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TAXATION POLICY OF HOST STATE IN INVESTOR-STATE DISPUTE SETTLEMENT

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ABSTRACT

Taxation has a massive influence on host State's policy and lawmaking in providing international investment agreement (IIA) obligations in light of promotion of good governance and rule of law at a national sphere. In this regard, taxation surely fosters legal and policy reforms in host States. However, there are some delicate tax-related investment cases, which illustrate that there is no direct impact of international investment law on changing national law and policy.

***Keywords**: taxation, international investment law, international investment agreement, investment dispute, host State, tax law.*

INVESTOR VA DAVLAT O'RTASIDAGI INVESTITSION NIZOLARINI HAL ETISHDA MEZBON DAVLATNING SOLIQ SOLISH SIYOSATI

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ANNOTATSIYA

Soliqqa tortish milliy sohada oqilona boshqaruv va qonun ustuvorligini rag'batlantirish nuqtai nazaridan xalqaro investitsiya shartnomasi (XISh) majburiyatlarini ta'minlashda qabul qiluvchi davlatning siyosati va qonun ijodkorligiga katta ta'sir ko'rsatadi. Shu munosabat bilan soliqqa tortish, shubhasiz, qabul qiluvchi davlatlarda huquqiy va siyosiy islohotlarga yordam beradi. Lekin soliq bilan bog'liq ba'zi nozik investitsiya holatlari mavjud bo'lib, ular xalqaro investitsiya huquqining milliy qonunchilik va siyosatni o'zgartirishga bevosita ta'siri yo'qligini ko'rsatadi.

***Kalit so'zlar**: soliqqa tortish, xalqaro investitsiya huquqi, xalqaro investitsiya shartnomasi, investitsion nizo, qabul qiluvchi davlat, soliq huquqi.*

НАЛОГОВАЯ ПОЛИТИКА ПРИНИМАЮЩЕГО ГОСУДАРСТВА ПРИ РАЗРЕШЕНИИ СПОРОВ ИНВЕСТОР-ГОСУДАРСТВО

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АННОТАЦИЯ

Налогообложение оказывает огромное влияние на политику и законотворчество принимающего государства в обеспечении обязательств по международным инвестиционным соглашениям (МИС) в свете поощрения надлежащего управления и верховенства закона в национальной сфере. В этом отношении налогообложение, несомненно, способствует проведению правовых и политических реформ в принимающих государствах. Тем не менее, есть несколько деликатных инвестиционных дел, связанных с налогами, которые показывают, что нет прямого влияния международного инвестиционного права на изменение национального законодательства и политики.

***Ключевые слова**: налогообложение, международное инвестиционное право, международный инвестиционный договор, инвестиционный спор, государство пребывания, налоговое право.*

INTRODUCTION

Contract-based disputes did not come out on top between investor and host States until mid-1990s and the foreign investors hardly sued host States on their tax policy. However, such tradition changed about 20 years ago [1]. Regarding to the number of treaty-based disputes started to increase dramatically, well protected spheres, such as taxation began to come across growing inspection of investment arbitration. International Trade Administration (ITA) questioned different kind of tax issues such as VAT, windfall profit taxes, withholding taxes, distribution taxes, tax penalties, behavior and interests of tax authorities that enjoyed wide scope of discretion [2]. The countries from Asia and Latin America have never thought about their tax sovereignty by external authority in such wide spectrum. After that, two categories of reactions have been anticipated by investment importing host States. First reaction, small number of countries such as Venezuela, Ecuador, Bolivia, South African Republic and Indonesia criticized ICSID and threatened to terminate all packages of IIAs with an eye to keep their sovereign right to taxation [3]. Second category reactions of host countries were extremely worried about such phenomenon

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and they mindfully followed the investment tribunal's interpretations of vague fair and equitable treatment or national treatments concerning tax-related disputes. This kind of host States tried to incorporate emerging principles of investment arbitration into national legislation and take them in account during decision-making process in order to avoid burdensome responsibility.

MATERIALS AND METHODS

1. To find out the underlying reasons of failures on tax-based investment disputes;

2. What should middle income or lower income countries do in order to tackle with taxation issues (such as Uzbekistan)?

3. To what extent taxation has an impact on regulatory system of host countries?

4. To what extent taxation policy of host State has a nexus with the core standards of investment principles (such as fair and equitable treatment, national treatment or expropriation)?

The empirical researches reveal that only small countries-for example, Burundi accepted to reimburse taxes and custom duties which foreign investor had paid. However, Russia and Ecuador, which are rich in natural resources, did not agree to reissue the compensation in favor of foreign investor. In case of *Yukos v Russia*, the investor has intentionally been made bankrupt through retrospective taxation whereas Ecuador raised 99% taxes despite the potential threat of arbitration by the foreign investor [4]. Furthermore, an immense telecommunication company, Vodafone did not avoid Indian government from amending the tax law retrospectively and obliged the company to pay 2.6 billion US dollars of tax regardless of a victory in Supreme Court of India [5].

In *Vodafone v. India,* Vodafone purchased Hong Kong based Hutchison Essar's Indian mobile unit for 11 billion US dollars in 2007. The transaction happened in offshore of the Cayman Islands and Indian tax authority required from Vodafone to pay capital gains tax, since the company obtained capital gain from the transaction. Despite the victory of Vodafone in Indian Supreme court, Indian government amended the tax law retrospectively and forced the company to pay 2.6 billion US dollars of tax. Moreover, Indian Parliament adopted a law on retroactively subjecting Vodafone to capital gains tax in 2012. Finally, regarding to India-Netherlands Bilateral Investment Treaty (BIT), Vodafone challenged investment arbitration under UNCITRAL rules against India [6].

