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Relationship of tax, trade and investment agreements

Co-Coordinators' Report

Summary
This paper outlines the current and proposed work of the Subcommittee on the Relationship of Tax, Trade and Investment Agreements, in accordance with the two remaining workstreams of the Subcommittee as agreed by the Committee at the Twenty-fourth session and confirmed at the Twenty-eighth session.

On **Workstream A** on the **relationship of tax and investment agreements**, the Subcommittee presented a draft guidance document for consideration at the Twenty-eighth session. The Subcommittee has taken into account the comments on that document at the session and afterwards and ***submits, at Attachment A, a draft of the guidance for a second reading with a view to final approval at this session.***

On **Workstream B**, as part of work on examining **options for improving guidance on the interaction of tax treaties with the WTO General Agreement on Trade in Services ("GATS") and non-tax agreements such as free trade agreements,** the Subcommittee proposed at the Twenty-seventh session that the GATS provision currently found in the UN Model Tax Convention Commentary on Article 25 (at para 53) should be given greater visibility by including it directly into the text of the Model Article. The Committee agreed to this at the Twenty-eighth session.

The Subcommittee seeks: (i) Committee guidance on which of two options (in Attachments B.1 and B.2) should be preferred for inclusion in the Model, (ii) approval of the GATS clause text for inclusion in Article 25; and (iii) a first consideration of the proposed text for the Commentary on the GATS Clause and of the preferred option for addressing the "extended provision".

The option at Attachment B.1 has two elements:
- ***A draft of the GATS clause as a provision in Article 25, with attendant commentary; and***
- ***Draft commentary addressing text of a treaty provision addressing the interaction of tax treaties with non-tax agreements more broadly (an "extended provision").***

The option at Attachment B.2 also has two elements:
- ***A draft of the GATS clause as a provision in Article 25, with attendant commentary. This is the same as in Attachment B.1; and***
- ***A draft of the "extended provision" clause as a provision in Article 25, with attendant commentary.***

Background and Subcommittee Mandate

1. Note E/C.18/2021/CRP.36 ("the 2021 Note") on the relationship of taxation with trade and investment agreements gave a history of the UN Secretariat work on the interaction of taxation policy and administration, including an earlier note E/C.18/2019/CRP.14 ("the 2019 Note") on similar issues. The 2021 Note recognized the work of the United Nations Conference on Trade and Development (UNCTAD) in that area, notably the March 2021 publication: International Investment Agreements and their Implications for Tax Measures: What Tax Policymakers Need to Know. UNCTAD consulted with the Secretariat and others when preparing that document, and the UNCTAD publication itself acknowledges the 2019 Note.

2. The 2021 Note addressed the need for guidance to tax policymakers and administrators on a variety of issues about the interaction of trade and investment treaties with tax policy and administration, including, but not limited to, tax treaties.

3. At the Twenty-third Session, the 2021 Note was considered and the Report of that Session noted the presentations made and the general discussion on the subject. As also indicated in the Report, at para 114:

> The Committee agreed to establish a Subcommittee on the Relationship of Tax, Trade and Investment Agreements, with Ms. Kana, Mr. Ligomeka, and Mr. Roelofsen as Co-Coordinators, and with the following mandate:
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> The Subcommittee is mandated:
>
> - To identify priority issues where guidance from the Committee may most usefully assist developing countries in differing situations, in particular, on the relationship of tax with investment and trade agreements, and initially report to the Committee on such issues at its Twenty-fourth Session, in 2022;
> - Within the above context, to make proposals for consideration by the Committee, with a view to providing guidance at various points during the current membership of the Committee.
>
> The Subcommittee may consult broadly, taking into account relevant work by other bodies in this area.

Subcommittee Workstream Progress and Key Developments

4. At the Committee's Twenty-fourth Session, three workstreams were proposed by the Subcommittee (E/C.18/2022/CRP.5) and accepted by the Committee, as reflected in the Report of that Session. They were:

> - Workstream A – Tax and Investment Agreements;
> - Workstream B – Tax and The General Agreement on Trade in Services (GATS); and
> - Workstream C – Other Issues in Trade Agreements or Mixed Trade and Investment Agreements;
>
> At that stage, the initial focus was on Workstream A.

5. At the Committee's Twenty-fifth Session, the Committee considered the outline of a paper prepared by Mr. Alain Castonguay, presented as an attachment to paper E/C.18/2022/CRP.18, and the discussions and conclusions helped shape the work since.

6. In the Co-Coordinators' Report to the Committee's Twenty-Sixth Session (E/C.18/2023/CRP.2) a short form of an outline of possible guidance on the relationship of tax and investment agreements was provided as well as the final form of Mr. Castonguay's consultant's report.

7. During the Session, Mr. Castonguay summarized the report, highlighting the key points: 1) the role and main features of international investment agreements, generally and in relation to tax measures, tax policy and double tax agreements; 2) the specific international investment agreement-

type provisions that interacted with tax, highlighting the issue of unintended consequences on taxation; and 3) some concrete steps to address the interaction in a whole-of-government way. Mr. Castonguay noted that the issue was significant because of the number of international investment agreements and their impact on taxation, especially given the increasing number of arbitration cases, many of which involve tax issues, and the related high cost of such "litigation". He recognized the legitimate role of international investment agreements, but also the legitimacy of tax officials' concerns, although his report did not propose specific solutions. The report noted the diverse treatment of tax in international investment agreements. Finally, the report proposed how revenue officials could ensure that tax matters were properly considered at the country level as part of a whole-of-government approach, including participation in negotiation teams and involvement in dispute resolution.

8. At the Twenty-sixth Session a basic outline of possible guidance was presented for comment and at the Twenty-seventh Session a more detailed version was discussed. The report of the Twenty-seventh Session noted the discussions and suggestions to be taken in drafting the guidance.

9. At the Twenty-eighth Session in March 2024, The Committee considered the Subcommittee report (E/C.18/2024/CRP.9) and the discussions and conclusions were as outlined in the Report of that Session (E/2024/45/Add.1) as follows.

> 85. The Co-Coordinator of the Subcommittee on the Relationship of Tax, Trade and Investment Agreements, Mr. Ligomeka, presented the Co-Coordinators' report on the Subcommittee's progress on its key areas of focus (E/C.18/2024/CRP.9). He provided an overview of the Subcommittee's mandate, objectives, guiding principles and workstreams.
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> 86. With regard to workstream A, on taxation policy and administration measures and their relationship with international investment agreements, draft guidance for tax and investment officials was presented. The Committee was requested to provide feedback on the draft, with a view to presenting a second draft for approval at the twenty-ninth session. Mr. Ligomeka emphasized the significance of the guidance, outlining the key reasons and criteria that justified its necessity. Members and observers recognized the importance of the work and acknowledged the assistance rendered by Alain Castonguay as a consultant to the Subcommittee.
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> 87. One member suggested highlighting the importance of tax officials' involvement in the stages before arbitration, citing provisions in existing international agreements. Some observers advocated greater emphasis on such topics as tax incentives and stability provisions. The Secretariat noted that existing relevant work on those issues was referenced in the paper, but it was agreed that the issues could be highlighted further in a manner consistent with the intent of the paper and its proposed length. It was agreed that a revised version of the paper would be presented to the Committee at its next session with a view to final approval.
>
> 88. The other Co-Coordinator of the Subcommittee, Ms. Kana, then presented an overview of workstream B, on the relationship between tax treaties and the General Agreement on Trade in Services of the World Trade Organization. Discussions focused on three main aspects: endorsement of the incorporation of the General Agreement provision in the Model Convention; whether the existing wording of the commentary, citing the commentary of the Organisation of Economic Co-operation and Development, should remain unchanged; and consideration of the introduction of a broader provision to encompass other trade and investment agreements.

89. The inclusion of the General Agreement provision in the text of the Model Convention itself received a great deal of support and was approved. Members highlighted the need to give greater prominence to the potential benefit of such a provision for countries, which would give them a better awareness and understanding of the issue. In the discussion of the introduction of a new commentary, there was broad support for the idea, provided that the new commentary was aimed at enriching the existing guidance with additional content, rather than offering an alternative interpretation. That approach was designed to ensure clarity and consistency, thereby mitigating the risk of misinterpretation.

90. Lastly, with regard to the extended provision, strong support was also expressed, although a minority of members raised concerns in relation to its scope, its interactions with other trade agreements and questions about its applicability in European Union member States, owing to possible inconsistencies with European Union law. Some members also expressed the concern that the extended provision essentially sought to override trade and investment agreements and was inconsistent with the whole-of-government approach endorsed under the first workstream. One of those members further questioned the legal effectiveness of the extended provision and noted that, while it appeared in a very small number of existing treaties (mostly with one other country), it had never been applied in practice. Other members recognized that the provision would only be implemented in the form of a treaty entered into by countries and, in entering into such a treaty, they would be taking government-level decisions about the relationship with their trade and investment treaties that should be respected.

91. Members also stressed that the rationale behind an extended provision was that tax disputes were resolved by tax authorities and that such a provision was already being used in treaty practice. A draft text was discussed and in principle agreed upon by members that favoured such an inclusion. It was agreed that the decision as to whether the extended paragraph would be included as a new article in the Model Convention or, instead, would be an option provided for in the commentary, would be taken at the twenty-ninth session.

92. The Committee also discussed the appropriateness of directly citing the commentary of the Organisation for Economic Co-operation and Development. While some members preferred such a reference, it was decided that, in the current instance, there was no particular interpretation issue and that the text of the United Nations commentary should be drafted without reference to the relatively outdated commentary of the Organisation for Economic Co-operation and Development, thereby also ensuring that it was more closely aligned with the text currently being incorporated in the relevant article of the Model Convention itself.

93. Members and observers were thanked for their comments. Ms. Kana noted that agreement had been reached on the proposed inclusion of the General Agreement on Trade in Services provision in the text of article 25 and that, at the twenty-ninth session, it would be decided whether the paragraph of the extended version, on which agreement in principle had been reached, would also be in the Model Convention or just in the commentary. A proposed draft commentary would be presented at the twenty-ninth session.

10. After the Twenty-eighth Session, the Subcommittee met virtually to advance the remaining Workstreams A and B on 12 June 2024, 26 August 2024 and 13 September 2024. Participants in the UN Model Update Subcommittee were also invited to participate.

Proposed Action on Workstream A

11. The Subcommittee presented draft guidance at Attachment A to paper E/C.18/2024/CRP.9 at the Twenty-eighth Session for Committee consideration and comment. ***Attachment A to this paper updates the proposed text to take into account comments at the Twenty-eighth Session and after, with a view to finalization at this Session.*** The main changes relate to adding some more discussion on general issues relating to investment incentives, and on so called "stabilization clauses". Stabilization clauses are commitments made by a host State to one or more foreign investors, which are designed to shield foreign investors from adverse legislative or regulatory change in the host State. The guidance also emphasizes or clarifies other matters, such as the importance of tax officials being involved at the early stages of an emerging dispute. ***Approval for the guidance is sought at this Session.***

The GATS Issue

12. The **GATS issue (Workstream B)** was outlined in paper E/C.18/2021/CRP.36 of the Committee's Twenty-third Session. The following points are essentially extracted from that paper's analysis of the issue, with further detail now added on the "grandfathering" of pre-1995 double tax agreements, for clarification.

- In examining compatibility of tax and non-tax agreements on these points, the World Trade Organisation (WTO) agreements are relevant both in their own right and because most non-discrimination provisions in non-tax agreements are based in significant part on the WTO provisions. The General Agreement on Trade in Services (GATS) is a trade agreement; however, it also constitutes an investment agreement because the definition of modes of service covers, in effect, investment through "commercial presence". When the GATS was negotiated, there was a concern that some tax measures where distinctions are made based on taxpayer residence might be in violation of the GATS National Treatment obligation. Both the OECD and UN Models note, in their commentaries to Article 24 (Non- Discrimination), that discrimination based on residence is not contrary to the National Treatment obligation.

- The GATS has an exception allowing measures inconsistent with the National Treatment obligation where "the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members". The GATS was amended, before its conclusion, to incorporate a footnote to that provision intended to illustrate with some degree of specificity what Members regarded as measures meeting the "equitable or effective" standard.

- A provision was also included in the GATS stating that the National Treatment obligation could not be invoked under the Agreement's dispute settlement procedures: "with respect to a measure of another Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation. In case of disagreement between Members as to whether a measure falls within the scope of such an agreement between them, it shall be open to either Member to bring this matter before the Council for Trade in Services". The final decision in the event of a dispute as to whether a measure falls within the scope of a tax agreement between them is therefore made by the Council for Trade in Services, a high-level body of country representatives at the WTO in Geneva referring the matter to binding resolution under the WTO dispute settlement procedure.

- A footnote to that provision, however, stipulates that "[w]ith respect to agreements on the avoidance of double taxation which exist on the date of entry into force of the WTO Agreement, such a matter may be brought before the Council for Trade in Services only with the consent of

both parties to such an agreement". This additional requirement thus places the decision with respect to the above issue in the hands of the parties, as opposed to the Council, and effectively provides an opportunity for taxation authorities of the parties to participate in such a decision, but only for what are now rather old treaties. The date of entry into force of the WTO Agreement was 1 January 1995.

- Nevertheless, treaties concluded after the entry into force of the WTO Agreement and, arguably, existing treaties substantially amended after that date, are not captured by the language of the above-mentioned footnote. To address that issue, in its 1995 Commentary on Article 25, the OECD Model Double Tax Convention proposed language for inclusion in tax treaties. The effect of the wording is to ensure that tax treaties concluded or amended since 1995 receive the same "grandfathered" protections as pre-1995 treaties. The UN Model picks up the language proposed, and the explanation of it. The OECD Commentary, as picked up in the UN Model, notes the potential difficulties of leaving these tax issues to trade experts as follows:

> "Contracting States may wish to avoid these difficulties by extending bilaterally the application of the footnote to paragraph 3 of Article XXII of the GATS to conventions concluded after the entry into force of the GATS. Such a bilateral extension, which would supplement— but not violate in any way—the Contracting States' obligations under the GATS, could be incorporated in the convention by the addition of the following provision: 'For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.'"

- Surprisingly, very few countries, especially developing countries, make use of that provision. The decision on whether an issue is within the scope of a tax treaty is therefore left to non-tax experts in the WTO dispute settlement system.

- There is at least some question of whether the provision should be elevated from an option in the Model Commentaries to a provision in the text of the Convention itself. A similar provision may be useful in relation to other similar agreements, especially the increasingly common regional trade and investment agreements.

13. A background note on some of the issues in this area and where Committee decisions are sought was provided at Attachment B of the Subcommittee paper to the Committee for the Twenty-eighth Session (E/C.18/2024/CRP.9). The Subcommittee considered possible options for improving guidance to countries in this area and, as indicated at the Twenty-seventh Session, was of the view that, while the likelihood of this issue arising in practice remains uncertain, there is value in raising the prominence in the Model of the GATS clause – found in both the OECD and UN Models. The Subcommittee considered that having the clause in the Text of Article 25 itself would help achieve this, without obvious disadvantages. The Committee agreed to that approach at the Twenty-seventh Session and Attachment B of the paper to the Twenty-eighth Session proposed text for Article 25 to implement that change.

14. ***This paper has two alternative options for addressing the interaction of taxation with non-tax agreements. Attachments B.1 and B.2 take the same approach as to the GATS clause, in terms of providing, consistent with the Committee's decision at the Twenty-eighth Session,*** Article text and attendant Commentary reflecting the discussion in the previous Commentary on such a clause, but ***including it for the first time in the text of Article 25 itself.***

15. ***The difference between the two attachments is that Attachment B.1 does not include the "extended provision" in the text of Article 25, but only provides for it as an option in the***

Commentary. Attachment B.2 includes both the GATS clause and the extended provision in the text of Article 25.

16. The reduction in direct quotation of the OECD Model Commentary on the GATS clause was seen by a majority of the Subcommittee as reflecting the fact that the provision would now be in the Article itself, unlike in that Model, and should directly reflect views held by the Committee, but making clear that no substantive difference was proposed in interpreting the GATS Clause as compared with the 2021 UN Model (including its more extensive quoting of the OECD Model). However, some Members saw a direct quotation of the OECD Model as preferable to make clear that there was no difference in interpretation as between the two models and as compared with the 2021 UN Model.

17. As Workstream B involves an input into the update of the UN Model, the Subcommittee has consulted with the Subcommittee on the Update of the UN Model Tax Convention as the work has progressed, and will continue to do so.

Proposed Action on Workstream B

18. ***The Subcommittee submits draft text to the Twenty-ninth Session for:***

(i) finalization of the text of the GATS clause placed in Article 25 as first considered at the Twenty-eighth Session; as well as

(ii) a first reading of commentary for the GATS clause, with a view to finalization at the Thirtieth Session;

(iii) A decision whether an extended provision addressing the relationship with non-tax treaties such as free trade agreements should be included as either an option in the Commentary only (Attachment B.1) or as a provision in the text of the Article itself (Attachment B.2) with a view to finalization of the text at the Thirtieth Session;

Sustainable Development Goals

19. As noted in the Report of the Committee's Twenty-third Session, held in October 2021, the Committee agreed:

(a) To continue to discuss taxation and the Sustainable Development Goals regularly during sessions, as a permanent agenda item;

(b) To request the secretariat to provide regular updates on taxation and the Sustainable Development Goals, at each session:

(i) To preserve the focus of the Committee's work in the area;

(ii) To identify any gaps in guidance;

(iii) To establish priorities for technical work to be carried out by the secretariat; and

(c) To have subcommittees reflect on the link between their work and the Goals.

20. In addressing paragraph (c) of that conclusion, the subcommittee recognizes that by promoting fair and effective tax systems, which support both revenue and trade and investment for development, through guidance products and through advising UN DESA on capacity building activities, the Committee's work contributes to achieving the interlinked SDGs as a totality.

21. More specifically in relation to the work of the Subcommittee, an effective guidance effort in this area will promote the balance of revenue needs and the development-focused investment climate which many countries seek, by promoting whole of government and informed approaches to interlinked tax, trade and investment policy objectives. This builds greater certainty for all stakeholders in tax systems. While contributing to achieving all the interlinked SDGs, this will particularly contribute to: SDG 16 (Peace, Justice and Strong Institutions) in terms of helping develop effective, accountable and transparent institutions at all levels; and SDG 17 (Global Partnerships for the Goals), in terms of strengthening domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.

Attachment A

Addressing the Issue of Taxation in International Investment Agreements: Guidance for Tax and Investment Officials for the Implementation of an Integrated Approach*

September 2024

* This Subcommittee on the Relationship of Tax, Trade and Investment Treaties paper is based on the draft prepared by Alain Castonguay (as a consultant to UNDESA) in consultation with the Subcommittee.

CRP.23: ATTACHMENT A: DRAFT GUIDANCE FOR OFFICIALS

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1. Introduction

1. Many tax policymakers and administrators (collectively referred to as "tax officials") are familiar with the purpose and operation of double taxation agreements (DTAs), which are international agreements intended to encourage cross-border trade and investment. They do so by allocating taxing rights between the parties, reducing source-state taxation of certain categories of income, relieving double taxation and providing a facility for the resolution of disagreements between taxation authorities. Tax experts, however, whether officials of small, developing or developed economies, may not be familiar with the purpose, operation and especially implications for taxation measures of international investment agreements (IIAs). This Report is addressed to them. Likewise, experts versed in the workings of IIAs, including investment negotiators, may not fully appreciate the issues and concerns that such agreements may raise with tax experts and, thus, may find this Report useful.

2. Like DTAs, IIAs are legally binding treaties concluded between countries to encourage cross-border investment and economic growth. IIAs seek to achieve this objective by conferring protection to investors of a country in respect of investments made in the other country (the host country). Such protection is comprised of a number of standards such as non-discrimination against foreign investors and their investments, fair and equitable treatment of foreign investors and investments and other specific commitments, which are legally enforceable through a dispute settlement mechanism between a foreign investor and the host country, which may be commenced by an investor alleging a breach of the agreement.

