax convention. 4. Tax terms or concepts not defined in this Agreement are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Party taking the measure.
<p>Cotonou Agreement (2003)</p>	<p>Article 52 Tax Carve-out Clause</p> <ol style="list-style-type: none"> 1. Without prejudice to the provisions of Article 31 of Annex IV, the Most Favoured Nation treatment granted in accordance with the provisions of this Agreement, or any arrangement adopted under this Agreement, does not apply to tax advantages which the Parties are providing or may provide in the future on the basis of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation. 2. Nothing, in this Agreement, or in any arrangements adopted under this Agreement, may be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation. 3. Nothing in this Agreement, or in any arrangements adopted under this Agreement, shall be construed to prevent the Parties from distinguishing, in the application of the relevant provisions of their fiscal legislation, between taxpayers who are not in the same situation, in particular with regard to their place of residence, or with regard to the place where their capital is invested.

AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
EFTA-SACU FTA (2003)	<p>Article 98 – Tax carve-out clause</p> <p>1. The most-favoured-nation treatment granted in accordance with the provisions of this Agreement, or any arrangements adopted under this Agreement, do not apply to tax advantages which South Africa and the Member States of the European Union are providing or may provide in the future on the basis of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation.</p> <p>2. Nothing in this Agreement, or in any arrangements adopted under this Agreement, may be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation.</p> <p>3. Nothing in this Agreement, or in any arrangements adopted under this Agreement, shall be construed to prevent the Member States of the European Union or South Africa from distinguishing, in the application of the relevant provisions of their fiscal legislation, between taxpayers who are not in the same situation, in particular with regard to their place of residence, or with regard to the place where their capital is invested.</p>
Ethiopia-Luxembourg BIT (2006)	<p>Article 4 – National and most favoured nation treatment</p> <p>1. In all matters relating to the treatment of investments, the investors of each Contracting Party shall enjoy national treatment or most-favoured-nation treatment in the territory of the other Contracting Party.</p> <p>2. With respect to the operation, management, maintenance, use, enjoyment and sale or other disposal of investments, each Contracting Party shall accord, on its territory, to investors of the other Contracting Party, treatment no less favourable than that granted to its own investors or to investors of any other state if the latter is more favourable.</p> <p>3. This treatment shall not include the privileges granted by one Contracting Party to investors of a third state by virtue of its participation or association in a free trade zone, customs union, common market or any other form of regional economic organisation.</p>
EU-South Korea FTA (2011)	<p>Article 15.7 – Taxation</p> <p>1. This Agreement shall only apply to taxation measures in so far as such application is necessary to give effect to the provisions of this Agreement.</p> <p>2. Nothing in this Agreement shall affect the rights and obligations of either Party under any tax convention between Korea and the respective Member States of the European Union. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency. In the case of a tax convention between Korea and the respective Member States of the European Union, the competent authorities under that convention shall have sole responsibility for jointly determining whether any inconsistency exists between this Agreement and that convention.</p> <p>3. Nothing in this Agreement shall be construed to prevent the Parties from distinguishing, in the application of the relevant provisions of their fiscal legislation, between taxpayers who are not in the same situation, in particular with regard to their place of residence or with regard to the place where their capital is invested.</p> <p>4. Nothing in this Agreement shall be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements or domestic fiscal legislation.</p>

AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
Germany-Afghanistan BIT (2005)	Article 3 [...] <p>(4) The treatment granted under this Article shall not relate to advantages which either Contracting State accords to investors of third States by virtue of a double taxation agreement or other agreements regarding matters of taxation.</p>
North American Free Trade Agreement (NAFTA) (1994)	Article 2103(6) <p>6. Article 1110 (Expropriation and Compensation) shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim under Article 1116 (Claim by an Investor of a Party on its Own Behalf) or 1117 (Claim by an Investor of a Party on Behalf of an Enterprise), where it has been determined pursuant to this paragraph that the measure is not an expropriation. The investor shall refer the issue of whether the measure is not an expropriation for a determination to the appropriate competent authorities set out in Annex 2103.6 at the time that it gives notice under Article 1119 (Notice of Intent to Submit a Claim to Arbitration). If the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation within a period of six months of such referral, the investor may submit its claim to arbitration under Article 1120 (Submission of a Claim to Arbitration).</p>

AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
OECD Multilateral Investment Agreement (MIA) (1998)	<p>VIII. Taxation</p> <p>1. Nothing in this Agreement shall apply to taxation measures except as expressly provided in paragraphs 2 to 5 below.</p> <p>2. Article ... (Expropriation) shall apply to taxation measures.</p> <p>3. Article ... (Transparency) shall apply to taxation measures, except that nothing in this Agreement shall require a Contracting Party to furnish or allow access to information covered by tax secrecy or any other provision or administrative practice protecting confidentiality in domestic laws or international agreements, and including information:</p> <ul style="list-style-type: none"> a) contained in or exchanged pursuant to any agreement or arrangement relating to taxation between governments and investors; b) pursuant to any agreement with a foreign government concerning the application or interpretation of an international agreement relating to taxation in the case of an investor, including exchange of information between governments; c) concerning the identity of an investor or other information which would disclose any trade, business, industrial, commercial or professional secret or trade process; d) pertaining to the negotiation of tax treaties or of any other international agreement relating partly or wholly to taxation or the participation by a government in the work of international organisations; or e) the disclosure of which would affect the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, taxation, or any information the disclosure of which would aid or assist in the avoidance or evasion of taxes. <p>4. The provisions of Article [C] (State to State Dispute Settlement) and Article [D] (Investor to State Dispute Settlement), [except for paragraph 1b of Article [D]], and only those provisions, shall apply to a dispute under paragraph 2 or 3 of this Article.</p> <p>5. For the purposes of this Article:</p> <ul style="list-style-type: none"> a) A Competent Tax Authority means the minister or ministry responsible for taxes or their authorised representatives. b) "Taxation measures" include <ul style="list-style-type: none"> i) any provision relating to taxes of the law of the Contracting Party or of a political subdivision thereof or a local authority therein, or any administrative practices of the Contracting Party relating to taxes; 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. Taxes shall be taken for this purpose to include direct taxes, indirect taxes and social security contributions.
Spain-Mexico BIT (2006)	<p>Article 4(3)(b)</p> <p>Treatment granted under paragraphs 1 and 2 above shall not be construed in obliging either Contracting Party to extend to the investors of the other Contracting Party and their investments the benefit of any treatment, preference or privilege resulting of:</p> <ul style="list-style-type: none"> a. its association or involvement, present or future, in a free trade area, customs, economic or monetary union or any other form of regional economic organization or agreement with similar characteristics; b. any international agreement relating wholly or principally to taxation or any domestic legislation or provision fully or partially relating to taxation. For greater certainty, the Contracting Parties may apply a different tax treatment to taxpayers available in their fiscal residency.

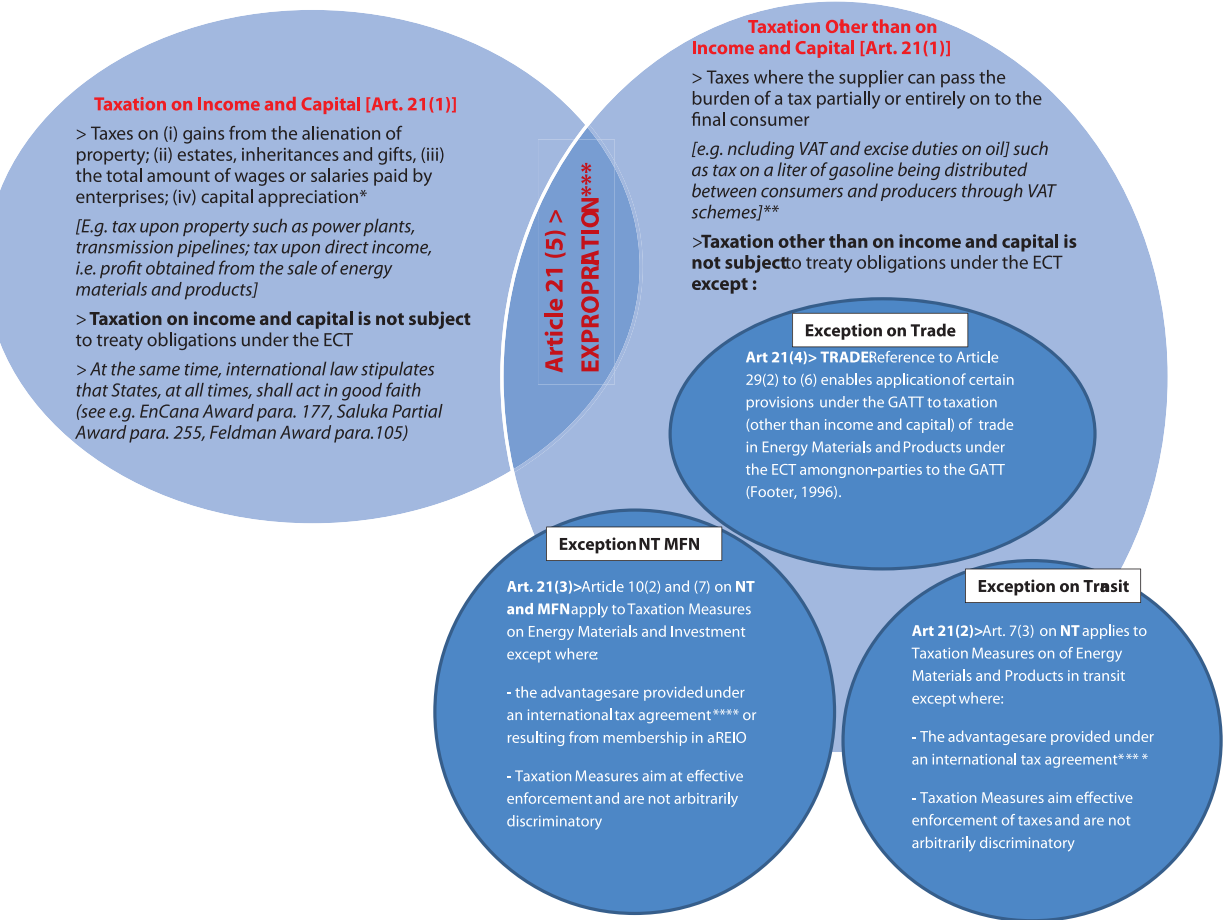
AGREEMENTS (IN ALPHABETICAL ORDER)	TAX EXCEPTION OR CARVE-OUT PROVISIONS
US-Ecuador BIT (1997)	<p>ARTICLE X</p> <p>1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.</p> <p>2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:</p> <p>(a) expropriation, pursuant to Article III;</p> <p>(b) transfers, pursuant to Article IV; or</p> <p>(c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article 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.</p>
US Model BIT (2012)	<p>Article 21 – Taxation</p> <p>1. Except as provided in this Article, nothing in Section A shall impose obligations with respect to taxation measures.</p> <p>2. Article 6 [Expropriation] shall apply to all taxation measures, except that a claimant that asserts that a taxation measure involves an expropriation may submit a claim to arbitration under Section B only if:</p> <p>(a) the claimant has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measure involves an expropriation; and</p> <p>(b) within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.</p> <p>3. Subject to paragraph 4, Article 8 [Performance Requirements] (2) through (4) shall apply to all taxation measures.</p> <p>4. Nothing in this Treaty shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Treaty and any such convention, that convention shall prevail to the extent of the inconsistency. In the case of a tax convention between the Parties, the competent authorities under that convention shall have sole responsibility for determining whether any inconsistency exists between this Treaty and that convention.</p>