In *Yukos shareholders v. Russia,* major oil company in Russia, met range of various tax reassessments, inspections and proceedings that eventually made the company bankrupt [7]. Hence, the tribunals in Yukos case had to clarify two following matters. First, whether subsequent tax assessments were a legitimate exercise by Russia to enforce its tax laws (from the perspective of Respondent's position) or all massive tax claims were fabricated against the Yukos which let the premeditated expropriation of all Yukos assets by the State (Claimant's position). The Russian Tax Ministry five times re-assessed Yukos a Repeat/Field Tax Audit Report and a Decision issued the amount of more than 24 billion US dollars. Further, the tribunal concluded that 'the primary objective of the Russian Federation was not to collect taxes rather to bankrupt Yukos and appropriate its valuable assets.'[8] Nevertheless, European Court of Human Rights, Permanent Court of Arbitration ruled in favor of Yukos and granted multi-billion awards in 2011 and 2014 as well [9].

In the case of *Burlington v. Ecuador,* foreign investor concluded Product Sharing Contracts (PSCs) with Ecuador in terms of exploring and exploiting oil reserves in several blocks inside the country [10]. Since the oil prices lifted in 2005, Ecuador strove to renegotiate the terms of PSCs with Burlington. When the negotiations went wrong, the Congress of Ecuador imposed a windfall tax on Burlington's excess profits [11]. Consequently, investor had to pay the sum of 50 percent of their profit if the market price of oil exceeds the price of oil when the contracts were executed. After some time Ecuador raised the tax rate of Law 42 from 50 percent to 99 percent in 2007 [12]. In response, Burlington demanded from Petro Ecuador (national oil company) to apply a correction factor to its oil participation share which would soften the impact of domestic law at 99 percent, reportedly linking to tax modification clauses of the PSCs. Nevertheless, Ecuador did not take these requests serious and Burlington rejected to pay the taxes in 2008. Then, Ecuador launched proceedings to confiscate and auction the production share of investor in order to collect overdue payment. Eventually, Ecuador gained the possessions of Burlington's blocks and terminated the PSCs. As a result, Burlington sought the case to the ICSID under the U.S.-Ecuador BIT and tribunal ruled that Ecuador illegally expropriated Burlington's investment rights.

RESEARCH RESULTS

On the other hand, there are several investment cases where investor achieved settlement agreement with host State on tax dispute as well. In *Goetz v. Burundi*, [13] the issue concerned AFFIMET, a company incorporated in Burundi specialized in the

production and marketing of precious metals, owned by six Belgium investors. The company was bestowed a "certificate of free zone" by the government of Burundi in 1993. The free zone was granted tax and customs exemptions. Nonetheless, after two years Burundi pulled the certificate out on the basis that free zone regime no longer applied to companies concerning extraction or sale of ore. Therefore, Belgian investors faced losses and brought the case under ICSID regarding Belgium-Luxembourg Economic Union and Burundi BIT. According to tribunal findings, settlement agreement was concluded and Burundi agreed to reimburse almost 3 million US dollars tax and custom duties which investor had to pay and initiate a new free zone regime.

Second case in this category, most important to this research, is *MTS v. Uzbekistan* [14]. Prior to 2012, the Russian owned MTS's 100-percent subsidiary kept top position on the mobile communications market in Uzbekistan, which had more than 9.5 million subscribers. Starting from June 2012, company began facing serious investigations by multiple State authorities. The primary reason for such inspection was tax evasion. Regarding to some information, 'Prosecutors soon reported that MTS-Uzbekistan had evaded taxes by founding fly-by-night companies, which were subsequently resulted in serious losses for the economy of Uzbekistan' [15]. The overall claim amount estimated 1.1 billion US dollars which was equal to MTS investments in Uzbekistan. Then, MTS took a 1.1 billion write-off after Tashkent economical court of Uzbekistan cancelled the company's local operating license which finally allowed company went bankrupt. Further, MTS brought the case under ICSID and after two years of legal proceedings, Uzbekistan agreed to conclude a settlement agreement with the investor in 2014. The settlement agreement gave a right to MTS resume its operation in Uzbekistan and parties agreed to establish a joint venture where Uzbek authorities transferred 50.01 percent stake of charter capital to MTS.

CONCLUSION

In fact, tax is an inherent power of all sovereign countries. In *Nicol v. Ames* Justice Rufus Peckham accurately stated on power to tax by mentioning that, *'it is not only the power to* destroy *but also the power to keep alive'* [16]. In this respect, taxation truly matters to both: for investors, the less they pay taxes, the more benefit they gain and for the host States, the higher taxes they raise, the more profit countries get. Mostly, host States aim to follow the interpretations of investment tribunals concerning tax-related disputes in terms of implementing forthcoming principles of

investment arbitration into national legislation. Further, host States try to take the basic principles of investment arbitration into account during investment period to avoid severe consequences of tax-related cases [17].

Given tax-related investments disputes show two different scenarios in host States' tax policy. First scenario, in a small and fragile States, investment treaty law failed to have an influence on the regulatory systems of host States. In case of Burundi tax-based dispute, host country even compromised to reissue foreign investors' tax and customs duties. In Uzbekistan case, host State agreed to suspend criminal proceedings on tax evasion against investor. One of the key reasons behind this scene could be vulnerability of these countries towards costly investment arbitration procedures or too heavy compensations [18]. Furthermore, there must be too many loopholes in middle income or lower income host countries' tax system which should be fixed to avoid such tax-related disputes in future. Second scenario, powerful or resource rich countries, such as Russia, India or Ecuador demonstrated a massive reluctance to keep a balance with foreign investors on their tax policies. These countries have never given up on levying taxes without any hesitation notwithstanding the threat of investment arbitration.

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