3. The obligations found in IIAs apply in respect of "measures of a party". The latter's definition is quite wide and, therefore, taxation measures are subject to the provisions of IIAs. Measures (be it legislative, regulatory or administrative practice) of the host country may therefore be the object of a complaint from an investor of the other country, the merit of which is usually adjudicated by an *ad hoc* international tribunal created in accordance with provisions set out in the IIA. Investors' allegations may arise under an IIA that would not arise under a DTA because the nature of their respective obligations differs significantly and because, unlike under a DTA's mutual agreement procedure, the investor alone (without the participation of its home country) may commence dispute settlement proceedings and is thus the claimant in the dispute against the host country.

4. Tax officials tend to be concerned with risks that IIAs pose for the integrity of their tax system for two main reasons: first, because what are generally regarded as legitimate taxation measures may be the object of challenges under IIAs and, second, because of the somewhat unpredictable nature of decisions handed out by international arbitral tribunals. A particular additional concern of relevance, especially for smaller economies, is the significant cost of litigation associated with the conduct of international arbitration and the potentially large financial impact of arbitral awards when a tribunal rules in favor of investors. As a result, uncertainty regarding how the obligations found in IIAs may apply to taxation measures and the potential for substantial monetary damage arising from a finding by an arbitral tribunal that a taxation measure is inconsistent with a provision of an IIA may somewhat limit the scope of tax policy choices available for governments. They may also affect the manner with which taxes are administered and enforced, as IIA provisions also include standards of due process that must be afforded to investors.

5. The purpose of this Report is to raise awareness of the concerns described in the previous paragraph, primarily among tax officials (but also investment officials) and to propose a number of tools and strategies that can assist in effectively addressing these challenges. It will do so by:

(i) providing a brief description of the most relevant features of IIAs;

(ii) providing an analysis of the implications of IIAs for taxation measures;

(iii) formulating approaches based on best practices currently followed by a number of countries to include provisions dedicated to taxation in IIAs to minimize risks and protect tax policy space, without undermining the basic purpose of IIAs; and

(iv) formulating recommendations to empower tax officials, in the context of an integrated, whole-of-government approach, to ensure tax officials actively participate, in cooperation with colleagues responsible for investment policy, in all aspect of the management of IIAs, as it concerns the area of taxation.

6. Taken together, the guidance set out in this Report should enable tax officials to:

(i) understand IIAs and their implications for taxation measures and the country's network of DTAs;

(ii) develop, in cooperation with IIA negotiators, a country position on the treatment of taxation in IIAs;

(iii) integrate tax officials with the team responsible for the negotiation of the provisions of IIAs, in particular provisions related to taxation;

(iv) gain awareness, through various information channels, including close relationship with country experts involved in IIA litigation, of emerging IIA disputes that concern taxation matters; and

(v) cooperate with the country's IIA litigation team in the formulation of the country's position with respect to a claim made by a foreign investor in respect of a taxation measure and directly participate in the process, where such participation is mandated by the terms of the IIA.

7. The Report is organized as follows: Section 2 provides a description of the main provisions of IIAs, and explains how they operate in practice. It also sets out key facts about IIAs and briefly situates IIAs in the broader context of both investment policy and tax policy. Section 3 provides an overview of how IIAs may impact taxation measures and tax administration. It focuses on how IIAs may limit flexibility in the development and implementation of tax policy and on the potential financial impact of litigation under the IIA, both from the point of view of participation in such proceedings as well as the payment of awards to foreign investors. Section 4 provides a more detailed explanation of how IIAs may affect taxation measures. For this purpose, the section reviews several of the key elements contained in IIAs and provides an analysis of their interaction with taxation measures that reflect past arbitral cases. Section 5 offers an overview of existing international efforts (in particular within the United Nations) aimed at addressing shortcomings that have been identified with the content and application of IIAs, with a focus on elements of potential reforms that are most relevant to the issues raised in this Report in respect of taxation.

8. Finally, Section 6 proposes a comprehensive framework for tax policy officials designed to address the tax aspects of IIAs. Intended mostly for the benefit of tax officials but also of interest to investment officials, the section begins with a discussion of the importance for tax agencies to consider the implementation of such a framework, based on a whole-of-government approach, that will secure a role for tax officials in the handling of the tax aspects of IIAs. The section then sets out non-prescriptive guidance on the design of a taxation article for inclusion in IIAs. It is followed by guidance intended to set out the role of tax officials in the negotiation of IIAs, as well as in support of the management of any IIA litigation that concerns a taxation measure.

2. Purpose and Features of International Investment Agreements

2.1 Basic Purpose and Operation

9. IIAs[1] are international treaties entered between states which set out rights and obligations for the contracting parties and for investors and their investments. Proponents of IIAs assert that they provide a framework intended to encourage cross-border investment, by providing legal predictability for investors, through the imposition of a number of obligations on the parties as well as procedures to address disputes regarding the interpretation and application of the agreement. Host countries enter into IIAs to attract foreign investment into their market to support economic development, for example in the extractive industries or the manufacturing sector. Foreign investment can encourage technological advancements, employment and foster a more competitive economy. Capital-exporting countries enter into IIAs to provide their enterprises a framework within which they may pursue opportunities to invest and expand in new markets.[2]

10. IIAs contain substantive obligations applicable to each contracting party which set out the conditions under which a host country must treat the investment and investors of the other party. They also contain procedures to address complaints by investors that one or more measures imposed by a host country do not accord with the substantive obligations of the agreement. Disputes are examined and adjudicated by an international arbitral tribunal formed under rules set out in the agreement, which may issue a legally-binding decision compelling the host country to pay monetary damages to investors commensurate with the injury that, according to the tribunal, the investor suffered as a result of the imposition of the disputed measure.

11. IIAs typically have a wide scope of application, as they apply in respect of all measures of a party, with the term "measure" being given a wide meaning which includes laws, regulations, administrative practices, etc. Likewise, they apply to "investors" and their "investment" which are also given a wide meaning, encompassing tangible and intangible assets, direct as well as portfolio investment and direct and indirect ownership of property. As will be seen later, the open-ended nature of this definition also opens the door to unintended consequences, similar to what is known in the tax world as "treaty shopping".

12. The key obligations contained in IIAs require the contracting parties to refrain from imposing discriminatory measures on foreign investors and their investments. There are two non-discrimination standards: Under the national treatment (NT) standard, an investment of a national of a country must be granted by the host country a treatment no less favourable than that afforded an investment in the same country held by a national of that country. Under the most favoured nation (MFN) standard, an investment of a national of a country must be granted by the host country a treatment no less favourable than that afforded an investment in the same country held by a national of a third country. Both standards are relative standards: irrespective of the intrinsic impact of a measure on investment or investors, the standards are respected if the measure does not apply less favourably in respect of foreign investors compared to domestic (or third country) investment/investors.

13. IIAs also require the parties to adhere to minimum standards of due process and protection and security as well as insuring the fair and equitable treatment (FET) of foreign investors. These standards

[1] In this Report, IIA refers to either a stand-alone investment agreement or the investment chapter contained in a comprehensive free trade agreement.

[2] This Report neither advocates for or against IIAs nor addresses the empirical question of whether IIAs are effective tools to encourage cross-border investment. Whether countries should enter into IIAs is a policy question that goes beyond the objectives of this Report. The starting point of this Report is that IIAs exist and that tax officials benefit from being made aware of their existence, their impact on tax policy, and the proactive steps tax officials can consider taking to limit the impact of IIAs on the development and implementation of tax policy.

differ from the non-discrimination provisions, as they set an absolute standard of conduct for the host country, intended to impose a floor below which measures may be regarded as resulting in abusive treatment or the denial of justice. There exist several different variations of such provisions in IIAs and they, more than other obligations of IIAs, tend to be given different interpretations by different international tribunals, making it difficult to predict their application in particular situations.

14. Section 4 will describe the various elements that comprise the FET standard. However, one particular element has proven to be a significant source of uncertainty in the course of litigation before international tribunals. Allegations that given measures frustrate the "legitimate expectations" of investors, and the various interpretations and applications of that concept by international tribunals, have put into question the ability of countries to legislate and regulate in the public interest when the implementation of the said policy has the effect of reducing the profitability of investments held by foreign investors. Investors tend to argue in the course of IIA complaints that any measure that negatively affects the profitability of their investment is a breach of the FET standard. A common understanding of the concept has proven to be somewhat elusive, as its application depends both on the facts of the case and the interpretation given to it by arbitral tribunals.

15. IIAs include provisions that set out the conditions under which a country may conduct a lawful expropriation of the property held by foreign investors. These conditions are that the expropriation must be for a public purpose, carried out in a non-discriminatory manner, under due process of law and against the payment of appropriate compensation to the foreign investor. The provision encompasses both direct expropriation (takings or nationalizations of property) as well as indirect expropriation, which includes measures that amount to direct expropriation, that result in a total or near-total deprivation of an investment (through the investor's inability to control, manage or use it) or the destruction of its value.

16. While the provisions of IIAs can be enforced under the domestic law and judicial system of the host country, investors usually prefer having recourse to an autonomous dispute resolution mechanism set out therein. Under the investor-state dispute settlement (ISDS) provisions, investors, not the country where they reside, can lodge a complaint that one or more measures of the host country that affect their investment are contrary to that country's obligations under the agreement. A complaint usually triggers the formation of an international tribunal to hear the allegations. Arbitrators are tasked with interpreting the relevant provisions of the IIA as they apply to the specific facts of the case in order to determine whether the disputed measures are inconsistent with the terms of the agreement. Where they make such findings, arbitrators must then determine the financial loss, if any, incurred by the investor as a result of the imposition of the measures, for purposes of determining the amount of financial compensation that the host country is required to pay to it to compensate for such loss. Arbitral awards are final, as IIAs do not include an appeal mechanism. Domestic courts may be called upon to enforce the terms of arbitral decisions.

2.2 Key Facts

17. There are more than 2,500 IIAs currently in force, including over 300 bilateral and plurilateral treaties that may have a broader operation but also include investment provisions[3]. The first IIA was signed

[3] See UNCTAD, *International Investment Agreements Navigator*, available at: https://investmentpolicy.unctad.org/international-investment-agreements/

in 1959 between Germany and Pakistan.[4] [5] It is generally understood that the first IIA to include a legally binding investor-state dispute settlement provision was the Indonesia-Netherland IIA of 1968.[6] The number of IIAs grew considerably during the last 20 years of the 20th century, from 385 to more than 1,850, encompassing more than 170 countries.[7]

18. The content of IIAs has become more sophisticated over time, and this is especially true with respect to how they address taxation issues. This evolution has occurred as countries gained experience with the operation of IIAs and, in particular, how their provisions were interpreted by arbitral tribunals. Thus, a distinction is often made between "first-generation" IIAs and more recent ones, that is, agreements signed after 2010. Generally, more recent IIAs differ from first-generation agreements in the manner with which they define investment and investors, the breadth of the FET and indirect expropriation provisions, as well as whether (and how) they address the treatment of taxation. A review of ISDS decisions rendered by arbitral tribunals in 2021 has shown that about 95 per cent of them concerned claims based on first-generation agreements.[8]

19. Work is on-going, in particular at the United Nations, to further refine the provision of IIAs in response to concerns with, and identified weaknesses of, IIAs, in particular the first-generation agreements. The objective is to facilitate the interpretation, amendment and replacement of older IIAs.[9] These efforts are described briefly in Section 5.

2.3 Investment Policy Background

20. While this Report focuses on the specific intersection of IIAs and taxation, it is useful to briefly situate this issue within a much broader context, both as regards foreign direct investment (FDI) and taxation policy more generally.

21. Countries, in particular developing countries, must make difficult policy decisions with respect to the manner with which they promote economic development and they implement investment policy, including FDI policy, having regards to the limited government resources available. They must carefully select the economic objectives that they can and should realistically pursue as well as the array of tools available to them for that purpose. In doing so, they must take into account competing policy goals, such as tackling climate change, as well as the financial and budgetary constraints that they face and the intense international competition that exists for FDI.

22. In this context, IIAs represent one among several tools that can be used to attract FDI in a country. Incentives, including tax incentives (exemption, tax rate reductions, tax credits, tax holidays, etc.) are also

[4] UNCTAD (2006), *The Entry into Force of Bilateral Investment Treaties (BITs)*, IIA Monitor No. 3, International Investment Agreements, United Nations, New York and Geneva, available at: https://unctad.org/system/files/official-document/webiteiia20069_en.pdf. This publication includes statistics on the number of IIAs that were signed and entered into force during the 1990-2005 period.

[5] For a detailed review of the evolution of the IIAs network between 1959 and 2000, see UNCTAD (2000), *Bilateral Investment Treaty*, United Nations, New York and Geneva, available at: https://digitallibrary.un.org/record/431727?ln=en.

[6] *World Investment Report 2015: Reforming International Investment Governance (WIR 2015)*. Chapter IV: Reforming the International Investment Regime: An Action Menu. United Nations, New York and Geneva, available at: https://unctad.org/system/files/official-document/wir2015_en.pdf.

[7] *Ibid.*, Figure 1, at pp. 1 and 4.

[8] UNCTAD (2023). IIA Issue Note No. 1, *Review of 2021 Investor–State Arbitration Decisions: Insights for IIA Reform*, United Nations, July 2023, available at: https://investmentpolicy.unctad.org/publications/1284/review-of-2021-investor-state-arbitration-decisions-insights-for-iia-reform.

[9] *World Investment Report 2015*, *supra* note 6.

widely used for that purpose. There exists a wide body of literature on the use, cost and effectiveness of tax incentives as a means of attracting FDI and a meaningful discussion of these issues is beyond the scope of this Report. One useful source of information is the Platform for Collaboration of Tax (PCT) 2015 toolkit[10]. A summary of the salient issues discussed in the toolkit is found in Annex 1. Moreover, Annex 1 offers a selection of publications that address these and other relevant issues relating to tax incentives.

[Note to readers: As per comments offered at the 28th Session, new material was prepared to better flesh out the policy considerations associated with the design and implementation of investment tax incentives. The Subcommittee considers that while this material is a useful addition to the Report, its placement in this Section would affect the flow of the Report, as it does not relate to its core subject matter. As such, the new material was added to Annex 1.]

3. The Impact of International Investment Agreements on Tax Policy and Administration

3.1 How IIAs Impact Taxation

23. Taxation measures and tax administration practices can run afoul of provisions of IIAs. While Section 4 provides a detailed analysis of relevant provisions and how they can affect taxation measures, this section briefly outlines how this can happen and sets out the consequences of an adverse arbitral decision in respect of a disputed taxation measure.

24. Governments design tax policy with the principal goal of achieving a fair and efficient means of collecting revenues and, in addition, may rely on certain categories of taxes (for example, the income tax) as tools to pursue economic, social and income distributional goals. Whether through the granting or denial of benefits to certain categories of taxpayers or in respect of certain categories of income or expenses, the design of provisions for that purpose necessarily requires that distinctions be made among defined categories of taxpayers. However, IIAs generally prohibit discrimination based on the nationality of investors. It is possible for taxation measures to be *de jure* or *de facto* inconsistent with that requirement[11]. Government officials crafting policies may not be aware that their design decisions may produce outcomes that are inconsistent with non-discrimination provisions in IIAs; they may not be aware that such provisions exist at all.

25. Tax laws are not static and tax officials are constantly called upon to adjust, if not change significantly, existing tax laws either to reflect new national priorities or to protect the tax system against the latest emerging abusive tax avoidance scheme. Such changes, in particular if they are significant and if they are implemented with little notice or public consultation, may result in certain foreign investors alleging that the changes have significantly decreased the expected profitability of their investment in the country, relative to what was expected under the tax rules as they existed at the time the decision to invest was made. This may trigger disputes under an IIA and invite scrutiny of the disputed taxation measures by an international arbitral tribunal.

26. Likewise, tax administrative practices, while governed by provisions of relevant tax laws, leave significant discretion in the hands of tax administrations, for example, the selection of taxpayers or transactions for audits, the interpretation of the law, decisions and enforcement actions taken in the course of an audit, etc. Tax administrators may not be aware of the various minimum standards of treatment

[10] *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment - A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank*, 15 October 2015, https://www.tax-platform.org/sites/pct/files/publications/100756-Tax-incentives-Main-report-options-PUBLIC_0.pdf

[11] In contrast, discrimination provisions under DTAs only consider whether the measure is discriminatory from a *de jure* perspective.

contained in IIAs. As a result, foreign investors may complain that decisions made by taxation authorities in the course of a tax examination that concerns them amount to an abuse of process, a denial of due process, or even *de facto* discrimination. In short, administrative practices are not immune from claims by foreign investors under an IIA.

27. The extent to which IIAs may affect tax policy and administration depends significantly on how the provisions of the particular IIA itself address matters of taxation. Many older IIAs do not contain provisions dealing with taxation, except perhaps to coordinate the application of an existing DTA in force between the parties. In such circumstances, mainstream taxation measures, including those which are specifically allowed under the terms of a DTA, may be potentially vulnerable to a finding that they contravene the IIA's national treatment obligations. Where a dispute concerning a tax matter occurs, it is ultimately adjudicated by an international arbitral tribunal under the ISDS process. In contrast, many newer IIAs contain comprehensive taxation provisions which specify in what circumstances its obligations apply in respect of taxation measures. For example, it may stipulate that the national treatment obligation does not apply to income tax measures. Moreover, such provisions may also include rules which modify the operation of the ISDS process in respect of disputed taxation measures. They may do so by assigning a direct role to the contracting parties' tax experts, allowing them to make certain determinations prior to the commencement of the ISDS process that may ultimately exclude a disputed taxation measure from the scope of the dispute settlement process.

28. In constraining tax policy and administration, IIAs' consequences for governments include, first, imposing a constraint on the ability to implement policies that pursue legitimate public policy goals and, second, exacting a financial impact, as regards the management of disputes before international tribunals, as well as the payment of arbitral awards to foreign investors.

3.2 Policy Flexibility

29. The various obligations imposed on governments by IIAs can constrain the range of measures they can adopt or the actions they can take to enact new policies or amend existing ones. This is true for the specific field of tax policy and administration. The most direct way this can materialize is when an international tribunal finds that a taxation measure implemented by the host country violates one or more obligations of an applicable IIA. Beyond the financial consequences, discussed in Subsection 3.3, the government of the host country may find it untenable to maintain the disputed measure in effect, if the risk exists that other investors potentially affected by it might also bring complaints under the same or similarly-worded IIAs. In this situation, the government may have no choice but to repeal or amend the disputed measure to remove the features that make it inconsistent with its IIA obligations.

30. The second-order impact of IIAs on tax policy concerns their incidence on the formulation of future tax policy. The mere fact that the country is bound by IIAs introduces an additional parameter to be taken into account by tax officials: is the contemplated measure consistent with the country's obligations under IIAs? Design decisions will be affected by the concern to avoid or minimize the exposure to litigation risks under its IIAs. The contour of specific taxation measures ultimately implemented may differ as a result. Likewise, care must be exercised by tax administrators as regards the manner with which they engage with foreign investors, to avoid the appearance that administrative practices or procedures are applied to them in a discriminatory manner (e.g., conducting a disproportionate number of audits of foreign-owned businesses) or in a manner that constitutes an abuse of procedures (e.g., failing to respect the due process rights granted taxpayers in tax laws or in the judicial system).

3.3 Financial Implications

31. The financial consequences for a government of having to defend against investor allegations before international arbitral tribunals can be significant. First, depending on the nature of the case, the financial compensation awarded by tribunals, when a country is found to be in breach of an IIA, can be important, and disproportionately so for small or developing countries. Figures for ISDS cases settled before May 2020 show that investors that were successful, on average claimed some $1.2 billion[12] in compensation and were awarded $438 million[13] [14]. More than 50 cases produced awards in excess of more than $100 million.[15] According to 2021 data[16], out of almost 2,000 disputes arising under IIAs, 165 of those concerned taxation measures. Analysis based on a sub-sample of 32 tax-related cases[17] reveals that slightly more than 50 percent of them were won by investors. Of these cases, 60 per cent were brought against developing countries. Investors from developed countries brought over 90 per cent of tax-related claims.