**ANNEX II:
DIAGRAM OF ART. 21 ECT CARVE
OUT OF TAXATION MEASURES ON FOREIGN
INVESTMENTS AND ON ENERGY MATERIALS**

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Carve Out of Taxation Measures on Foreign Investments and on Energy Materials



* See Art. 21(7)(b); see also OECD Model Tax Convention 2003

** Atkinson & Stiglitz, 1976

*** Subject to the referral mechanism articulated in Art. 21(5)(b)

**** Article 21(7)(a)(ii): International tax agreement include Double Taxation Treaties (DTT) and/or taxation provisions provided under any other international agreements by which the Contracting Party is bound

Taxation of Foreign Investments and Energy Materials and Products under the ECT: Taxation Other than Income and Capital

Taxation Other than Income and Capital [Art. 21(1)]

Art 21(3)* > NT and MFN provision under Art. 10(2) and (7) do not apply to:

> DTTs: Advantages/favorable treatments provided in DTTs (by which the Contracting Party is bound) [which require avoidance of double taxation of a foreign investment]

> Advantages resulting from membership in a REIO [REIO is defined as "an organization to which its member states have transferred competence over some matters governed by the ECT" in Art. 1(3)] [E.g. the European Union (EU), the African Union (AU), the Union of South American Nations (USAN)]

Art 21(4) > TRADE Reference to Article 29(2) to (6) enable application of e.g.:

- MFN provision under Article I of the GATT;

- NT provision under Article III of the GATT;

to taxation (other than income and capital) of trade in Energy Materials and Products under the ECT among non-parties to the GATT.

Art 21(2)* > NT provision under Art. 7(3) does not apply to:

> DTTs: Advantages/favorable treatments provided in DTTs (by which the Contracting Party is bound), which require avoidance of double taxation of a foreign investment

> **Other international agreements/arrangements** such as BITs, FTAs or cooperation agreements which include provisions that avoid double taxation of a foreign investments

* In addition, both subparagraphs 2 and 3 provide that NT and MFN treatment do not apply to Taxation Measures where states "aim effective enforcement of taxes" provided that the Taxation Measure is not arbitrarily discriminatory. This, in our view, is a broad obligation, and may raise controversial issues of interpretation.

**Taxation of Foreign Investments under International Law:
Article 21 of the Energy Charter Treaty in Context**

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English, PDF
ISBN 978-905948-172-5