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International arbitration: a new avenue for challenging tax enforcement

BY KAT GREGOR AND ELLEN GILLEY

International arbitration has been heralded for offering individuals a neutral forum to settle disputes. This benefit is important to foreign investors in developing or transitional nations, as the host-country's courts are often viewed as being biased toward the interests of the country and its citizens, thereby depriving foreign investors of an impartial judge and a fair outcome. This concern about national courts is particularly relevant in the area of tax disputes. In times of shifting political ideology and regimes, tax policies are often changed. The change can apply either consistently across all taxpayers or target specific classes of taxpayers, such as foreign companies or investors. Regardless of the reason for a new tax assessment, whether it is genuinely for the public good or simply retaliatory, disputing it in a national court system can be challenging. Taxation is universally seen as a sovereign right and questioning the government's rationale for a tax is often out of the comfort zone, if not purview, of a national court, particularly in countries that do not have an entrenched system of judicial independence. Additionally, navigating the spider web of a nation's regulatory framework and processes will, at the very least, be tedious and long. As a result, international arbitration's offer of an impartial forum and comparatively fast resolution is well suited to disputing aggressive or unexpected taxation. But this raises two key questions: when is international arbitration available to a taxpayer, and at what point in a dispute, if ever, should a taxpayer seek recourse to an international arbitral tribunal?

When is international arbitration available to a taxpayer?

For a taxpayer to contest a tax assessment through international arbitration, there are three general requirements. First, there must be an underlying agreement between either the taxpayer or the taxpayer's resident nation, on the one hand, and the nation imposing the tax, on the other. Second, this agreement must, directly or indirectly, provide the taxpayer with some assurance of a stable or non-discriminatory tax regime. Third, the taxing authority must violate this agreement. Furthermore, for the dispute to be subject to an international arbitration, the taxpayer must have a different nationality than the taxing authority. The presence of an agreement regulating the conduct of the state, vis-à-vis the investor, is key and the two broad types of agreements that typically give rise to an international tax arbitration and will be discussed here are bilateral investment treaties (BITs) and investor-state agreements, such as concession agreements.

BITs are international agreements concluded between states that guarantee certain rights and protections to investments made by the nationals of one state into the other. The most common include protections against expropriation, guarantees of fair and equitable treatment (FET), most-favoured nation (MFN) status and national treatment, where, for example, a resident of the foreign nation will be treated the same as residents. Other international agreements, such as the Energy Charter Treaty, also provide similar protections.

If a BIT provision is violated, an investor can typically bring an international arbitration directly against the state, pursuant to the BIT's mandatory arbitration clause. In the context of contesting tax assessments, arbitral tribunals have found that a tax has constituted an unlawful expropriation when the tax, either by itself or as part of other regulatory actions, removes substantially all the value of the investment. Less aggressive taxes have also been found to violate a BIT under the FET protection. In this scenario, the investor must demonstrate that there was a change in the tax law and that this change was contrary to the 'legitimate expectations' on which the investment relied. In 2015, in *Oxus Gold v. Republic of Uzbekistan*, the tribunal upheld the investor's FET claim against Uzbekistan, holding that because Uzbekistan entered into a formal agreement with the investor promising specific tax rates, the investor had legitimate expectations that those rates would continue to apply. Another possible argument is if a tax is designed to target non-resident taxpayers, whether companies or individuals, a non-resident may be able to argue that such a tax violated either the FET or national treatment clauses.

Unlike BITs, concession agreements are entered into directly between the state and a specific foreign investor in which the host country provides specific guarantees, including regulatory guarantees, for a length of time, generally the life of the project. Whereas BITs apply to all investors from a given country, concession agreements cover a specific investment between a specific investor and the host country. Typically, concession agreements are formed in relation to mining investments or natural resource extractions, as these projects have a long life, and investors demand predictability. Another common context for concession agreements is infrastructure development.

A common provision in a concession agreement is a tax stabilisation clause, which guarantees a certain degree of stability in the tax regime, ranging from a total freeze of the rates at the time of investment, to a promise to consult with the investor before any change occurs. Often, these tax stabilisation clauses are entered into in conjunction with general regulatory stability clauses. Additionally, a concession agreement usually has a mandatory arbitration clause, and thus like a BIT, can also become the basis of an international tax arbitration. Similar to the argument advanced in *Oxus Gold*, if the host country imposes a higher tax than what was agreed, the investor can initiate an arbitration for breach of the concession contract.

When is the time right for an arbitration claim?

International arbitration cannot supplant all national litigation in resolving tax disputes. As described, there must be an agreement regulating the relationship between the investor and the state, and this agreement must both provide for arbitration, and, directly or indirectly, some guarantee about the applicable tax regime. Additionally, if an international agreement (such as a BIT) is to serve as the basis of a claim, the investor must ensure that tax disputes are not excluded and that any requirements for the exhaustion of local remedies have been satisfied.

Assuming a tax claim can be raised in an international arbitration, tribunals are careful when examining a tax claim under any agreement. Taxation remains a sovereign right and is fundamental to the proper functioning of a country. Thus, tribunals are more inclined to infringe on

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the state's recognised right to tax when the tax is egregious or when the state explicitly agreed to a tax arrangement with an investor.

This means that even when a tax assessment is egregious, an investor must weigh the possible benefits of removing a claim from local courts to an international arbitral tribunal against the possible negative impact on ongoing local country litigation. Bringing a treaty claim when local administrative or judicial processes remain ongoing carries the risk of antagonising local authorities. If a tribunal is not likely to accept jurisdiction over a tax claim, the potential harm to traditional disputed processes may not be worth it. On the other hand, waiting to exhaust local remedies undoes much of the efficiency and timing benefits of international arbitration.

In any event, international arbitration remains a useful avenue to dispute aggressive taxation. Taxpayers should consider the international agreements that are in effect between the taxpayer's home country and the host country of the investment to determine whether a BIT or similar treaty exists to offer protection. Even if bringing an arbitral claim to remove an issue from local courts is not the right strategy, investors might consider incorporating the threat of such a claim in the background of negotiations. ■