32. Beyond the amount of awards, the cost of participating in ISDS proceedings as respondent can be significant. While estimates vary, it is said that the average cost of litigation for investors is $6.4 million; the median figure is $3.8 million. For respondent countries the average cost is $4.7 million and the median cost is $2.6 million, but the cost of certain cases for defendants can be multiple times that latter figure[18] [19]. In addition, litigation can absorb resources of respondents for years. The average length of ISDS proceedings is 4.4 years (with a median of 3.8 years), but cases with amounts at play over $1 billion can take twice as much time to resolve.[20]

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[12] Unless otherwise indicated, all amounts cited in this Report are in US dollars.

[13] M. HODGSON, Y. KRYVOI, and D. HRČKA, 2021 *Empirical Study: Costs, Damages and Duration in Investor-State Arbitration*, Allen & Overy and BIICL, London, 2021, at p. 28.

[14] These figures are somewhat skewed upward by a series of high amounts (totalling $50 billion) awarded in compensation in connection with a singular series of controversial cases arising from the nationalization of Yukos by Russia in 2003. Removing such awards reduces the respective figures to $817.3 million claimed and $169.5 million awarded. In short, the Yukos case refer to claims made in 2005 by several foreign shareholders of the company under the *Energy Charter Treaty* that the Russian government expropriated the company through several acts starting in 2003, including taxes, fines, and enforcement measures, leading to the company's bankruptcy in 2006. The case is exceedingly complex and highly unusual in many respects, and it remains under litigation in the courts of several countries. This Report will not consider it further.

[15] J. BONNITCHA and S. BREWIN, *Compensation Under Investment Treaties: What are the problems and what can be done?* The International Institute for Sustainable Development. Policy Brief, Winnipeg, December 2020. Figure 1 at p. 2 shows the progression over time of awards.

[16] UNCTAD (2022). IIA Issue Note No. 1. *Facts on Investor–State Arbitrations in 2021: With a Special Focus on Tax-Related ISDS Cases*. United Nations, July 2022, available at: https://investmentpolicy.unctad.org/publications/1266/facts-on-investor-state-arbitrations-in-2021-with-a-special-focus-on-tax-related-isds-cases. Annex provides a list of such cases spawning from 1987 to 2021.

[17] J. CHAISSE and J. KIRKWOOD (2021). *Foreign Investors vs. National Tax Measures: Assessing the Role of International Investment Agreements*, in I. J. MOSQUERA VALDERRAMA, D. LESAGE, and W. LIPS (Eds.) *Taxation, International Cooperation and the 2030 Sustainable Development Agenda*, United Nations University Series on Regionalism, Vol 19, Springer, available at: https://link.springer.com/book/10.1007/978-3-030-64857-2, see in particular Chapter 8, at p. 150.

[18] M. HODGSON, Y. KRYVOI, and D. HRČKA, *supra* note 13, at p. 10.

[19] Anecdotal evidence suggests that countries incur high costs either on particular cases or because they must face multiple cases. For examples, see figures cited in T.R. SAMPLES, *Winning and Losing in Investor–State Dispute Settlement*, American Business Law Journal, Volume 56, Issue 1, 115–175, Spring 2019, at 151-152.

[20] M. HODGSON, Y. KRYVOI, and D. HRČKA, *supra* note 13, at p. 32.

4. How Key Provisions of International Investment Agreements Affect Taxation

4.1 Introduction

33. This section examines in some detail the main elements of IIAs, how they operate generally and how they may affect taxation measures.[21] IIAs, like other international treaties, are structured to include a description of its object and its scope; a definition of key terms; the rights and obligations imposed on the contracting parties; reservations and exclusions; and an enforcement mechanism in the form of legally-binding ISDS procedures.

4.2 Definition of "Investors of a Party" and "Investment"

34. The terms "investor of a party" and "investment" are given definitions that go beyond what is generally understood to be encompassed by the term "foreign direct investment" (FDI is generally defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in the host country)[22]. The definition of the term in IIAs tends to be open-ended and includes direct and portfolio investment, direct and indirect ownership and tangible and intangible assets. While the goal of an extensive definition of investment is to accommodate a wide range of investment modes under IIAs, it can also result in unintended consequences.

35. While the benefits of IIAs are intended to accrue to investors of the parties to the agreement, complex and creative corporate structures can result in investors of third countries gaining access to the benefits of the agreement. Tax officials familiar with DTAs will recognize this as akin to the phenomenon of "treaty-shopping." IIAs seek to limit the scope of this issue by including therein denial of benefit provisions, which allow the host country to disregard companies with little or no substance in the host country and which set out a threshold of acceptable "economic presence" or level of substantive business activity in the country. While arbitral tribunals have been reluctant in the past to limit the scope of application of IIAs absent a denial of benefits provision, the growing incidence of treaty shopping has seen arbitral tribunals increasingly open to arguments that aggressive forms of treaty shopping constitute an "abuse of rights" (a legal concept derived from national legal systems, mostly the civil codes of European countries). Under this doctrine, the creation of a company for the purpose of enjoying benefits under an IIA may constitute an abuse of rights, and where such a finding is made, a tribunal will conclude that it, in fact, does not have jurisdiction over the investor claim under the IIA.[23] Perhaps this is an area where investment negotiators would benefit from becoming acquainted with reforms proposed and implemented under Action 6 of the BEPS project[24] to address treaty shopping in the tax area.

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[21] This section is a condensed version of the analysis found in A. CASTONGUAY (2023), *The Treatment of Taxation in International Investment Agreements: Issues Raised and Possible Policy Responses*, Department of Economic and Social Affairs, United Nations, New York, available at: https://financing.desa.un.org/what-we-do/ECOSOC/tax-committee/thematic-areas/tax-trade-and-investment-treaties.

[22] *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. United Nations, New York and Geneva, at p. 245. Available at; https://www.unctad.org/system/files/official-document/wir2007_en.pdf

[23] See J. CHAISSE (2015), *The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration*, 11 Hastings Bus. L.J. 225, available at: https://repository.uchastings.edu/hastings_business_law_journal/vol11/iss2/1.

[24] Relevant documents on work in this area can be found on the webpage of the Organisation for Economic Co-operation and Development (OECD) at: https://www.oecd.org/tax/beps/beps-actions/action6/.

4.3 National Treatment (NT)

36. National treatment is the non-discrimination standard which bars a different treatment of investors and investment on the basis of nationality. Under this standard, an investment of a national of a country bound by an IIA with another (host) country, is to be treated in the host country in a manner no less favourable than an investment in the same country of a national of that country. NT is a relative standard: any measure of a country, be it favourable or detrimental towards a given economic sector, does not breach the NT standard as long as it does not apply less favourably to foreign investors and their investment relative to domestic investment. The provision is generally interpreted to prohibit both *de jure* discrimination (that is, a difference in treatment spelled out in a law or regulation) as well as *de facto* discrimination (reflected in a different application of a law or a policy). The language of some provisions includes the term "in like circumstances" or "in similar situations". The addition of such terms is understood to require that the comparison to be made under the standard between investors or investments take into account the totality of circumstances, including legitimate policy objectives pursued by the measure[25]. It remains uncertain, however, whether this qualification alone would permit the types of distinctions usually found in income tax laws.

37. Indeed, income tax policy encompasses several distinctions among taxpayers that are based on well-reasoned rationales which may, *prima facie*, be construed as being inconsistent with the NT standard. This is because the principle of full taxation, generally on a worldwide basis, rests on the concept of residence, which means that income tax laws necessarily provide for different treatment between resident and non-resident taxpayers. Residence is also fundamental to the apportionment of taxing rights between contracting parties to a DTA. The residence criterion is not based on nationality: a non-national can be a resident and *vice versa*.

38. Income tax laws contain different categories of distinctions based on the residence of taxpayers. First, there are measures which are directed exclusively at non-resident taxpayers. The most common are in the form of dedicated collection mechanisms owing to the fact that non-residents are not subject to worldwide taxation, for example withholding tax on payments (dividends, interest, royalties, etc.) made to non-residents. Since most non-resident recipients tend to be non-nationals, one could envisage a complaint alleging this mechanism is *de facto* discriminatory under the NT standard of IIA.

39. The second category of measures are those affecting resident taxpayers in respect of specific transactions entered with non-resident taxpayers. In such a case, while the measure applies to a resident, it could be argued to constitute an indirect form of discrimination against a non-national. An example is thin capitalization rules, in substance anti-avoidance measures intended to protect the tax base, which may restrict the deduction of interest payments made to related non-resident creditors when such interest is in respect of what is regarded as "excessive" indebtedness. The goal of such measures is to limit the extent of the stripping of taxable profits in the form of tax-deductible interest payments.

40. Finally, the third category of measures are those which limit certain tax benefits to resident taxpayers. Among those are certain deductions and credits relevant to the calculation of personal income tax, such as those granted on the basis of civil status or family responsibility. These include, for example, deductions, credits or exemptions for spouses, children, old age, low-income taxpayers, or that pursue other social objectives. The granting of such benefits assumes that the taxpayer enjoying them is taxable on a worldwide basis and thus, that it would not be appropriate for non-resident individuals to enjoy them.

[25] UNCTAD (2021). *International Investment Agreements and Their Implications for Tax Measures: What Tax Policymakers Need to Know – A Guide Based on UNCTAD's Investment Policy Framework for Sustainable Development*. New York and Geneva: United Nations, at 21, available at: https://unctad.org/webflyer/international-investment-agreements-and-their-implications-tax-measures-what-tax.

41. DTAs include non-discrimination provisions that take into account the type of distinctions described above. The first sentence of paragraph 1 of Article 24 (Non-Discrimination) of the UN Model reads as follows (emphasis added):

> Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State **in the same circumstances, in particular with respect to residence**, are or may be subjected.

42. The provision makes clear that rules that make distinctions based on residence are not intended to offend the non-discrimination provision otherwise set out by paragraph 1, and that one cannot argue that "a different treatment based on residence is indirectly a discrimination based on nationality for purposes of that paragraph".[26] The Commentary on paragraph 1 also specifies that the term "in the same circumstances" refers to taxpayers that are, in relation to applicable tax laws, in substantially similar circumstances both in law and in fact.

43. As regards a specific category of distinctions made in income tax laws discussed earlier, paragraph 3 of Article 24 is quite explicit in that the non-discrimination provision set out therein cannot be construed to oblige a country to grant non-residents "any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents".

44. As a result, as described in Section 6, most modern IIAs contain provisions that address the application of the NT obligation on taxation.

Examples of NT claims in ISDS cases

In *ADM*[27], *Corn Products*[28] and *Cargill*[29], ISDS cases brought under the North American Free Trade Agreement, the imposition in 2002 by Mexico of an excise tax on soft drinks and syrups was found to be a breach of the NT obligations, because the tax only applied to soft drinks and syrups that used any sweetener other than cane sugar; soft drinks and syrups sweetened exclusively with cane sugar were tax exempt. The plaintiffs, US companies, produced and sold high fructose corn syrup, a sweetener that was impacted by the tax. In the three cases, arbitral tribunals held that the imposition of the excise tax was a breach of the NT obligation. In *ADM*, the Tribunal asserted that the purpose of the tax was protect the domestic Mexican sugar industry from foreign competitors producing alternative sweeteners.

In *Occidental*[30] and *EnCana*[31], a US and a Canadian company brought cases under, respectively, the 1993 Ecuador-US Bilateral Investment Treaty (since terminated) and the 1996 Canada-Ecuador Bilateral Investment Treaty (since terminated), stating that amendments made between 1999 and 2002 by Ecuador to its VAT law had the effect of denying them the right to obtain VAT credits and refunds on their purchases to which they had been entitled to. In *Occidental*, the tribunal found that the measures had breached the NT obligation, as exporting companies other than oil and gas companies were not denied VAT credits. In *EnCana*, the Tribunal applied the exception found in the IIA's taxation article, which excluded taxation from the scope of the NT obligation and, therefore, found that the measure was not a breach of the agreement.

[26] UN (2021). *Model Double Taxation Convention Between Developed and Developing Countries*, New York: UN Publishing, paragraph 1 of the Commentary on Article 24 (Non-Discrimination).
[27] *Archer Daniels Midland Company v. The United Mexican States*, Award (November 21, 2007), ICSID, Case No. ARB(AF)/04/05.
[28] *Corn Products International, Inc. v. United Mexican States*, Award (August 18, 2009), ICSID Case No. ARB(AF)/04/1. The award is not public.
[29] *Cargill, Incorporated v. United Mexican States*, Award (September 18, 2009), ICSID Case No. ARB(AF)/05/2.
[30] *Occidental Exploration and Petroleum Company v. The Republic of Ecuador*, Award (July 1, 2004), UNCITRAL, Case No UN-3467.
[31] *EnCana Corporation v. Republic of Ecuador*, Award (February 3, 2006), Case No. UN3481.

4.4 Most Favoured Nation (MFN)

45. Most favoured nation (MFN) treatment is the non-discrimination standard which bars discrimination among foreign investors and investment of different countries. Thus, under this standard, an investment of a national of a country bound by an IIA with another (host) country, is to be treated in the host country in a manner no less favourable than an investment in the same country of a national of a third country. Like NT, MFN is a relative standard. It has been the cornerstone of the international trading system, in particular of the *General Agreement on Tariffs and Trade* (GATT).

46. The MFN standard is intended to prevent measures of a country from discriminating among foreign investors. Under IIAs, however, that provision has been used to seek the benefit of more generous procedural provisions of IIAs that the host country has concluded with third countries, for example, more beneficial dispute settlement procedures.

47. By this logic, the MFN obligation could arguably be invoked by an investor seeking to benefit from an advantage granted by the host country under any of its bilateral DTAs, for example, a lower rate of dividend withholding tax found in a DTA with a third country. This would not be in accordance with the intent of the contracting parties to the IIA, as it would amount to subordinating the operation of DTAs to that of IIAs. For that reason, most IIAs contain an explicit exception to prevent such an outcome.

48. The IIA's MFN provision may also potentially apply to domestic taxation measures though, in practice, much less frequently than is the case of the NT obligation.

4.5 Fair and Equitable Treatment (FET)

49. The fair and equitable treatment (FET) provision is intended to protect investors against undesirable conduct of the government of the host country that would not be captured by other provisions of IIAs. Unlike the non-discrimination provisions, it sets an absolute standard of conduct, originally intended to guard against abusive treatment or the denial of justice. It has become the most often invoked provision of IIAs in disputes, including in tax-related disputes.

50. While the FET provision is intended, and understood, to be an objective standard, it has been given different interpretations by arbitral tribunals, in part because provisions of IIAs are not all similarly written and in part because there exist different views as to its meaning and scope. There are different variations of the core elements of FET in IIAs, but the prevailing view comprises the following elements:

(a) Prohibition of manifest arbitrariness in decision-making;

(b) Prohibition of the denial of justice and disregard of the fundamental principles of due process;

(c) Prohibition of targeted discrimination on manifestly wrongful grounds;

(d) Prohibition of abusive treatment of investors, including coercion, duress and harassment;

(e) Protection of the legitimate expectations of investors arising from a government's specific representations or investment-inducing measures, although balanced with the host country's right to regulate in the public interest.[32]

[32] UNCTAD (2012). *Fair and Equitable Treatment*, UNCTAD Series on Issues in International Investment Agreements II: A sequel, United Nations, New York and Geneva, at xvi, available at: http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf. This publication provides a detailed discussion of the FET standard.

51. It is the last element of the definition that has most often been invoked in ISDS cases and the interpretation of which gives rise to much uncertainty. Investors will typically claim that a government policy change that affects the profitability of their investment amounts to a breach of the FET obligation because the change has frustrated the legitimate expectations that they held at the time that they decided to invest in the host country. However, there can be a fair degree of subjectivity as regards both the extent to which the profitability of the investment has decreased as a result of the policy change and the extent to which it was reasonable for the investors to expect that government policies that affect them would remain unchanged over the horizon of their investment. For example, in assessing the validity of the investor's "legitimate expectations", a mere assumption on the part of investors that the policy/regulatory environment would remain stable carries less weight than an explicit commitment made by a government to investors with respect to a key policy applicable to them.

52. Successive international tribunal decisions with respect to this provision have put into question the ability of countries to legislate in the public interest. The record shows that the applicability of the concept of FET is difficult to predict owing to the exact wording of the provision, the specific facts of the case and, in particular, the analytical framework adopted by an international tribunal.[33]

53. Certain countries have rejected the notion that the FET obligation protects an investor's legitimate expectations, such as a right to a stable legal environment or reliance on commitments a government may have made. As a result, they have sought to circumscribe the scope of the FET standard in their IIAs by reference to its very limited meaning under customary international law[34]. Such countries take the view that this narrow customary international law meaning was, in fact, the meaning that was always intended in IIAs, not the more expansive reading given to it by many international investment tribunals. Arbitral rulings are inconsistent in this respect, even across different ISDS cases spawned by the same government measure.[35] On the other hand, arbitral tribunals have recognized in several decisions that, in principle, the FET standard does not prevent countries from exercising their powers to regulate in the public interest.

Examples of FET claims in ISDS cases

In *Occidental*, referred to in Subsection 4.3, the Tribunal held that the FET obligation had been breached. The claimant had essentially argued that the denial of VAT refunds had frustrated the company's legitimate expectations regarding the commercial and economic conditions under which the investment was made and the Tribunal agreed, stating that the legal and business environment was changed as a result of the tax change.

In *Vodafone*[36], the Indian government demanded payment of $2.2 billion as capital gains tax, in respect of the capital gains arising from the sale of the share capital of CGP acquired in 2007 by Vodafone from Hutchison group, asserting that since CGP held the underlying Indian assets, it created a tax liability in India in respect of the gains. Vodafone contested the notice before India's High Court, which sided with India's revenue authorities. On appeal, however, the Supreme Court ruled in Vodafone's favour, finding that the transaction, which was executed between non-residents, fell outside India's tax jurisdiction under the statute. In 2012, India's parliament amended the *Income Tax Act 1961*, incorporating therein what was presented as "an explanation of existing law", such that transactions like the one concluded by Vodafone would retrospectively fall within the scope of the Act. The Indian tax authorities reissued a notice requesting payment of the capital gains tax in respect of the transaction. In the same year, Vodafone launched a claim under the 1995 India-Netherlands Bilateral Investment Treaty, alleging a violation of the FET provisions of the treaty.

[33] For example, see the analysis of three arbitral decisions found in A. CASTONGUAY (2023), *supra* note 21, at Annex 1.
[34] For example, Canada and the U.S. See OECD (2017). D. GAUKRODGER, *Addressing the Balance of Interests in Investment Treaties the Limitation of Fair and Equitable Treatment Provisions to the Minimum Standard of Treatment under Customary International Law*, OECD Working Papers on International Investment 2017/03.
[35] I. REYNOSO, *Spain's Renewable Energy Saga: Lessons for international investment law and sustainable development*, Investment Treaty News, International Institute for Sustainable Development, June 27, 2019.
[36] *Vodafone International Holdings BV v. Government of India*, PCA Case No. 2016-35.

In *Cairn*[37], India imposed in 2015 a tax liability of $1.6 billion on Cairn India Ltd for its failure to deduct withholding tax on capital gains arising during a restructuring transaction in 2006 in the hands of its parent Cairn UK Holdings Ltd, relying on the 2012 amendment of its income tax laws. Cairn Energy initiated a claim under the 1994 India-United Kingdom Bilateral Investment Treaty, alleging violations of the FET and expropriation provisions of the treaty.

In decisions rendered in 2020, the tribunals in both *Vodafone* and *Cairn* concluded that the imposition of the capital gains tax was a breach of the FET obligation of the respective IIAs. In *Cairn*, the Tribunal was not convinced that the 2012 amendments to the Act were mere "clarification" of the law. It found that the retrospective application of the amendments to prior year transactions disregarded Cairn's expectation of legal certainty, stability and predictability.

Finally, in *Murphy*[38], a consortium of foreign companies, one of which was controlled by Murphy, a US company, signed a participation contract with a state-owned company controlled by Ecuador for the purpose of oil exploration and production in the country. Under a participation contract, Consortium members are entitled to a share in the oil produced. After a substantial rise in oil prices between 2002 and 2006, Ecuador adopted Law 42 in April 2006, pursuant to which a 50 percent tax was imposed on the company on "windfall profits," (profits resulting from an "unforeseen" rise of oil prices in excess of the price level at the time of conclusion of the participation contract). In October 2007, the rate was raised to 99 percent by decree.

Murphy launched a complaint under the 1993 Ecuador-US Bilateral Investment Treaty arguing that Law 42 represented a unilateral modification of the participation contract (which ultimately led it to sell its interest in the consortium) and thus, a breach of the FET obligation under the Treaty. Ecuador took the view that, on the other hand, that Law 42 was a "matter of taxation" explicitly carved out from the BIT. The Tribunal rejected Ecuador's argument that Law 42 was a tax measure immune from the application of the FET obligation, on the ground that the "tax" was not enacted under the regular tax law but the Hydrocarbons Law, which governed the conclusion of participation contracts; thus, the measure amounted to a unilateral amendment to the participation contract signed by the consortium. While the Tribunal agreed with the concept of legitimate expectations, it found that Law 42 (50 percent tax) did not breach the FET obligations; however, it held that the decree (raising the rate to 99 percent) did breach Murphy's legitimate expectations.

4.6 Full Protection and Security (FPS)

54. IIAs include a provision which requires the contracting parties to accord to investment covered by the agreement "full protection and security" (FPS). It is most commonly found as part of broader provisions setting out the requirement for the parties to provide a "minimum standard of treatment", which typically also includes the FET requirement. Many IIAs clarify that the FPS standard is to be interpreted in accordance with international law or, more explicitly, that it refers only to the physical security of an investor and their investment.

55. Older IIAs do not include such interpretation and thus, much like in the case of the FET standard, arbitral tribunals have, in some instances, interpreted the concept to include legal or commercial security. As in the case of the FET obligation, this result can be avoided by clarifying that the concept is to be understood in accordance with international law.

4.7 Expropriation

56. IIAs set out the parameters within which a country can proceed to a lawful expropriation of property held by a foreign investor: the expropriation must be for a public purpose, carried out in a non-discriminatory manner, under due process of law and against the payment of appropriate compensation. The concept encompasses both the taking of property (direct expropriation) and actions of a government

[37] *Cairn Energy PLC and Cairn UK Holdings Limited v. The Republic of India*, PCA Case No. 2016-7.
[38] *Murphy Exploration & Production Company – International v. The Republic of Ecuador* (II) (PCA Case No. 2012-16).

that are the equivalent of a direct expropriation, when they result in the investor being unable to control, manage or use the property, or when it becomes worthless.[39]

57. Investors have argued in ISDS cases that measures adopted by a country (for example, safety, environmental and labor regulations, financial regulations, and taxation measures) that are alleged to have affected the profitability of their investment amounted to an indirect (and illegal) expropriation. Such claims, however, are not necessarily successful before arbitral tribunals, as international law and relevant jurisprudence have established a distinction between measures that constitute indirect expropriation and measures adopted by a country in a non-discriminatory manner in the course of legislating or regulating in the public interest. Nonetheless, it is a common occurrence, when taxation measures are being challenged by investors under other provisions of IIA, that they also be challenged as constituting an indirect expropriation. Taxation measures that have been alleged to constitute an expropriation in ISDS cases include[40]:

- Non-payment of VAT refunds;
- Initiation of tax investigations/tax audit proceedings;
- Withdrawal of government subsidies;
- Withdrawal of tax-free status;
- Withdrawal of or decision not to grant tax exemptions;
- Increases in windfall profit taxes and royalties;
- Large tax assessments;
- Withholding tax; and
- (Forcible) collection of taxes, customs or other liabilities.

58. Most expropriation claims made to arbitral tribunals are unsuccessful, because the bar to meet is relatively high: in order to amount to an indirect expropriation, a measure must have a destructive and long-lasting effect on the value of the investment, or must lead to the loss of effective (if not legal) control of the investment, and must be definitive and permanent. In the specific case of taxation, the effect of the taxation measure on the investment must be equivalent to what a direct expropriation measure would have achieved, that is, make the investment worthless. Tribunals tend to recognize that governments have a legitimate right to levy taxation to finance the missions of the state and to change their tax laws for valid policy purposes. A measure that reduces the profitability of the investment while still leaving its control in the hands of investors is generally not found by arbitral tribunals to be the equivalent to an expropriation. [41]

Examples of expropriation claims in ISDS cases

In *ADM*, *Cargill* and *Corn Syrup*, described earlier, the tribunals rejected the claims that the measure was tantamount to an expropriation. In *ADM*, the Tribunal stressed that the severity of the economic impact must determine whether an indirect expropriation has occurred. The Tribunal held that the measure did not deprive the claimants of fundamental rights of ownership or management of their investment and that the effects of the tax were not of sufficient intensity and duration to produce a significant loss of profitability or an effective loss of the investment.

In *Occidental*, described previously, the Tribunal rejected the allegation that the denial of VAT credits and refunds amounted to an indirect expropriation. It found that the disputed measures did not meet the standards required by

[39] For a comprehensive discussion of the issue, see UNCTAD (2012). *Expropriation*, UNCTAD Series on Issues in International Investment Agreements II: A sequel. United Nations, New York and Geneva, available at: https://unctad.org/system/files/official-document/unctaddiaeia2011d7_en.pdf

[40] UNCTAD (2021), *supra* note 25, at p. 31.

[41] For a discussion of actual cases that illustrate this, see A. CASTONGUAY (2023), *supra* note 21, at para. 67ff.

international law, in particular the need for the alleged measure to deprive the owner, in whole or in significant part, of the use or expected economic benefit of the investment.

In a claim filed in 2007 under the North American Free Trade Agreement, Marvin and Elaine Gottlieb *et al* ("Gottlieb"), US residents, asserted that changes made in October 2006 by the government of Canada to rules governing the taxation of certain "flow-through entities" had destroyed the value of their investment held in such vehicles. They claimed that the change breached the NT, MFN, FET and expropriation obligations of the agreement. Ultimately, the case never reached the ISDS stage. On its face, the taxation article precluded the application of the first three obligations with respect to an income tax measure. As regards the expropriation claim, the taxation article contained a filter that requires a referral of the claim be made to taxation authorities of the parties in order for them to determine whether the disputed measure was not an expropriation. The Canadian and US taxation authorities did reach a joint determination under that provision: in an exchange of letters[42] that took place within the allotted six-month period, they agreed that the measure at issue did not constitute an expropriation. Consequently, the expropriation claim was precluded from proceeding to the ISDS stage.

4.8 Transfer of Funds

59. The transfer of funds provisions in IIAs are intended to prevent impediments to the free and prompt use by foreign investors of investment and returns on investment, in any form and at any time. Unlike first generation agreements, newer IIAs contain exceptions to this basic requirement, which permit the imposition of certain restrictions to the transfer of funds in certain situations, such as when balance of payment issues arise, or to require compliance with a country's laws dealing with the integrity of the financial system, bankruptcy, securities, criminal offences and, less often, the payment of taxes.

60. Such provisions are generally understood not to restrict imposition of taxes, including at the time a payment (be it interest, dividends or royalties) is made to a non-resident person and are seldom invoked by investors in the course of IIA disputes.

4.9 Stabilization Clauses and their Relationship with Umbrella Provisions

61. Investment commitments made by a foreign investor in a host country are often governed by a contract signed between them. Such "investment agreements" often include so-called "stabilization clauses" – sometimes also called "stability clauses". Stabilization clauses have been described in the following terms:[43]

> At the heart of every stabilization clause is a simple concept: to stop time. A stabilization clause in an investor-state contract effectively freezes the laws, rules, and regulations applicable to the foreign investment as they existed at the time the investment contract was concluded. This means that a host state may not apply subsequent adverse changes in its domestic law to the investor and the investment, and agrees to leave the investment project unaffected by these changes. The host country, however, is not prohibited from exercising its legislative power and changing its laws. The state merely promises to spare the investment from any later, deleterious regulatory changes, or else reimburse the investor for any damages incurred as a result.

62. Such clauses can be provided by contract only or can be provided legislatively.[44] They commit the host country to maintain a stable legislative environment with respect to the specific investment covered by

[42] The exchange of letters can be found at: https://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/gottlieb-02.pdf.

[43] J. WONG and A. ABUELFUTUH ALI, "The Legislative Stabilization Clause", International Law *a*nd Politics (2022) Vol. 55:67 at pp. 68-69, available at: https://www.nyujilp.org/wp-content/uploads/2023/03/Article2.pdf

[44] *Ibid*, at p. 70. See also J. GJUZI, *Stabilization Clauses in International Investment Law : a sustainable development approach* (2018); P. CAMERON, "Stabilization Clauses: Do They Have a Future?", BCDR International Arbitration Review, Kluwer Law International 2020, Vol. 7, Issue 1), p. 109.

the agreement. Such commitment may extend to guaranteeing stable tax rules for the investor in respect of its investment over a certain period of time. In a February 2023 IMF staff paper on International Corporate Tax Reform, the need for Governments to revisit policies that introduce legal barriers, such as stabilization clauses, and could hinder some tax reforms was noted.[45]

63. Investment agreements concluded between an investor and the host country, including the stabilization clauses that they may contain, are normally enforceable under the judicial system of the host country as a contractual or legislative obligation. However, countries entering into an IIA sometimes bring the enforcement of such agreements within the ambit of the investor-state dispute settlement provisions of the IIA. This is the purpose of so-called "umbrella provisions" included in IIAs. Such a provision stipulates that a contracting party to an IIA is required to observe obligations that it has undertaken with respect to an investment made by an investor of the other contracting party pursuant to an investment agreement. This means that any dispute between an investor and the host country regarding the terms of that agreement, including investor claims that the host country has breached the provision of the stabilization clauses that it may contain, can be addressed under the dispute settlement provisions of the IIA as a breach of IIA obligations (hence the enforcement of a separate contract comes "under the umbrella" of the IIA).The UNCTAD Reform Package also suggests options to clarify the FET provision in an IIA so that the standard does not itself include a stabilization obligation that would prevent the host country from changing its legislation.[46] Whether stabilization clauses are desirable or not is beyond the scope of this Report. It should be noted, however, that they can impose a constraint on the ability of the host country to adjust tax policies in response to changing circumstances, in particular where they have been applicable for long periods of time.

4.10 Investor-State Dispute Settlement (ISDS)

64. The ISDS system is a key feature of IIAs. Without it, a dispute arising between an investor and the host country would be addressed by the courts and the judicial system of that country. Instead, under the ISDS, such disputes are examined and adjudicated by an international tribunal formed specifically to that effect, operating under its own rules and composed of arbitrators, the majority of which are usually not nationals of the host country. Under such a system, the investor is solely responsible for deciding to bring claims under the ISDS provisions. The purpose of an ISDS claim is for the investor to seek financial compensation from the government of the host country commensurate with the economic injury alleged to have been suffered by it as a result of the imposition by that country of the disputed measure.

65. An arbitral tribunal is typically comprised of three arbitrators, one chosen by the investor, one chosen by the respondent country and the third selected jointly (or by the two other selected arbitrators), paid by both contracting parties. Arbitration usually takes place under a comprehensive body of rules set out by international agreements: most commonly, the UNCITRAL Arbitration Rules[47] and the Rules of the

[45] IMF, "*International Corporate Tax Reform*" (February 2023), at p. 27, available at: https://www.imf.org/-/media/Files/Publications/PP/2023/English/PPEA2023001.ashx.

[46] UNCTAD (2018), "*UNCTAD's Reform Package for the International Investment Regime*", at p.36, available at: https://investmentpolicy.unctad.org/publications/1190/unctad-s-reform-package-for-the-international-investment-regime-2018-edition.

[47] UNICTRAL, *Arbitration Rules*. The rules, first adopted in 1976, were developed by the United Nations Commission on International Trade Law (UNCITRAL), a subsidiary body of the General Assembly of the United Nations created in 1966 and are kept up to date. For the latest version of the rules see https://uncitral.un.org/en/texts/arbitration/contractualtexts/arbitration. UNCITRAL is mandated to further the progressive harmonization and unification of the law of international trade. It has produced several conventions, model laws and other instruments.

International Centre for Settlement of Investment Disputes (ICSID), established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States[48].

66. The decisions rendered by arbitral tribunals are legally-binding and are final. In exceptional circumstances, an investor that was awarded a financial compensation by an arbitral tribunal can turn to the courts of any country to compel the host country to pay said compensation.[49] Likewise, a country that was ordered by an arbitral tribunal to pay a financial compensation to an investor may seek, in a court of law or pursuant to a special mechanism available under the rules that govern the formation of international tribunals, to invalidate the award, generally on grounds that the IIA was misapplied in that particular case.

67. The ISDS process has come under significant criticism from different quarters in recent years. In particular, it has been argued that arbitrators may not have sufficient legitimacy to exercise the power to sanction legislative and regulatory actions taken by the state, given that their frame of analysis tends to focus on the effect of the disputed measure on investors, at the expense of the broader social or economic context that may have justified its adoption. The following is a subset of criticisms expressed about the ISDS process[50]:

- ISDS opposes the enforcement of private (investor) rights against the right of the state to legislate or regulate in the public interest[51]. This can raise doubt as to the ability of governments to regulate in the area of health, public welfare, the environment, etc. For a country to lose an ISDS case means not only a direct financial impact, but an infringement on its regulatory powers, ultimately forcing it to amend or withdraw the disputed measure.[52];
- Benefits and obligations are asymmetrical between states and investors. Substantive obligations of an IIA are one-sided: countries are bound by them but cannot receive awards (only their own investors can). Investors have no substantive obligations but stand to gain financially;
- By definition, the ISDS process confers substantive and procedural rights on foreign investors that domestic investors do not have, producing an uneven playing field;
- An arbitral tribunal is not bound by prior decisions made by other tribunals and, except in the exceptional case of a petition for annulment in a court of law, decisions cannot be appealed by states. As a result, decisions are inconsistent across seemingly similar issues, as regards the decision to compensate investors, the reasoning used to arrive at that decision, as well as the manner used to calculate said compensation.
- The confidential nature of the ISDS process is criticized as being secretive and non-transparent. This is in part due to the origin of ISDS procedures, based on how commercial arbitration is conducted between private parties.

[48] World Bank Group, *ICSID Convention, Regulations and Rules*, International Centre for Settlement of Investment Disputes, Washington, D.C. The Convention, which was developed under the auspices of what is now the World Bank Group, entered into force in 1966.

[49] An instance of such an occurrence is described in A. CASTONGUAY (2023), *supra* note 21, at para. 89ff.

[50] For example, see J. CHAISSE (2015), *supra* note 23; T.R. SAMPLES, *supra*, note 19; UNCTAD (2018), *UNCTAD's Reform Package for the International Investment Regime*, *supra* note 46.

[51] For example, allegations made in multiple cases against several countries by the tobacco manufacturer Philip Morris against laws that sought to curb tobacco consumption through changes made to cigarette packaging. For example, see *Philip Morris Asia Limited v. The Commonwealth of Australia*, Award (March 8, 2017), Case No. 2012-12 and *Philip Morris Brands Sàrl v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016).

[52] A rebuttal argument can be made that such a narrow frame of analysis would equally be observed in litigation undertaken before a domestic court and that this simply suggests that the IIA is being applied as intended by the parties.

68. As a result, the impetus for reforms of the ISDS process has grown in recent years and several countries have reacted by curtailing the inclusion of ISDS provisions in their IIAs, if not outright abandoning them altogether. In the latter case, this means that disputes may be addressed by domestic courts or possibly under a state-to-state dispute settlement procedure, although monetary damages would not typically be awarded to investors under such procedures. Current international efforts to revisit the ISDS process are discussed in the next section.

69. Tax officials are generally unfamiliar with ISDS procedures of IIAs as they are not the means employed to address international tax disputes. Most tax disputes between a taxpayer and a revenue authority are addressed by the domestic courts. Where there is taxation not in accordance with the provision of a DTA, the traditional route is to seek relief, when a DTA is applicable, through the process set out therein, the mutual agreement procedure (MAP). The differences between the ISDS process and the MAP are significant.

70. Unlike the ISDS process, the MAP is a state-to-state process. Whereas taxpayers can present a case to the domestic tax authorities, the request may not lead to MAP proceedings with the other country that is party to a DTA. First, the tax administration must be satisfied that the request is justified; second, it may be possible for the issue to be resolved unilaterally.[53] Under the ISDS process, no such discretion exists: arbitration is compulsory once a notice of claims is filed by an investor; the cooling off period prior to the formation of the arbitral tribunal, during which consultation may take place between the investor and the host country, rarely if ever produces a resolution. Another important difference concerns the role of the respective approaches. The goal of the MAP is to alleviate double taxation; in contrast, investors challenge tax measures under IIAs with the view of obtaining a financial compensation for injuries allegedly caused by the imposition of the disputed tax measure. Competent authorities under the MAP have an intimate knowledge of their respective tax systems and of the applicable DTA. Arbitrators under ISDS are not tax experts and may be invited to form a view on intricate tax policy or administration issues.[54]

4.11 Tax Provisions

71. Many IIAs, especially those concluded recently, include comprehensive provisions dealing specifically with taxation, in order to address the issues identified in this section. They are usually found in a dedicated article. A taxation article may address taxation matters both from a substantive and a procedural point of view. Substantive provisions will, for example, remove certain taxation measures from the scope of application of one or more of the key obligations of IIAs (e.g., the national treatment obligation) or will modify the manner in which the obligation applies to taxation (e.g., laying out an interpretation of national treatment similar to that found in DTAs). From a procedural point of view, a taxation article may alter the manner in which the ISDS applies in respect of taxation measures, most often by explicitly granting a role to taxation authorities to decide either substantive issues (for example, is the disputed measure an expropriation) or issues of jurisdictions between the IIA and a DTA in force between IIA parties (for example, whether the DTA and not the IIA should govern the resolution of the dispute).

72. The content of taxation articles is discussed in greater detail in Section 6.

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[53] UN (2021), *supra* note 26. The first sentence of paragraph 2 of Article 25 of the UN Model reads: "*The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention*".

[54] While legally binding arbitration provisions are increasingly being integrated into DTAs of several countries, these provisions do not replace or provide an alternative to the MAP. Instead, arbitration under DTAs is used when mutual agreement between the competent authorities cannot be achieved. Arbitration under DTAs is a state-to-state process, in which taxpayers have little role. Arbitrators in a DTA arbitration generally possess significant international tax expertise and are appointed by the countries themselves.

5. Tax-relevant Elements of Potential Reforms of International Investment Agreements

73. Before turning to the examination of potential approaches for addressing taxation matters under IIAs, it is useful to situate these proposals in their wider context. As mentioned earlier, several aspects of IIAs have been the subject of criticism over the years and much has been written about them and about potential avenues for reform. There currently exists a substantial body of work dedicated to identifying shortcomings with IIAs and proposing changes to a number of their key provisions. Some ideas put forward to that effect would affect how taxation issues are dealt with under IIAs and, thus, might impact details of any proposals intended to address taxation matters.

74. The most important work is currently being conducted by UN bodies, UNCTAD[55] and UNCITRAL[56]. Proposals formulated by the former cover the entire range of issues identified with respect to IIAs, whereas the latter exclusively focuses, at the granular level, on all aspects of the ISDS process. The analytical material produced by both is considerable and a complete review of such material is beyond the scope of this Report. Annex 2 briefly describes specific initiatives that have relevance for the issues discussed in this Report.

6. A Framework to Address the Tax Aspects of International Investment Agreements

6.1 Introduction

75. This section presents proposals and offers practical guidance to assist tax officials wishing to build capacity to exercise greater control over the treatment of taxation matters in their country's network of IIAs, in order to better manage the issues and risks identified in this Report. The guidance may also be beneficial to investment policymakers and negotiators (collectively referred to as "investment officials") wishing to better understand the concerns and needs of tax officials and why they have an important role to play in the formulation and implementation of the country's policy toward IIAs. Capacity building, in this context, requires from tax officials that, first, they develop specialized knowledge about the particulars of IIAs and the potential impact that they may have on their country's tax policy and administration and, second, that they become familiar with the intra-governmental process by which they can integrate into the workstream led by investment officials, the cooperation of which is essential for the framework to meet its objectives.

6.2 Importance of Developing a Framework

6.2.1 Why a Framework is Necessary

76. Previous sections of this Report have detailed the implications of IIAs for a country's ability to legislate and regulate for a public purpose, with a particular focus on taxation. Tax officials of countries that have entered into a sizable number of IIAs cannot simply ignore the issue or minimize its importance; they must gain awareness of the issue. Having done so, they may wish to know what concrete steps they must pursue to ameliorate the situation, in particular: how to formulate their concerns within their government; how the wording of IIAs may ideally be revised to take such concerns into account; and how to go about incorporating such language into their country's IIAs (which are negotiated by their government but which are not within their direct purview). For tax officials who have never been involved in such an endeavor, the task may at first appear to be considerable, in particular if their office already functions within significant resource constraints.

[55] The United Nations Conference on Trade and Development (UNCTAD), an intergovernmental body established by the United Nations General Assembly in 1964, is a leading UN institution dealing with trade and development, with the mandate to support developing countries to access the benefits of a globalized economy more fairly and effectively.
[56] UNCTAD (2018), *supra* note 46.

77. Implementing an efficient strategy to address taxation issues in IIAs requires early acceptance of an incontrovertible requirement: any involvement of tax officials in this area requires the allocation of adequate financial and human resources for that purpose by the government department responsible for tax policy ("tax department"). In considering whether and to what extent to do so, the tax department must be mindful that the cost associated with such an effort must be compared with the potential cost of inaction as well as the expected benefits of achieving the right balance within their country's IIAs. Better calibrating the content of IIAs as they apply to taxation matters brings benefits in terms of protecting the country's ability to make tax policy choices and limiting the potential financial costs and risks associated with IIA litigation. It would serve little purpose for a government to formulate elaborate tax policies designed to achieve important economic and social goals if the attainment of some of them may be at risk of being undermined because they are vulnerable to challenges by foreign investors under IIAs.

78. Achieving the right balance in IIAs with respect to treatment of taxation should also be an objective of investment officials, since preserving tax policy space can be achieved without undermining the basic objective of IIAs of making the country attractive to foreign investors. Such an outcome, however, can only be accomplished through a continuous cooperative effort between tax and investment officials. Indeed, tax officials can bring important value added for purposes of strengthening the integrity of IIAs, for example in the area of the abuse of IIAs by investors of third countries (so called, treaty-shopping), a topic which is very familiar to international tax officials and for which solutions have been developed both at the country level and in a multilateral context.[57]

6.2.2 How to Develop a Framework: Consider a Whole-of-Government Approach

79. A "whole-of-government" approach means public service agencies working together across organisational portfolio boundaries in a shared response to particular issues.[58] While governments are usually organized around a number of departments each tasked with the development and/or implementation of specific policies within defined areas of responsibility, the handling of certain policy issues can span across two or more departments. When working in silos, departments may not be able to implement a cohesive government response to a particular policy challenge. A whole-of-government approach seeks to remedy this problem by ensuring that departments coordinate their efforts in the pursuit of achieving a given government-wide objective.

80. Much has been written about the benefits associated with, and challenges in implementing, a whole-of-government approach as well as about the actual implementation of such an approach in specific policy fields by various governments[59]. In a complex area such as the relationship of tax and investment rights and obligations, some of the benefits of the approach are that:

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[57] See, for example: UNCTAD (2021), *supra* note 25 at pp. 23-24; J. CHAISSE, *supra* note 23; J. BAUMGARTNER, *Treaty Shopping in International Investment Law*, Oxford University Press (2016).

[58] UNDESA, *E-government for policy integration* (UN E-Government Survey 2016), 2017, at para 1.1, available at https://publicadministration.un.org/egovkb/Portals/egovkb/Documents/un/2016-Survey/Chapter%201.pdf,.

[59] For example, see A. COLGAN, L. A. KENNEDY, and N. DOHERTY (2014), *A Primer on Implementing Whole of Government Approaches*, Dublin: Centre for Effective Services, p. 3, available at: https://effectiveservices.notion.site/Primer-on-Implementing-Whole-of-Government-Approaches-4e6166a521ec43f0a16c7b5fb5ed0a2a; See also Australian National Audit Office, Audit Report No.41 2009–10, *Effective Cross-Agency Agreements*, Commonwealth of Australia, 2010, available at: https://www.anao.gov.au/sites/default/files/ANAO_Report_2009-2010_41.pdf?acsf_files_redirect#:~:text=Key%20requirements%20for%20cross%2Dagency,communication%20arrangements%3B%20considering%20risks%2C%20and; J. JOHNSON, "Don't Break Your Silos Down – Master Them" (2020), available at: https://services.blog.gov.uk/2020/01/16/dont-break-your-silos-down-master-them/; S. NAWAZ, "7 Strategies to Break Down Silos in Big Meetings" (2021), https://hbr.org/2021/07/7-strategies-to-break-down-silos-

- It promotes coherence of approach and certainty for administrators and taxpayers/investors;
- It recognises the integrated nature in the modern world of policy development, legislation, and provision of services, and reduces fragmentated responses by linking up the analysis and responses of different offices;
- It encourages broader perspectives, such as sustainable development approaches in an interdependent world, so that policy responses and administration can best meet desired wider goals;
- It makes the best use of government capacity, and can help identify inefficiencies and better target resources;
- It makes it easier to provide a "one-stop-shop" for provision of services and advice, reducing inefficiencies and uncertainties and enhancing competitiveness as a destination;
- It decreases the risk profile and can, through sharing information and experience, serve as an early warning and response system to emerging issues, such as potential disputes or more systemic problems with treaty obligations.

81. The elements of an effective whole-of-government approach include:[60]

- *structures*, such as interdepartmental committees or taskforces meeting regularly, with clear agendas and reports;
- *work processes*, including accountability systems that centralize the importance of whole of government effectiveness, information sharing (including the IT aspects) and joint problem solving.
- *political and administrative leadership*, in terms of giving the necessary political support but at both the political and administrative level putting a premium on building and sustaining relationships, managing complexity and interdependence, and managing multiple and conflicting accountabilities;
- *culture and capacities* – this includes developing a culture within the department/ organizational unit that encourages the qualities needed by the personnel operating in an inter-organizational setting, including: cultivation of productive and professional relationships, communication skills, political skills and an appreciation of the interdependencies involved in understanding and solving complex problems. A capacity to see the problem from the perspective of other stakeholders is key. Other capacities include an awareness of the risks and challenges, but also the opportunities of working across horizontal and vertical boundaries, with multiple and potentially conflicting accountabilities. An ability to influence developments is important.

82. A critical part of a whole-of-government approach is that it involves improving inter-departmental networks within governments, such as between tax agencies and investment ministries, as well as between tax policymakers and tax administrators. Since IIAs may also impact administrative guidance and practice, revenue agencies must be aware of the implications of IIA provisions on their practices and decisions (see paragraph 57 for examples of measures that have triggered a dispute in the past). To achieve this, intra-departmental networks within, for example, the revenue agency may also need to be improved, so that a single person or team has the information, skills and authority, to speak effectively for the agency in

in-big-meetings; S. DANAA (UNDESA), "Introduction to the Whole-of-Government Approach" (2023 – PowerPoints).

[60] A. COLGAN, L. A. KENNEDY, and N. DOHERTY, *supra* note 59, at p. 26ff.

dealings with other departments. Effective intra and inter-departmental networks will also help in engaging on these issues with other countries in the international arena.

83. As the next section will set out, the implementation of this integrated approach is not intended to be a process that is finite in time. Once a cooperative process has been established between tax and investment officials, it does not end with an agreement between them on the terms of provisions relating to taxation for inclusion in the country's IIAs. To the same extent that the process of negotiation, ratification and implementation of new IIAs and the management of litigation arising under the country's IIAs is an on-going endeavor for investment officials, so should the cooperative process between officials be at each stage (including at the litigation stage, where it concerns a taxation measure).

6.3 Developing and Implementing a Framework

6.3.1 Integrating with the Government's Investment Team as Part of a Whole-of-Government Approach

84. While tax officials are responsible for matters relating to tax policy and administration, ensuring that their concerns and preferences are reflected in the content of their country's IIAs necessarily implies the cooperation and participation of investment officials. The latter are responsible for the country's policy on investment and for the negotiation of IIAs and the treatment of taxation is one among many issues that need to be addressed in determining the content of such agreements.

85. Indeed, investment officials usually have the primary responsibility for the development and implementation of the country's investment policy and the content of IIAs. They respond to the minister responsible for the country's investment policies, the parameters of which determine in large part to what extent the country is attractive to foreign investment. On the other hand, investment officials do not have particular expertise in all areas covered by an IIA and, in particular, in the tax area. This may create a tension between two objectives: the need for investment officials to account for concerns expressed by tax officials, and the natural tendency to be protective of what they may regard as their exclusive area of responsibility.

86. On the other hand, tax officials respond to the minister responsible for the country's tax and fiscal policies. The power to tax is a pillar of a country's sovereignty and, thus, tax policy and tax collection are critical functions of the state, as they determine how much revenue accrues to the government to finance its several social and economic missions, and how such revenue is collected. To the extent that the country's investment policy can affect what is exclusively their area of responsibility, tax officials can legitimately claim a role in the design of investment policies that affect their core mandate. Since IIAs can impact on the efficacy of tax policy, it is important that their concerns regarding the preservation of policy flexibility be heard and taken into account by investment officials.

87. Because of the existence of such an overlap – and a tension – between tax and investment policy, it is in the best interest of the government to acknowledge its existence and to manage it in a manner that benefits both policies. If one accepts this premise, it follows that tax officials must form an integral part of all the decisions that affect their policy area and that they must be prepared to participate in all the steps associated with IIAs; likewise, investment officials must be amenable to including tax officials in their decision-making process. This is obviously the case at the initial stage, when a tax article needs to be designed. But it does not stop at that stage. Tax officials must also be involved in the negotiation of the tax article when investment officials conduct bilateral IIA negotiations. They must also be aware of emerging litigation brought about by foreign investors when the disputed measure is a taxation measure, and work together with investment officials in the preparation of a defense to be presented at the arbitral tribunal. The following subsections address each stage in turn.

88. As mentioned at the outset, from an organizational perspective, the department responsible for tax policy must be prepared to allocate adequate financial and human resources for it to fulfil this mandate. This department must develop its own expertise in this area to be able to play a constructive role as part of the team responsible for IIAs. Tax officials assigned to this role must be given an explicit mandate from their department. When clearly formulated and communicated at senior departmental levels (including between senior officials in tax and investment departments), such a mandate represents both a clarity of purpose for tax officials and a source of strength and legitimacy for them when interacting with their investment colleagues. This establishes the basis of their inter-departmental cooperation in this area. Even at that early stage, cooperation at the working level must be established between the respective departments, as tax officials will require the support of investment officials to develop the expertise that they must necessarily acquire with respect to investment policy and IIAs. At some point in this process, tax officials will be able to commence work on the first step towards the development of a framework: developing a model taxation article/ provision for IIAs.

6.3.2 Developing a Substantive Position on the Treatment of Taxation

89. The development of a substantive position on the treatment of taxes in IIAs will determine to what extent obligations of IIAs apply in respect of taxation measures. One of the first decisions in this respect concerns the choice of the approach to be adopted in the design of the taxation article. The preliminary tendency of tax officials concerned with preserving their ability to develop and implement tax policy may be to consider the outright exclusion of taxation matters from the scope of IIAs. It is indeed a simple approach, from a design point of view, that ensures the complete preservation of the country's tax policy space. However, it comes with its own issues and is very likely to be opposed by investment officials concerned with preserving the attractiveness of the country as a foreign investment destination. Thus, what may be perceived at the outset as the preferred approach from the sole point of view of tax officials may not be the one that, in the end, will be mutually acceptable under a whole-of-government approach.

90. The design and content of a tax article is for each country to determine and, thus, this Report does not put forth specific recommendations in this regard. A recent report[61] offered a detailed analysis of how and to what extent key obligations of an IIA may apply to taxation measures. This report analyzed a number of tax provisions found in existing IIAs, particularly recent ones, and suggested that they can be grouped into three broad categories: articles that favour the targeted exclusion of taxation measures, articles that achieve the broad exclusion of taxation measures and, finally, articles that provide for the complete or near complete exclusion of taxation measures from the scope of IIAs. Annex 3 provides a summary of the features of each category, together with their pros and cons.

91. In summary, a tax article may include two types of provisions. The first type includes provisions limiting the extent to which certain IIA obligations apply to taxation measures. The second type are procedural in nature (usually referred to as "filters", as alluded to previously) and typically impose an additional step prior to the commencement of the ISDS process, which allow tax officials of both contracting parties to the IIA to make a determination about the application of certain obligations of the IIA to taxation measures. An example of the first type of provision might be one providing that the national treatment obligation does not apply with respect to income tax measures. An example of the latter type might be one inviting tax officials of both contracting parties to determine if a disputed taxation measure does not amount to an expropriation; if they so determine, the matter cannot be examined at the ISDS level.

92. Consistent with the whole-of-government approach discussed in the earlier subsection, it will be necessary, in crafting a taxation article, to reconcile the point of view and objectives of tax officials with those of investment officials. It is quite possible that this will require a period of negotiation between the

[61] A. CASTONGUAY (2023), *supra* note 21, at para 129ff.

respective departments. In the end, it will often be the case that the agreed-upon content of the tax article will necessarily reflect compromises made by each side.

6.3.3 Participating in IIA Negotiations

93. While investment negotiators entrusted with a detailed mandate from their tax counterpart might be capable of negotiating the terms of the taxation article with other countries, experience has shown that this is neither ideal nor often effective. The advisable course of action is for tax officials to be at the negotiating table as active participants when the tax provision is being negotiated.

94. In practice, negotiating the tax provisions of IIAs is much more about the intricacies of taxation laws than the particulars of investment policy. Usually, it will be necessary to explain the basis for carving out certain taxation measures from certain obligations of the IIA and to illustrate the position with the help of concrete examples. This necessarily requires an intimate knowledge of the measures in question and of tax policy. Where the negotiations solely involve investment officials, the iterative process inherent in all negotiations may be drawn-out, as officials may be unable to answer specific questions and may not have the mandate to edit language at the negotiating table, requiring them to consult tax officials in preparation for the subsequent negotiating round. This sub-optimal process also runs the risk that taxation matters be one of the last issues to be resolved, which may put undue pressure on tax officials to reach a compromise.

95. Ideally, tax issues should be discussed early in the negotiating process, which will help ensure that the relevant tax officials are identified at an early stage. Moreover, tax officials will typically be able to answer technical tax questions and will have some flexibility to adjust the language in order to move toward an acceptable compromise position. Consequently, the optimal arrangement to address taxation is when both parties can count on tax officials to carry out the negotiation of tax provisions. It is understood that where tax officials are given the lead for this purpose, they must nonetheless operate within certain parameters set by, and under the supervision of, senior investment negotiators.

96. There are of course costs (opportunity cost for officials and financial costs for the tax department) associated with sending tax officials abroad for IIA negotiations, especially if several IIA negotiations are on-going at once. Admittedly, resource constraints may raise a genuine issue for small and developing countries. Realistically, it is important for such costs to be factored in the initial decision made by the relevant tax department to assign resources to this issue. Fortunately, the emerging ease associated with the use of tele-conference facilities can contribute to the mitigation of such costs and, in practice, it is common for the tax article to be negotiated virtually to facilitate the involvement of the relevant tax officials. An IIA negotiation often involves several rounds on a wide variety of issues and it may be difficult to justify the cost of travel for tax officials who are only involved in one part of the agreement.

97. Once the negotiation of an IIA with a country is completed, it must be signed and ratified by each party. Tax officials may be required to assist, as mandated by the particular system in place, to help in the process leading to the signature and the ratification of the IIA.

98. A model tax article will be used for the negotiation of new IIAs. But it will most certainly be the case that the country is bound by existing IIAs negotiated prior to the development of the current model tax article, the tax provisions of which may diverge, perhaps significantly, from the new model. In this case, it will be advisable for tax officials to identify which IIAs present the most important vulnerability in their treatment of taxation, for purposes of establishing, in concert with investment officials, which IIAs should be given priority for renegotiation.

6.3.4 Participating in IIA Litigation

99. Once in force, IIAs may be used by a foreign investor to file a complaint (i) alleging that a given measure of the host country is not in accordance with the provisions of the IIA and has caused it a financial prejudice and (ii) seeking a financial compensation under the ISDS process. As was seen earlier, this may encompass a taxation measure.

100. As part of a whole-of-government process, it is important that tax officials are involved in the earliest stages of an emerging potential dispute that involves a taxation measure, as their familiarity with tax systems and agreements may help prevent the need for formal dispute settlement, and may put the government in the best position to defend any action that does eventuate. While it is important for tax officials to be aware of the emergence of such disputes, it will also be desirable to establish a permanent channel of communication (a "hotline" or a periodical exchange of information) between key tax and investment officials to help ensure each ministry benefits from the experience and intelligence of the other.

101. For tax officials, the "earliest stage" of a potential dispute is after the investor has filed a notice of intent to commence arbitration but before the official establishment of the investment tribunal. The dispute settlement provisions of most IIAs include language which encourages the claimant (the investor) and the respondent (the host country) to resolve the matter amicably through consultation and negotiation, which may include conciliation or mediation or other non-binding procedure. While such provisions do not formally refer to the participation of tax officials, they offer the earliest opportunity for them to be involved with the efforts to settle the matter before the commencement of formal proceedings and, as such, it is advisable that they participate in such efforts when the dispute concerns a taxation measure.

102. In practice, however, irrespective of the nature of the protection that the taxation article of the relevant IIA may confer on the disputed taxation measure, investor allegations almost invariably trigger the formation of an arbitral tribunal under the agreement's ISDS provisions. This means that the respondent country must mount a defense of the disputed measure before the arbitral tribunal.

103. As stated earlier, under a whole-of-government approach, tax officials must be informed promptly by investment officials of the existence of a challenge against a taxation measure by a foreign investor. While tax officials may themselves monitor on an ongoing basis the filing of IIA cases against their country, the primary responsibility for such a task rests with either the department responsible for investment policy and/or the department responsible for the management of IIA litigation (e.g., the department of justice) and, therefore, it will be incumbent upon them to ensure that tax officials are informed in real time as investor allegations are formally filed. Similarly, tax officials would benefit from becoming aware on a timely basis of litigation instigated by investors of their country, when it concerns a taxation measure. This would particularly be relevant should tax officials' direct involvement be necessary under a filter mechanism found in the tax article. Should this occur, tax officials may find it useful to communicate with the claimant to better understand the facts that gave rise to the claim and impart confidence that tax officials understand, and are actively engaged in, the process, where there appears to be some merit in the investor's claim.

104. To the same extent that tax expertise is required in the course of negotiating the tax aspects of IIAs, tax expertise will be essential in the defense of taxation measures being challenged under an IIA. The substantive defense of a tax measure will, depending on the nature of the allegation and the content of the tax article, take two alternative routes: one will be to argue that the measure is not a violation of the obligations of the IIA identified by the investor. The other will be to argue that, irrespective of whether or not the measure constitutes such a violation, the measure does not offend the IIA read as a whole because the disputed measure is protected by a provision of the tax article. For example, a measure that may arguably be discriminatory, according to the investor, may nonetheless be consistent with the agreement because,

say, the tax article prevents the national treatment provision from being invoked in respect of that particular measure.

105. From an organizational point of view, investment officials and/ or department of justice officials will have the primary responsibility for the preparation of a defense to be presented to an arbitral tribunal. Tax officials should be invited to provide a supporting role in the preparation of a responsive position in respect of taxation measures targeted by the complaint and, therefore, this will require close cooperation between the respective departments. Tax experts are usually not involved in the actual proceedings of arbitral tribunals, but both sides in the dispute are given opportunity to set out their position in detailed written briefs. Tax officials may also be in a position to offer views at the outset on the choice of the arbitrator to be selected by the respondent country (the investor and the respondent typically nominate one panelist each on the tribunal) and, where appropriate, the participation of expert witnesses.

106. Beyond a substantive defense based on merits, the taxation article may also explicitly require that tax experts be formally involved in the examination of the allegation made by the investor. As discussed earlier, a number of taxation articles found in more recent IIAs contain provisions that gives tax experts of the respective contracting parties the opportunity to reach a joint decision with respect to a specific issue set out in the article. As mentioned earlier, the most prevalent example is where an investor alleges that a taxation measure is tantamount to an expropriation. The tax article may contain a provision such as the following[62]:

> 8. Article 9.8 (Expropriation and Compensation) shall apply to taxation measures. However, no investor may invoke Article 9.8 (Expropriation and Compensation) as the basis for a claim if it has been determined pursuant to this paragraph that the measure is not an expropriation. An investor that seeks to invoke Article 9.8 (Expropriation and Compensation) with respect to a taxation measure must first refer to the designated authorities of the Party of the investor and the respondent Party, at the time that it gives its notice of intent under Article 9.19 (Submission of a Claim to Arbitration), the issue of whether that taxation measure is not an expropriation. If the designated 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 the referral, the investor may submit its claim to arbitration under Article 9.19 (Submission of a Claim to Arbitration).

107. In such cases, the involvement of tax authorities is thus a statutory requirement of the provision. Tax authorities are usually given a time period (e.g., 6 months) to come to a determination that the disputed taxation measure is not, contrary to what is being alleged by the investor, an expropriation. When both tax authorities arrive at such a determination, it precludes the issue from being examined by the arbitral tribunal. Such a "filter" relies on the unique expertise of tax officials and can be useful to discard manifestly frivolous expropriation claims, with respect to taxation measures that both contracting parties regard as legitimate. Other issues that may arise under the IIA which can benefit from tax expertise can also be decided under similar mechanisms. As mentioned in paragraph 103, tax officials of the country of the claimant may find it useful to gain a better understanding of the facts of the case by communicating with the claimant early in the course of the ISDS process.

108. After the conclusion of ISDS proceedings, it will also be advisable (and sometimes necessary) for tax experts to participate in any review of the case that may be conducted within the government, especially if a tribunal's decision has had a direct impact on the disputed taxation measure. This may inform the future formulation of tax policy or possible amendments to the country's model IIA.

[62] Paragraph 8 of Article 29.4 of the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership*, signed on March 8, 2018, and entered into force on December 30, 2018, in the first six countries to have ratified the agreement: Canada, Australia, Japan, Mexico, New Zealand, and Singapore.

7. Conclusions

109. This Report is intended to convey two important messages to officials responsible for tax policy:

(i) the need to be aware of the potential impacts of IIAs, entered into by their country, on taxation measures and the development and implementation of tax policy, and

(ii) the importance of their being proactive in addressing their concerns, by becoming participants in the development and implementation of their country's investment policy as it relates to taxation, including the negotiation of IIAs.

110. Tax officials who ignore IIAs do so at the peril of their country's tax policy and investment officials who ignore the importance of tax expertise risk undermining their country's investment policy. IIAs intended to make their country an attractive destination for foreign investment need not do so at the expense of posing an unknown risk to existing taxation measures or the future development and implementation of tax policy. This Report shows that a number of countries have achieved a satisfactory balance between both goals through the crafting of tax provisions that both reduce risks and allow tax officials, through filters, to participate in the mitigation of some of them. This Report does not prescribe a preferred tax provision for inclusion in IIAs, but presents a range of possible approaches among which tax and investment officials can, in a cooperative process, design a set of tax provisions that reflect their policy preferences.

111. For tax officials to be proactive within a wider government process requires two essential ingredients. First, a long-term commitment on the part of the tax department's leadership to develop in-house expertise in the IIA field, and to participate in all aspects of the country IIA policy, which necessarily requires the allocation of proper human and financial resources dedicated for that purpose. Second, the implementation of a cooperative relationship between tax officials and investment officials in the context of a whole-of-government approach.

112. The latter also requires a commitment on the part of investment officials to accept that tax officials have a role to play in the design of solutions to address their concerns. They must be prepared to assist tax officials in the development of their competence in the area of IIAs, to work with them in the design of a taxation article and to involve them in the negotiation of IIAs and the management of disputes that concern taxation measures.

113. The commitment that tax officials must make in this process is necessarily a long-term one. While the initial stage of the process, leading to the drafting of a taxation article for inclusion in the country's IIAs is a critical one, it should not be the end of the process. Tax officials should be prepared to participate in the negotiation of the tax aspects of IIAs with other countries. Likewise, investment officials should welcome the participation of those who hold expertise in the tax area, as this can only enhance both the efficacy of the process of negotiation and the quality of the ultimate outcome of such negotiation.

114. In addition, tax expertise may be called upon in the event that an investor of another contracting party challenges a taxation measure. Tax officials can be expected to provide critical insight into the purpose and operation of the disputed measure, for purposes of preparing a comprehensive defense before an international arbitral tribunal. When the taxation article contains so-called "filters" pursuant to which the consideration of certain issues is delegated to designated taxation authorities, tax officials can also play a direct and mandated role in the process leading to whether the said issues will ultimately be decided by an international tribunal.

[Note to readers: The following responds to a suggestion that readers of this Report should be made aware of the amendment made to the UN Model Tax Convention that concerns the interaction between DTAs and

IIAs. The language for that purpose, which is reproduced below, would preferably be added to the document serving as the introduction to the Report. Alternative placements include a footnote to the conclusions of the Report or a box added at the end of the conclusions.]

[115. The guidance set out in the Report does not relate to the negotiation or the administration of DTAs. However, the upcoming revision of the UN Model Double Taxation Convention is expected to propose a new provision intended to coordinate the application of DTAs with IIAs. The primary objective of this provision is to ensure that the DTA is the preferred vehicle to address tax-related disputes arising between an investor of a party and the government of the other party under the IIA in force between the parties. This would apply in circumstances where the IIA does not already provide for such an outcome, for example, where the IIA does not contain tax provisions. In keeping with the broad objectives of the Report, the decision by tax officials to initiate bilateral DTA negotiations for purposes of including such a provision in the DTA would preferably be made in consultation with the parties' investment officials. This would align with the whole-of-government approach advocated in the guidance, in particular since the alternative of including new, or amending existing, tax provisions in the relevant IIA between the parties might be available.]

Annex 1

1. Platform for Collaboration of Tax (PCT) 2015 toolkit

This publication offers a detailed discussion of the issues relevant to the design and implementation of investment tax incentives. Executive Summary of that Toolkit[63] notes:

> **Experience shows that there is often ample room for more effective and efficient use of investment tax incentives in low-income countries**. Tax incentives generally rank low in investment climate surveys in low-income countries, and there are many examples in which they are reported to be redundant—that is, investment would have been undertaken even without them. And their fiscal cost can be high, reducing opportunities for much-needed public spending on infrastructure, public services or social support, or requiring higher taxes on other activities.
>
> **Effective and efficient use of tax incentives requires that they be carefully designed.** Many low-income countries use costly tax holidays and income tax exemptions to attract investment, while investment tax credits and accelerated depreciation yield more investment per dollar spent. Tax incentives targeted at sectors producing for domestic markets or extractive industries generally have little impact, while those geared toward export-oriented sectors and mobile capital appear to be relatively effective—but the former need to be tempered by considerations of WTO consistency and both can be instances of mutually damaging tax competition. Enabling conditions—good infrastructure, macroeconomic stability, rule of law, etc.—are important for effectiveness.
>
> **Good governance of incentives is critical for their effectiveness and efficiency.** Transparency is necessary to facilitate accountability and reduce opportunities for rent seeking and corruption. Tax incentives should therefore be subject to legislative process, consolidated under the tax law, and their fiscal costs reviewed annually as part of a tax-expenditure review. The approval process of tax incentives may involve several stakeholders, but is ultimately best consolidated under the authority of the Minister of Finance and enforced and monitored by the tax administration. To the extent possible, the granting of tax incentives should be based on rules rather than discretion. Despite political obstacles, several countries have successfully reformed their tax incentive regimes.
>
> **The proliferation of incentives is largely a manifestation of international tax competition—which regional coordination can help mitigate,** although this requires political commitment and an effective supranational enforcement mechanism—which is often lacking. Common reporting standards and data collection can be an important first step toward coordination and enhanced transparency.
>
> **More systematic evaluations are needed to facilitate informed decision making.** In most low-income countries, the effectiveness and efficiency of tax incentives cannot be assessed due to lack of data and the absence of analytical tools and skills. The background document to the PCT toolkit offers guidance on how to develop the data and tools required for systematic analysis. Progress requires concerted action by several stakeholders to ensure evidence-based, transparent decision making.

[63] *Platform for Collaboration on Tax* (2015), *supra* note 10.

That report then addresses elements of a cost-benefit assessment of tax incentives, as follows[64]:

> Investment tax incentives ultimately aim to contribute to a country's development and improved living conditions for its citizens. As elaborated on in the background document, the following elements are critical for the achievement of ***social benefits***:
>
> - Size of the net investment effect—the rise in investment should be corrected for redundancy effects (investments that would have occurred without the incentive) and displacement effects (the reduction in any other investments) to infer the net incremental increase in capital due to the incentive.[65]
>
> - Net impact of higher investment on jobs and wages. New jobs can yield significant social gains if they reduce unemployment. However, if new jobs displace existing jobs, the social benefits depend on the productivity (and wage) differential between the new and old jobs.
>
> - Productivity spillovers. To the extent that new investment boosts productivity elsewhere in the domestic economy, such as in supplying or competing firms (often seen as a particular benefit from inward FDI), this magnifies social benefits by raising income levels more widely.
>
> The ***social costs*** of tax incentives depend on the following factors:
>
> - Net public revenue losses—public revenue falls if tax incentives are redundant or create leakage and abuse. But additional net investment and jobs can recover some of the revenue loss.
>
> - Administrative and compliance costs, which can rise due to tax incentives, especially if they are complex or create opportunities for rent seeking and corruption.
>
> - Scarcity of public funds. Often overlooked is that $1 of tax revenue has a higher social value than $1 of private income. However, public funds may be scarcer than private income, owing to the distortionary nature of taxes and the administrative constraints, especially felt in developing countries, to domestic revenue mobilization. To compare changes in private income and tax revenue, the latter thus need to be weighted by the 'marginal cost of public funds', which will be greater than unity.
>
> - Distorted resource allocation. Discrimination in favor of some and against other investments implies that taxes, rather than productivity differences, determine resource allocation. This distortion reduces average productivity and lowers income per capita.

[64] *Ibid*, at p.10.

[65] A tax incentive results in foregone tax revenue (hence the "cost" in the cost-benefit assessment). A tax incentive is beneficial if it induces new investment that would not have occurred without it. A tax incentive reduces tax revenue without any associated benefit where the investor would have made the investment without the existence of the incentive (the redundancy effect) or where the investor is induced to reduce investment elsewhere that does not qualify for the tax incentive in order to invest in activities that do (the displacement effect). Most tax incentives have these various effects. The size of the "net investment effect" is measured in accordance with the relative importance of new investment induced by the tax incentive vs. the total amount of foregone tax revenue associated with the tax incentive, including those associated with redundant and displaced investment.

The report also notes the importance of transparency in tax incentives, noting that:

> Transparency is fundamental to empowering all stakeholders—the legislature, businesses, civil society and the public at large—with information about tax incentive policies, so that they can hold government accountable for its decisions. Transparency also generates information required for evaluation. Transparency should be created along three dimensions:
>
> - Legal: tax incentives should have a statutory basis in relevant tax laws.
>
> - Economic: the rationale for tax incentives should be clearly spelled out to enable a public debate on the country's policy priorities. The costs and benefits of an incentive scheme should be assessed *ex-ante* and *ex-post*, based on clearly stated assumptions and methodologies, and the assessments published.
>
> - Administrative: qualifying criteria should be clear, simple, specific and objective, so as to reduce the discretion afforded to officials that grant the incentives. The decision-making process should be open and a list of incentives granted should be published.

2. List of Publications Addressing the Use and Effectiveness of Tax Incentives, as well as Ongoing OECD Work

Addis Tax Initiative (2022). *Regional Workshop on Tax Expenditures. Workshop Report.* Lagos. Available at:

González Cabral, Ana Cinta; APPELT, Silvia; GALINDO RUEDA, Fernando; HANAPPI, Tibor; and O'REILLY, Pierce (2023). *Design features of income-based tax incentives for R&D and innovation*. *OECD Taxation Working Papers No. 60*. Paris. Available at: https://doi.org/10.1787/a5346119-en.

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Annex 2

Summary of Current Work at UNCTAD and UNCITRAL

1. UNCTAD

1. UNCTAD has produced detailed analysis and formulated options for reforms of the international investment system in a report (hereafter "WIR2015") issued in 2015[66]. Of particular relevance for this Report, this was followed in 2020[67] by another publication that examined, in substantial detail, the same issues from the point of view of taxation, for the benefit of tax officials.

2. The essence of the recommendations put forward by UNCTAD are succinctly summarized in two tables found in WIR2015, which are reproduced at the end of this annex. Of interest, among the objectives for reforms identified, are the following:

- Safeguarding the right to regulate, in recognition of the fact that IIAs place limits on the ability of countries to pursue domestic policy goals and that countries need to be able to regulate for the public interest, citing areas such as the protection of the environment, public health, as well as economic and financial policies; this has relevance for taxation.

- Reforming investment dispute settlement, in light of the "legitimacy crisis" faced by the ISDS system arising from the many criticisms levelled against it.

3. WIR2015 identified the possible elements of reforms that might fulfil the above objectives. Of interest for this Report are the following:

- As regards the objective of safeguarding the right to regulate, one approach would be to better circumscribe key IIA obligations, such as the FET standard, indirect expropriation and MFN and include exceptions for, among others, public policies. Alternatively, a more ambitious approach would allow for the outright omission of key provisions (FET and MFN obligations, umbrella clause, ISDS provisions) from IIAs;

- As regards ISDS reforms, options would include three alternatives: (i) improving the existing ISDS process (improving transparency, limiting investors' access, enhancing the contracting parties' control and introducing local litigation); (ii) adding elements to the existing process (e.g., alternative dispute resolution approaches, introducing an appeals facility); and (iii) simply replacing the existing ISDS system with another mechanism (e.g., creating a permanent international investment court, or rely on state-to state dispute settlement).

4. While a detailed analysis of the above is beyond the scope of this Report, it is worth spelling out in more detail some of them. In order to address the open-ended and undefined nature of the FET obligations, options for reforms would include (i) to qualify the FET standard by reference to the minimum standard of treatment under customary international law; (ii) clarify the FET standard with an open-ended list of specific obligations, containing either what is included or what is excluded in its definition (under this approach, the concept of legitimate expectation would not be listed as a component of FET); (iii) replace the FET obligation with a list of well-defined obligations.

[66] *World Investment Report 2015*, *supra* note 6.
[67] UNCTAD (2021), *supra* note 25.

5. In order to address the issues arising when investors rely on the provisions on indirect expropriation to challenge laws or regulations of general application that affect negatively on the profitability of their investment, options for reforms would include: (i) limit the scope of the indirect expropriation provisions by defining criteria that must be present for a measure to constitute an indirect expropriation; (ii) define which measures do not constitute indirect expropriation (e.g., non-discriminatory, good faith regulations relating to public policy objectives) and affirm that a measure's adverse effect on the economic value of the investment is not sufficient to establish an indirect expropriation: and (iii) simply exclude indirect expropriation from the scope of IIAs.

6. Options are considered to address the issue of treaty shopping, whereby investors from a country can access the benefits of IIAs signed between two other countries: (i) supplement the definition of "investors" to require that substantial business activities be conducted in the host country; and (ii) include a "denial of benefits" provision to deny the benefits of IIAs to companies with little or no substantial business activities. In addition, the report mentions the possibility of excluding portfolio investment, including short term and speculative investments.

7. Finally, leaving aside the several proposals addressing dispute settlement reform (addressed in the next subsection), one idea is of particular relevance to this Report, which is reproduced in full (emphasis is ours)[68]:

> 3. Using **filters** for channeling sensitive cases to **State-State dispute settlement**
>
> This reform option provides for State-State dispute settlement if a joint committee fails to resolve a case. While maintaining the overall structure of today's ISDS mechanism, this constitutes a "renvoi" of disputes on sensitive issues to State-State dispute settlement; e.g. whether a measure is a "prudential" measure aimed at safeguarding the integrity and stability of the financial system or **whether a taxation measure constitutes an expropriation**. In this case, the ISDS proceeding is suspended until the State-to-State tribunal renders its decision. The latter is binding on the ISDS tribunal. This approach has been adopted in the BIT concluded between Canada and China in 2012 and in NAFTA (for investment disputes in financial services). The "filter" was evoked by the European Commission in its Public Consultation on the TTIP.
>
> State-State dispute settlement (be it in the form of arbitration, judicial or other procedures) may be better suited for sensitive issues of systemic importance, such as those relating to the integrity and stability of the financial system, **the global system of international tax relations**, or public health. For example, States are likely to use only those legal arguments with which they would feel comfortable in cases directed against them.

8. The detailed options for reform laid out in WIR15 are summarized in two tables found in that report, which are reproduced in the following pages. Table IV.3. sets out the objectives of the proposed reforms and the specific elements of IIAs with respect to which changes could be considered, while Table IV.4. suggests various means (e.g., adding or omitting provisions, etc.) by which changes could be implemented.[69]

[68] *World Investment Report 2015*, *supra* note 6, at p. 149.
[69] *World Investment Report 2015*, *supra* note 6, at pp. 133-134.

Table IV.3. Objectives and areas for IIA reform

Reform objectives	Reform areas
1. Safeguarding the right to regulate	Circumscribed (clearly defined) IIA standards of protection • Fair and equitable treatment • Indirect expropriation • MFN "Safety valves"; e.g. exceptions for • Public policies • National security • Balance-of-payments crises
2. Reforming investment dispute settlement	Clauses that • Fix the existing ISDS mechanism by improving transparency, limiting investors' access, enhancing the contracting parties' control and introducing local litigation requirements • Add new elements to the existing ISDS mechanism (e.g. building in effective alternative methods of dispute resolution, introducing an appeals facility) • Replace the existing ISDS mechanism (e.g. by creating a standing international investment court, reliance on State-State dispute settlement and/or reliance on domestic dispute resolution)
3. Promoting and facilitating investment	Clauses that • Strengthen promotion measures (inward and outward) • Target promotion measures to sustainable development • Foster cooperation in this regard
4. Ensuring responsible investment	Clauses that • Prevent the lowering of environmental or social standards • Ensure compliance with domestic laws • Strengthen corporate social responsibility (CSR) and foster cooperation in this regard
5. Enhancing systemic consistency	Clauses and mechanisms that manage interaction between • IIAs and other bodies of international law • IIAs and domestic investment and other policies • Different IIAs within a country's network

Source: UNCTAD.

Table IV.4. Reform tools

Reform tools	Examples
1. Adding new provisions	• Public policy exceptions • Clause on compliance with domestic laws • Clause on not lowering of standards • Clause on CSR
2. Eliminating (omitting) existing provisions	• FET, MFN, umbrella clause, ISDS
3. Reformulating existing provisions	Clarifying the content of • FET • Indirect expropriation
4. Carving-out aspects	Circumscribing (in IIA clauses or reservations) the • Scope of the treaty • Scope of protected investments/investors • Scope of application of key clauses (e.g. MFN, national treatment) • Scope of access to ISDS
5. Linking provisions	Conditioning protections on • Investor behaviour
6. Calibrating the normative intensity of provisions	• Hortatory language • Transition phases/phase-ins • Differentiated obligations
7. Creating/strengthening institutional mechanisms	Within the IIA, a joint committee, council or working group, coordinating and facilitating dialogue and cooperation on • Investment promotion, the prevention of disputes, the interpretation of provisions, the review of the agreement Beyond the IIA, • An appeals facility, an international investment court
8. Referring to other bodies of law	Managing the interaction between IIAs and other bodies of law with a view to avoiding inconsistencies and seeking synergies, e.g. • Preamble • References to CSR instruments • Reaffirmations of contracting parties' commitments under other international law instruments • References to the Vienna Convention on the Law of Treaties • ISDS rules

Source: UNCTAD.

2. UNCITRAL

9. In 2017, UNCITRAL tasked a working group (Working Group III or "WG3") to investigate potential reforms of the ISDS process. WG3 listed the concerns expressed about ISDS:

> Concerns commonly expressed about the existing ISDS regime include (i) inconsistency in arbitral decisions, (ii) limited mechanisms to ensure the correctness of arbitral decisions, (iii) lack of predictability, (iv) appointment of arbitrators by parties ("party-appointment"), (v) the impact of party-appointment on the impartiality and independence of arbitrators, (vi) lack of transparency, and (vii) increasing duration and costs of the procedure. These concerns, further considered below, have been said to undermine the legitimacy of the ISDS regime and its democratic accountability (see document A/CN.9/917, paras. 11-12). These concerns fall within two broad categories: those concerning the arbitral process and outcomes (see section B) and those relating to arbitrators/decision-makers.[70]

[70] UNCITRAL (2017), *Possible reform of investor-State dispute settlement (ISDS)*, Working Group III (Investor-State Dispute Settlement Reform), Thirty-fourth session, Vienna, November 27-December 1, 2017, A/CN.9/WG.III/WP.142, at 20.

10. WG3 identified, for discussion purposes, a wide array of possible reforms for potential consideration, with the view, among other objectives, of improving the coherence and consistency of the ISDS regime. Among possible avenues for reform, the following were identified[71]:

- Establish a multilateral advisory centre to provide legal advice on investment law before a dispute arises and act as counsel when there is a dispute; the centre could also help countries in capacity-building and the sharing of best practices;

- Establish a procedure for the prior scrutiny of arbitral awards and alternatively, the creation of a stand-alone appellate mechanism, for purposes of ensuring consistency in the interpretation of the provisions of IIAs and rectifying errors in awards;

- Establish a stand-alone international investment court, possibly supplemented by an appellate tribunal;

- Improve the manner and conditions of selecting and appointing ISDS tribunal members and considering implementing a code of conduct for arbitrators;

- Promote greater use of methods that improve the parties' control over their IIAs, such as by including in their IIAs provisions on joint, unilateral or multilateral interpretative declarations, providing guidance to arbitral tribunals on the meaning of certain terms, or adopting binding interpretations of IIA obligations;

- Strengthen the involvement of State authorities through mechanism that would allow for State-State preliminary consideration of issues, including technical consultations, decisions by the respective State authorities, as well as setting-up a joint review committee by the treaty Parties, or other mechanisms that could intervene if the issue cannot be settled at the technical level in a given time period;

- Strengthen alternative dispute settlement mechanisms, such as mediation and the institution of an ombudsman;

- Address frivolous or unmeritorious claims; include limitations, such as statute of limitations for bringing claims, or summary dismissal of claims; and

- Establish expedited procedures in order to reduce the duration and costs of ISDS.

11. Of particular interest for purposes of this Report was a suggestion to strengthen the involvement of state authorities for preliminary settlement of disputes with respect to "technical issues" (identifying taxation as an example). This would mean the design of "a mechanism that would allow technical authorities established by treaty Parties to decide whether a claim falls outside the limited scope of claims that are subject to ISDS, as well as substantive matters such as questions relating to violations of national treatment and substantive MFN clauses".[72] No specific recommendation on this issue appears to have been formulated to date.

[71] UNICTRAL (2019), *Possible reform of investor-State dispute settlement (ISDS)*, Working Group III (Investor-State Dispute Settlement Reform), Thirty-eighth session, Vienna, October 14–18, 2019, A/CN.9/WG.III/WP.166.
[72] UNICTRAL (2018), *Possible reform of investor-State dispute settlement (ISDS)*, Working Group III (Investor-State Dispute Settlement Reform) Thirty-sixth session Vienna, October 29–November 2, 2018, A/CN.9/WG.III/WP.149, at pp. 31-32.

12. In July 2023, UNCITRAL approved the finalization of guidance in two areas: a code of conduct for arbitrators[73] and a model[74] and guidelines[75] to promote the use of mediation an alternative dispute resolution mechanism. The code of conduct sets out ethical rules for arbitrators involved in international investment disputes. It seeks to promote the integrity of the ISDS process and reduce conflicts of interest. Its key provisions reinforce the duty of independence and impartiality of arbitrators (avoid conflicting loyalties or taking instruction from outside persons regarding a case), broaden the requirements to disclose any potential conflicts of interest, and restricts the practice of "double-hatting", by which an individual acts in two different roles in ISDS cases simultaneously or within a short time period (for example, acting as an arbitrator and a counsel simultaneously), a practice that appears to be quite prevalent[76].

13. The model provisions on mediation seek to encourage the use of mediation for resolving international investment disputes amicably. Recommended for inclusion in investment treaties, the model provisions allow parties to exercise control over the mediation process to reach a mutually acceptable outcome. The Guidelines provide practical guidance to parties on the use of mediation by listing and briefly describing issues that should be considered when undertaking investment mediation. The model provisions stipulate that the parties may engage in mediation at any time, including after the commencement of any other dispute resolution proceeding. Where mediation is agreed upon after the commencement of an ISDS process, the latter must be suspended until the termination of mediation.

14. The work of WG3 is on-going and specific recommendations in other areas are expected to be presented in the future.

[73] UNICTRAL (2023), *UNCITRAL Code of Conduct for Arbitrators in International Investment Dispute Resolution*. United Nations, New York and Geneva.
[74] UNICTRAL (2023), *UNCITRAL Model Provisions on Mediation for International Investment Disputes.* United Nations, New York and Geneva.
[75] UNICTRAL (2023), *UNCITRAL Guidelines on Mediation for International Investment Disputes*. United Nations, New York and Geneva.
[76] In about 47% of ISDS cases, at least one of the appointed arbitrators was simultaneously acting as legal counsel in at least one other ISDS proceeding. See World Bank Group (2021), International Centre for Settlement of International Disputes, *Code of Conduct – Background Papers: Double-Hatting*, available at: https://icsid.worldbank.org/sites/default/files/Background_Papers_Double-Hatting_(final)_2021.02.25.pdf

Annex 3

Categories of Taxation Articles

While there exist many different ways to codify the treatment of taxation matters in IIAs, it is possible to sort out taxation articles in broad categories, according the basic design approach that they adopt. Three main categories can be identified: targeted tax exclusion, broad tax exclusion and complete or near complete tax exclusion. The following provides a description of the defining characteristics of each approach.

1. Targeted Tax Exclusion

Basic approach

Under this approach, the default position is that the obligations of the IIA **do apply to taxation measures**, except as provided for in the article.

Typical content of tax article

- Definition of terms used in the article;
- Interpretation of the NT obligation as it applies to taxation measures; for example, it is specified that distinctions based on residence are acceptable;
- Clarification that the agreement does not prevent the imposition of anti-avoidance measures;
- Exclusion of advantages granted under DTAs from the scope of the MFN obligation;
- Coordination of the jurisdiction of the IIAs with relevant DTAs (i.e., stipulating that a DTA prevails over the IIA in case of conflict); this is supplemented by a procedure (filter) requiring tax experts to determine, in specific cases, whether there exists an inconsistency between both agreements.

Pros

- The treatment of taxation is calibrated such that a balance is struck between the necessity to protect tax policy space and the goal of ensuring investment protection.
- Filter(s) grant(s) a formal role to tax officials in the adjudication of important issues before they proceed to ISDS.

Cons

- Unlike other approaches, allegations of a breach of the NT, MFN and FET obligations against an income tax measure may be litigated by an arbitral tribunal under an IIA, subject to the host country invoking in the course of ISDS proceedings the provisions of the taxation article that allows tax laws to make distinctions on the basis of the residence or to enact anti-avoidance measures; thus, some degree of uncertainty as regards the development and implementation of tax policy remains under this approach.

Recent examples of agreements that adopted the approach

- *Advanced Framework Agreement between the European Union and Chile* (signed December 13, 2023);
- *Free Trade Agreement between the European Union and New Zealand* (signed July 9, 2023);
- *Agreement Between the European Union and Japan for an Economic Partnership* (signed on July 17, 2018; came into force on February 1, 2019).

2. Broad Tax Exclusion

Basic approach

Under this approach, the default position is that the obligations of the IIA **do not apply to taxation measures**, except as set out in the article.

Typical content of tax article

- Definition of terms used in the article;
- No obligations of the IIA apply to taxation measures, except as is set out in the article;
- Coordination of the jurisdiction of the IIAs with relevant DTAs (i.e., stipulating that a DTA prevails over the IIA in case of conflict); may be supplemented by a procedure (filter) requiring tax experts to determine, in specific cases, whether there exists an inconsistency between both agreements
- Selected obligations of the IIAs are made to apply in respect of taxation measures. For example, they may include:
  - The NT obligation and the MFN obligation; they may apply in respect of all taxation measures or certain taxes only (e.g., taxes other than direct taxes);
  - The obligations may apply in respect of existing and future taxation measures or only in respect of future taxation measures; in addition, this provision may specify that the obligations do not prevent the adoption or enforcement of new taxation measures aimed at ensuring the equitable or effective imposition or collection of taxes;
  - Other selected provisions may apply in respect of taxation measures, for example, the provisions prohibiting certain performance requirements, and those pertaining to expropriation;
- Exclusion of advantages granted under DTAs from the scope of the MFN obligation; and
- Provision of a filter to allow taxation authorities to determine whether a taxation measure alleged to be an expropriation is, in fact, not an expropriation. A similar filter may be used to mandate that other issues be addressed by taxation authorities. The joint determination of taxation authorities is binding on the arbitral tribunal.

Pros

- No ISDS litigation can take place pursuant to the NT or MFN obligation in respect of taxation measures specifically excluded under the tax article (e.g., existing or existing and future direct taxation measures), thus providing certainty that they are immune from ISDS proceedings.
- Filter(s) grant(s) a role to tax officials in the adjudication of important issues before they proceed to ISDS.

Cons

- May be viewed as less favourable to the objective of investment protection, as certain taxation measures are immune from the application of certain key obligations of the IIA.

Recent examples of agreements that adopted the approach

- *Free Trade Agreement between New Zealand and the United Kingdom of Great Britain and Northern Ireland* (signed on February 28, 2022; entered into force on May 31, 2023);
- *Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and Australia* (signed on December 17, 2021; entered into force on May 31, 2023);
- *Free Trade Agreement Between the Government of the State of Israel and the Government of the Republic of Korea* (signed on May 12, 2021);
- *Agreement between the United States of America, the United Mexican States, and Canada* (USMCA) (signed on December 12, 2019; entered into force on July 1, 2020);
- *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (CPTPP) (signed on March 8, 2018; entered into force on December 30, 2018, in the first six countries to have ratified the agreement: Canada, Australia, Japan, Mexico, New Zealand, and Singapore);
- *Agreement Between the Government of Canada and the Government of the Republic of Moldova for the Promotion and Protection of Investments* (signed on June 12, 2018; entered into force on August 23, 2019).

3. Complete or Near Complete Tax Exclusion

Basic approach

Under this approach, the default provision is that the obligations of the IIA **do not apply to taxation measures**, sometimes with some limited exceptions set out in the article.

- Few, if any, provisions of the IIA apply in respect of taxation measures;
- Typically, taxation measures are fully immune from the NT and MFN obligations
- In some instances, one or more of the following provisions may be applicable in respect of taxation measures: transfers of funds; transparency; and expropriation. In the latter case, the article may include a filter to allow taxation authorities to determine whether a taxation measure alleged to be an expropriation is, in fact, not an expropriation. The joint determination of taxation authorities is binding on the arbitral tribunal.

Pros

- Provides maximum certainty with respect to the goal of protecting tax policy space,

Cons

- Undermines significantly the goal of investment protection, as taxation is effectively removed from the scope of the IIA, thus leaving investors uncertain regarding the theoretical prospect of taxation being used in an abusive manner, without any legal recourse being available under the IIA.

Recent examples of agreements that adopted the approach

- *Comprehensive Economic Partnership Agreement between the Government of the Republic of Indonesia and the Government of the Republic of Korea* (signed on December 18, 2020; entered into force on January 1, 2023);
- *Agreement between Japan and the Kingdom of Bahrain for the Reciprocal Promotion and Protection of Investment* (signed on June 22, 2022; entered into force on September 6, 2023)
- *Agreement Between Australia and the Oriental Republic of Uruguay on the Promotion and Protection of Investments* (signed on April 5, 2019; entered into force on January 27, 2022);
- *Economic Cooperation and Trade Agreement between the Government of the Republic of India and the Government of Australia* (signed on April 2, 2022; entered into force on December 29, 2022);
- *Comprehensive Economic Partnership Agreement between the Republic of Indonesia and the EFTA States* (signed on December 16, 2018; entered into force on November 1, 2021);
- *Investment Cooperation and Facilitation Treaty between the Federative Republic of Brazil and the Republic of India* (signed on January 25, 2020);
- *Investment Agreement Between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the Republic of Chile* (signed on November 18, 2016; entered into force on July 14, 2019);
- *Agreement Between the State of Israel and Japan for the Liberalization, Promotion and Protection of Investment (signed on February 1, 2017; entered into force on October 5, 2017);*

Attachment B.1

Article 25

MUTUAL AGREEMENT PROCEDURE

(1) Changes to Article 25

Article 25 (Alternative A)

(…)

5. For the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

Article 25 (Alternative B)

(…)

6. For the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

(2) Changes to Article 25 Commentary

…. [Deleted text is in strikethrough. New text is in bold italics]

D. INTERACTION BETWEEN THE MUTUAL AGREEMENT PROCEDURE AND THE DISPUTE RESOLUTION MECHANISM OF THE GATS

[Paragraph 5 of Article 25 (Alternative A)/ Paragraph 6 of Article 25 (Alternative B)]

53. In some rare cases, a dispute between countries concerning the application of the national treatment rule of Article XVII of the General Agreement on Trade in Services (GATS) to taxes covered by a tax treaty could lead to both the mutual agreement procedure and the dispute resolution mechanism of the GATS being applicable to address the issue. ~~This problem, the solution adopted in the GATS with respect to tax treaties that existed at the time that it entered in force and a possible solution with respect to subsequent tax treaties are discussed in the following parts of the Commentary on Article 25 of the 2017 OECD Model Tax Convention, which countries may want to take into account when negotiating a tax treaty:~~

> ~~88. The application of the General Agreement on Trade in Services (GATS), which entered into force on 1 January 1995 and which all member countries have signed, raises particular concerns in relation to the mutual agreement procedure.~~
>
> ~~89. Paragraph 3 of Article XXII of the GATS provides that a dispute as to the application of Article XVII of the Agreement, a national treatment rule, may not be dealt with under the dispute resolution mechanisms provided by Articles XXII and XXIII of the Agreement if the disputed measure "falls within the scope of an international agreement between them relating to the avoidance of double taxation" (e.g. a tax convention). If there is disagreement over whether a measure "falls within the scope" of such an international agreement, paragraph 3 goes on to provide that either State involved in the dispute may bring the matter to the Council on Trade in Services, which shall refer the dispute for binding arbitration. A footnote to paragraph 3, however, contains the important exception that if the dispute relates to an international agreement "which exist[s] at the time of the entry into force" of the Agreement, the matter may not be brought to the Council on Trade in Services unless both States agree.~~
>
> ~~90. That paragraph raises two particular problems with respect to tax treaties.~~

54. The negotiation of the GATS raised concerns that certain tax measures that differentiated based on taxpayer residency could breach the national treatment obligation contained in Article XVII of the GATS. To remedy potential conflicts, Article XIV of the GATS allows measures that diverge from the national treatment provision if such differences aim to ensure "equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members". A specific footnote to this article provides examples of measures that meet the "equitable or effective" criteria.

55. Additionally, Article XXII, paragraph 3, of the GATS stipulates that a Member cannot invoke Article XVII under the dispute resolution mechanisms provided by Articles XXII and XXIII in relation to a measure covered by a bilateral double taxation agreement. Should there be a dispute over whether a measure falls under such an agreement, either Member may seek resolution through the Council for Trade in Services, which shall refer the matter to arbitration. Notably, a footnote indicates that for double taxation agreements in existence as of the date of entry into force of the GATS - January 1, 1995- this recourse is only available with both parties' consent.

56. That GATS paragraph and its related footnote introduced two critical issues concerning tax treaties. First, the different treatment of tax agreements established before and after the GATS entry into force could be seen as inappropriate, in particular where a convention in existence at the time of the entry into force of the GATS is subsequently renegotiated or where a protocol is concluded after that time in relation to a convention existing at that time. Second, the term "falls within the scope" is ambiguously defined, leading to potential disputes on its interpretation. as indicated by the inclusion in paragraph 3 of Article XXII of the GATS of both an arbitration procedure and a clause exempting pre-existing conventions from its application in order to deal with disagreements related to its meaning. Whilst it seems clear that a country could not argue in good faith[1] that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is not clear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.

57. To mitigate these complications, the Commentary on Article 25 of this Model (from 2001 – quoting the OECD Model discussion first seen in the equivalent Commentary from 1995) proposed an optional provision with the aim to extend the grandfathering protection of pre-1995 treaties provided for in the footnote to paragraph 3 of Article XXII of the GATS, to those concluded or modified after the GATS came into effect. The proposed provision was the same in both Models:

> ***For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.***

58. Accordingly, under this provision, disputes about the scope of a convention would require mutual consent for referral to the WTO Council for Trade in Services. This approach was endorsed in the Commentary on Article 25 of this Model from 2001 until its 202[5] version.

> ~~94. Problems similar to those discussed above may arise in relation with other bilateral or multilateral agreements related to trade or investment. Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with~~

[1] The obligation of applying and interpreting treaties in good faith is expressly recognized in Articles 26 and 31 of the *Vienna Convention on the Law of Treaties*; thus, the exception in paragraph 3 of Article XXII of the GATS applies only to good faith disputes.

~~through the mutual agreement procedure rather than through the dispute settlement mechanism of such agreements.~~

59. In 202[5], the Committee decided to amend Article 25 to include in the text of Article 25 itself the provision referred in the preceding paragraph, with no substantive amendments. It would be paragraph 5 in Alternative A of Article 25 and paragraph 6 of Alternative B. In making this change, the Committee recognized the need for a clear, consistent framework to address potential issues arising from the interaction between tax treaties and the GATS. The inclusion of the GATS clause in the Article itself was in response to concerns that providing the text of the GATS provision in the Commentary alone does not sufficiently promote solution of the identified potential issues.

60. In making this change, the Committee noted that this provision was not being included in tax treaties to the extent that might be expected. In the view of the Committee, integrating the GATS provision into the text would raise the profile of a solution already provided in both the UN and OECD Models. The Committee considered that the provision's presence in the Article itself would encourage discussion of the treaty interaction issue before and during treaty negotiations, and is likely to lead to wider adoption across jurisdictions, recognizing the importance of the UN Model Tax Convention in tax treaty negotiations, especially for developing countries. In light of these considerations, the Committee deemed it prudent to elevate the GATS provision, establishing it as a standard element of the text of Article 25. It is important to note, however, that the supporting reasons for such a provision are essentially stated in the same way under the UN Model and OECD Model Commentaries.

A possible "extended provision"

61. Problems similar to those discussed above may arise in relation to other bilateral or multilateral agreements related to trade or investment. As has been noted in previous versions of both the UN and OECD Model Commentaries to Article 25, Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure, or otherwise, under the tax convention, rather than through the dispute settlement mechanism of such agreements.

62. In 202[5] the Committee decided to include the following specific clause in the Commentary on Article 25 as an option to address the relationship of tax treaties to bilateral or multilateral agreements related to trade or investment.

> ***A taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties, and any dispute over whether a taxation measure taken by a Contracting State is in accordance with this Convention, or whether***

the measure falls within the scope of the Convention, shall be settled only under the Convention. As respects any other dispute over a taxation measure, or as to whether a measure is a taxation measure, the settlement of such dispute shall, unless the competent authorities of the Contracting States agree otherwise, be undertaken without regard to any dispute resolution arrangements under [Variant A: any other treaty of which the Contracting States are, or become, parties. Variant B: [such treaties as are agreed to be covered through bilateral negotiations].]

63. The inclusion of a drafting option to specifically address interactions with other agreements was a response to the complex and multi-dimensional network of trade, investment and related treaties (such as so-called "Free Trade Agreements" or "Trade and Investment Agreements") that countries are increasingly entering into.

64. With that background, the purpose of this paragraph ("the extended provision") is to ensure that tax disputes, whether or not they relate to a Double Taxation Convention ~~(Convention~~, do not become subject to a dispute resolution procedure under an International Investment Agreement (IIA) – being an investment agreement or other treaty that, in whole or part, addresses international investment. Where a dispute could be settled under the Convention, it must be settled only under that Convention. In the case of any other dispute, it is to be settled without recourse to dispute resolution arrangements under IIAs (unless the competent authorities agree otherwise).

65. Some Contracting Parties may regard this provision as rendering a specific GATS clause unnecessary. Others may prefer to follow the established wording in relation to GATS, in which case that provision should be expressed as applying notwithstanding the extended provision or else the extended provision should be expressed as subject to the operation of the GATS clause.

66. The extended provision comprises two sentences, each of which has its own separate focus: The first sentence sets out that disputes in relation to the scope and correct application of the Convention are to be settled solely ("only") under that Convention and the second sentence then restricts recourse to dispute settlement arrangements under IIAs.

First sentence of the extended provision

67. The first part of the first sentence, which provides that a taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties has a number of purposes:

- ***If a tax-related measure that is taken by the State is in accordance with the Convention relevant to the investor making a claim, then the lines concerned***

exclude any possibility that it could, nevertheless, be construed as contravening or breaching any provision of an IIA.

- ***Clearly, to be "in accordance with" a Convention, a measure must involve a tax covered by Article 2 of the Convention; or, where relevant, covered by paragraph 6 of Article 24 or paragraph 1 of Article 26 ("taxes of every kind and description"). Accordingly, the scope of "taxation measures" encompassed by this first sentence will, as respects the type of tax involved, be determined by the provisions of the Convention concerned.***

- ***By providing that there can be no breach of an IIA if the measure concerned is in accordance with the provisions of the Convention, the first two lines will channel all claims under IIAs, in the first instance, into a consideration of whether the measure concerned is in accordance with the Convention.***

68. Providing that a measure is deemed not to breach an IIA if that measure is aligned with the Convention ensures that consideration under the Convention is a mandatory requirement for all investor claims - and this gives context to what is set out in the second half of the first sentence.

69. The second part of the first sentence provides that every dispute about whether a measure is aligned with a Convention, or within the scope of the Convention, must be determined or settled solely ("only") under the Convention. Settlement under the Convention means settlement taking account of the provisions of that Convention. This could, but need not, be through a Mutual Agreement procedure —and, in many cases, would be a determination by the Courts of the Contracting State whose measure is alleged not to be in accordance with, or within the scope of, the Convention concerned.

70. Accordingly, disputes within the scope of the Convention will stay within a process of determination and settlement governed by the provisions of the Convention. It should be noted that in such instances, it is not just the arrangements for dispute settlement under an IIA that are inapplicable: None of the provisions of the IIA will be applicable to the case and the dispute will be decided solely under the provisions of the Convention. Further, no discretion is given to the competent authorities to allow disputes that are within the scope of the Convention to be dealt with otherwise than under that Convention.

Second sentence of the extended provision

71. Disputes over taxation measures could fall outside the scope of the relevant Convention for various reasons, including the following (as possible examples only):

- ***The Convention could be silent in relation to the alleged IIA breach— in the sense that the Convention Articles might include no provision, on the basis of***

which the disputed claim could be determined— for instance, a claim that a generally applicable increase in a tax rate represents an expropriation.

- ***The disputed claim could involve an indirect tax, in a context in which the Convention does not apply to indirect taxes.***
- ***A dispute in relation to administrative actions that are the subject of a claim might not come within the scope of the Convention.***

72. As respects any dispute over a taxation measure that cannot be settled under the relevant Convention, the second sentence prohibits a claimant from recourse to dispute resolution arrangements under other treaties. The purpose of the second sentence is to prevent the involvement of such arrangements in the settlement of disputes in relation to tax measures, where such disputes cannot be settled under the Convention.

73. Having so provided, the second sentence goes no further to limit the modes of settlement of such disputes. The investor may bring its case to the relevant courts, claiming a breach of the IIA concerned, or to any tribunal seized with such matters— but not to any dispute settlement arrangements provided under an IIA.

74. It should be noted that the prohibition or exclusion refers only to the dispute settlement arrangements under an IIA. The restriction or exclusion does not extend to the substantive provisions of an IIA— and an investor will remain entitled to invoke the protections set out in such provisions in making its claim to the Courts. Accordingly, while the second sentence disapplies IIA procedural provisions, the substantive IIA provisions are unaffected by this second leg of the extended provision.

75. In the case of disputes that cannot be settled under the Convention (second-sentence disputes), the competent authorities have discretion to allow recourse to the IIA dispute settlement arrangements— but only if the competent authorities both agree to permit such recourse. The prohibition will apply if there is no agreement between the competent authorities to exercise their discretion to allow the use of the IIA dispute settlement arrangement.

76. The second sentence also recognizes the possibility of a dispute about whether a measure is actually a tax measure. A possible example might be in a case where the tax elements of a measure might not be readily separated from more significant non-tax elements of a State action: A claimant might wish to dispute the identification of the measure as a tax measure and if there were no reference to such disputes in the provision an IIA forum could effectively disapply the whole provision by determining the measure was not a tax measure. However, such a dispute cannot be brought to the IIA dispute settlement arrangements (unless both competent authorities are agreeable to submission of the matter to such a forum).

77. The provision provides two options as to its operation, a more general coverage, and a more targeted or specific coverage.

Variant A – general operation

78. This text represents the preference of some Members for a very broad application of the prohibition of recourse to dispute settlement arrangements under IIAs. Any "other treaty" would be any treaty, such as bilateral or multilateral treaties, other than the Convention concerned. Such a broad coverage would, of course, only be possible with the agreement, in principle, of the other Contracting State concerned.

79. A notable aspect of Variant A is that it would provide for its effect to extend to treaties agreed subsequently to the agreement of the Convention (or protocol to the Convention) concerned. As the interaction of treaties that appear to be in conflict and that have been entered into at different times can be a complex issue, it may be prudent to take advice on the operation in practice of this aspect of the provision.

Variant B – more specific operation

80. Variant B has a more targeted approach that would involve identifying relevant existing bilateral or multilateral treaties, access to the dispute settlement arrangements of which would be restricted under the extended provision. The treaties concerned would be identified through negotiation by the Contracting States.

81. On the agreement of an actual bilateral tax Convention, the italicized brackets and text of Variant B would be replaced by the identified treaties.

82. If the extended provision is adopted in a Convention that already contains the GATS clause as paragraph 5 or 6 of its Mutual Agreement Procedure Article, the words "Notwithstanding paragraph [6/7]", i.e. notwithstanding the paragraph of that Article containing the extended provision, should be added at the start of the GATS clause paragraph if the Contracting States intend that the GATS clause should continue to operate unaffected by the extended provision.

Views of Members not favouring the extended provision

83 … [Expression of views by those opposed to the provision to be added]

The importance of whole of government approaches

84. The Committee noted that countries proposing a broader provision should carefully evaluate the potential issues arising from the interaction of such broader provision with their specific network of bilateral and multilateral agreements, in accordance with international law as well as any constitutional or other legal impediments. This, including consultation with other relevant departments or ministries, would be

important for avoiding misunderstandings and inconsistencies and for ensuring the effectiveness over time of any such provisions.

Attachment B.2

Article 25

MUTUAL AGREEMENT PROCEDURE

(1) Changes to Article 25

Article 25 (Alternative A)

(…)

5. [Notwithstanding paragraph 6, for] [F]or the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph 3, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

6. A taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties, and any dispute over whether a taxation measure taken by a Contracting State is in accordance with this Convention, or whether the measure falls within the scope of the Convention, shall be settled only under the Convention. As respects any other dispute over a taxation measure, or as to whether a measure is a taxation measure, the settlement of such dispute shall, unless the competent authorities of the Contracting States agree otherwise, be undertaken without regard to any dispute resolution arrangements under [Variant A: any other treaty of which the Contracting States are, or become, parties. Variant B: *[such treaties as are agreed to be covered through bilateral negotiations]*.]

Article 25 (Alternative B)

(…)

6. [Notwithstanding paragraph 6, for] [F]or the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph 3, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

7. A taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties, and any dispute over whether a taxation measure taken by a Contracting State is in accordance with this Convention, or whether the measure falls within the scope of the Convention, shall be settled only under the Convention. As respects any other dispute over a taxation measure, or as to whether a measure is a taxation measure, the settlement of such dispute shall, unless the competent authorities of the Contracting States agree otherwise, be undertaken without regard to any dispute resolution arrangements under [Variant A: any other treaty of which the Contracting States are, or become, parties. Variant B: *[such treaties as are agreed to be covered through bilateral negotiations]*.]

(2) Changes to Article 25 Commentary

…. [Deleted text is in strikethrough. New text is in bold italics]

D. INTERACTION BETWEEN THE MUTUAL AGREEMENT PROCEDURE AND THE DISPUTE RESOLUTION MECHANISM OF THE GATS

[Paragraph 5 of Article 25 (Alternative A)/ Paragraph 6 of Article 25 (Alternative B)]

53. In some rare cases, a dispute between countries concerning the application of the national treatment rule of Article XVII of the General Agreement on Trade in Services (GATS) to taxes covered by a tax treaty could lead to both the mutual agreement procedure and the dispute resolution mechanism of the GATS being applicable to address the issue. ~~This problem, the solution adopted in the GATS with respect to tax treaties that existed at the time that it entered in force and a possible solution with respect to subsequent tax treaties are discussed in the following parts of the Commentary on Article 25 of the 2017 OECD Model Tax Convention, which countries may want to take into account when negotiating a tax treaty:~~

> ~~88. The application of the General Agreement on Trade in Services (GATS), which entered into force on 1 January 1995 and which all member countries have signed, raises particular concerns in relation to the mutual agreement procedure.~~
>
> ~~89. Paragraph 3 of Article XXII of the GATS provides that a dispute as to the application of Article XVII of the Agreement, a national treatment rule, may not be dealt with under the dispute resolution mechanisms provided by Articles XXII and XXIII of the Agreement if the disputed measure "falls within the scope of an international agreement between them relating to the avoidance of double taxation" (e.g. a tax convention). If there is disagreement over whether a measure "falls within the scope" of such an international agreement, paragraph 3 goes on to provide that either State involved in the dispute may bring the matter to the Council on Trade in Services, which shall refer the dispute for binding arbitration. A footnote to paragraph 3, however, contains the important exception that if the dispute relates to an international agreement "which exist[s] at the time of the~~

~~entry into force" of the Agreement, the matter may not be brought to the Council on Trade in Services unless both States agree.~~

~~90. That paragraph raises two particular problems with respect to tax treaties.~~

54. The negotiation of the GATS raised concerns that certain tax measures that differentiated based on taxpayer residency could breach the national treatment obligation contained in Article XVII of the GATS. To remedy potential conflicts, Article XIV of the GATS allows measures that diverge from the national treatment provision if such differences aim to ensure "equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members". A specific footnote to this article provides examples of measures that meet the "equitable or effective" criteria.

55. Additionally, Article XXII, paragraph 3, of the GATS stipulates that a Member cannot invoke Article XVII under the dispute resolution mechanisms provided by Articles XXII and XXIII in relation to a measure covered by a bilateral double taxation agreement. Should there be a dispute over whether a measure falls under such an agreement, either Member may seek resolution through the Council for Trade in Services, which shall refer the matter to arbitration. Notably, a footnote indicates that for double taxation agreements in existence as of the date of entry into force of the GATS - January 1, 1995- this recourse is only available with both parties' consent.

56. Article XXII, paragraph 3, of the GATS and its related footnote introduced two critical issues concerning tax treaties. First, the different treatment of tax agreements established before and after the GATS entry into force could be seen as inappropriate, in particular where a convention in existence at the time of the entry into force of the GATS is subsequently renegotiated or where a protocol is concluded after that time in relation to a convention existing at that time. Second, the term "falls within the scope" is ambiguously defined, leading to potential disputes on its interpretation. as indicated by the inclusion in paragraph 3 of Article XXII of the GATS of both an arbitration procedure and a clause exempting pre-existing conventions from its application in order to deal with disagreements related to its meaning. Whilst it seems clear that a country could not argue in good faith[1] that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is not clear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.

57. To mitigate these complications, the Commentary on Article 25 of this Model (from 2001 – quoting the OECD Model discussion first seen in the equivalent Commentary from 1995) proposed an optional provision with the aim to extend the grandfathering protection of pre-1995 treaties provided for in the footnote to paragraph 3 of Article XXII of the GATS, to those concluded or modified after the GATS came into effect. The proposed provision was the same in both Models:

[1] The obligation of applying and interpreting treaties in good faith is expressly recognized in Articles 26 and 31 of the *Vienna Convention on the Law of Treaties*; thus, the exception in paragraph 3 of Article XXII of the GATS applies only to good faith disputes.

> ***For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.***

58. Accordingly, under this provision, disputes about the scope of a convention would require mutual consent for referral to the WTO Council for Trade in Services. This approach was endorsed in the Commentary on Article 25 of this Model from 2001 until its 202[5] version.

> ~~94. Problems similar to those discussed above may arise in relation with other bilateral or multilateral agreements related to trade or investment. Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure rather than through the dispute settlement mechanism of such agreements.~~

59. In 202[5], the Committee decided to amend Article 25 to include in the text of Article 25 itself the provision referred in the preceding paragraph, with no substantive amendments. It would be paragraph 5 in Alternative A of Article 25 and paragraph 6 of Alternative B. In making this change, the Committee recognized the need for a clear, consistent framework to address potential issues arising from the interaction between tax treaties and the GATS. The inclusion of the GATS clause in the Article itself was in response to concerns that providing the text of the GATS provision in the Commentary alone does not sufficiently promote solution of the identified potential issues.

60. In making this change, the Committee noted that this provision was not being included in tax treaties to the extent that might be expected. In the view of the Committee, integrating the GATS provision into the text would raise the profile of a solution already provided in both the UN and OECD Models. The Committee considered that the provision's presence in the Article itself would encourage discussion of the treaty interaction issue before and during treaty negotiations, and is likely to lead to wider adoption across jurisdictions, recognizing the importance of the UN Model Tax Convention in tax treaty negotiations, especially for developing countries. In light of these considerations, the Committee deemed it prudent to elevate the GATS provision, establishing it as a standard element of the text of Article 25. It is important to note, however, that the supporting reasons for such a provision are essentially stated in the same way under the UN Model and OECD Model Commentaries.

[Paragraph 6 of Article 25 (Alternative A)/ Paragraph 7 of Article 25 (Alternative B)]

61. Problems similar to those discussed above may arise in relation to other bilateral or multilateral agreements related to trade or investment. As has been noted in previous versions of both the UN and OECD Model Commentaries to Article 25, Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure, or otherwise, under the tax convention, rather than through the dispute settlement mechanism of such agreements.

62. In 202[5] the Committee decided to include a specific clause in Article 25 as an option to address the relationship of tax treaties to bilateral or multilateral agreements related to trade or investment. This comprises paragraph 6 of Article 25 (Alternative A) and paragraph 7 of Article 25 (Alternative B).

63. The inclusion of a provision specifically addressing interactions with other agreements was a response to the complex and multi-dimensional network of trade, investment and related treaties (such as so-called "Free Trade Agreements" or "Trade and Investment Agreements") that countries are increasingly entering into.

64. With that background, the purpose of this paragraph ("the extended provision") is to ensure that tax disputes, whether or not they relate to a Double Taxation Convention, do not become subject to a dispute resolution procedure under an International Investment Agreement (IIA) – being an investment agreement or other treaty that, in whole or part, addresses international investment. Where a dispute could be settled under the Convention, it must be settled only under that Convention. In the case of any other dispute, it is to be settled without recourse to dispute resolution arrangements under IIAs (unless the competent authorities agree otherwise).

65. Some Contracting Parties may regard this provision as rendering a specific GATS clause unnecessary. Others may prefer to follow the established wording in relation to GATS, in which case that provision should be expressed as applying notwithstanding the extended provision.

66. The extended provision comprises two sentences, each of which has its own separate focus: The first sentence sets out that disputes in relation to the scope and correct application of the Convention are to be settled solely ("only") under that Convention and the second sentence then restricts recourse to dispute settlement arrangements under IIAs.

First sentence of the extended provision

67. The first part of the first sentence, which provides that a taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties has a number of purposes:

- ***If a tax-related measure that is taken by the State is in accordance with the Convention relevant to the investor making a claim, then the lines concerned exclude any possibility that it could, nevertheless, be construed as contravening or breaching any provision of an IIA.***

- ***Clearly, to be "in accordance with" a Convention, a measure must involve a tax covered by Article 2 of the Convention; or, where relevant, covered by paragraph 6 of Article 24 or paragraph 1 of Article 26 ("taxes of every kind and description"). Accordingly, the scope of "taxation measures" encompassed by this first sentence will, as respects the type of tax involved, be determined by the provisions of the Convention concerned.***

- ***By providing that there can be no breach of an IIA if the measure concerned is in accordance with the provisions of the Convention, the first two lines will channel all claims under IIAs, in the first instance, into a consideration of whether the measure concerned is in accordance with the Convention.***

68. Providing that a measure is deemed not to breach an IIA if that measure is aligned with the Convention ensures that consideration under the Convention is a mandatory requirement for all investor claims - and this gives context to what is set out in the second half of the first sentence.

69. The second part of the first sentence provides that every dispute about whether a measure is aligned with a Convention, or within the scope of the Convention, must be determined or settled solely ("only") under the Convention. Settlement under the Convention means settlement taking account of the provisions of that Convention. This could, but need not, be through a Mutual Agreement procedure —and, in many cases, would be a determination by the Courts of the Contracting State whose measure is alleged not to be in accordance with, or within the scope of, the Convention concerned.

70. Accordingly, disputes within the scope of the Convention will stay within a process of determination and settlement governed by the provisions of the Convention. It should be noted that in such instances, it is not just the arrangements for dispute settlement under an IIA that are inapplicable: None of the provisions of the IIA will be applicable to the case and the dispute will be decided solely under the provisions of the Convention. Further, no discretion is given to the competent authorities to allow disputes that are within the scope of the Convention to be dealt with otherwise than under that Convention.

Second sentence of the extended provision

71. Disputes over taxation measures could fall outside the scope of the relevant Convention for various reasons, including the following (as possible examples only):

- ***The Convention could be silent in relation to the alleged IIA breach— in the sense that the Convention Articles might include no provision, on the basis of***

which the disputed claim could be determined— for instance, a claim that a generally applicable increase in a tax rate represents an expropriation.

- ***The disputed claim could involve an indirect tax, in a context in which the Convention does not apply to indirect taxes.***
- ***A dispute in relation to administrative actions that are the subject of a claim might not come within the scope of the Convention.***

72. As respects any dispute over a taxation measure that cannot be settled under the relevant Convention, the second sentence prohibits a claimant from recourse to dispute resolution arrangements under other treaties. The purpose of the second sentence is to prevent the involvement of such arrangements in the settlement of disputes in relation to tax measures, where such disputes cannot be settled under the Convention.

73. Having so provided, the second sentence goes no further to limit the modes of settlement of such disputes. The investor may bring its case to the relevant courts, claiming a breach of the IIA concerned, or to any tribunal seized with such matters— but not to any dispute settlement arrangements provided under an IIA.

74. It should be noted that the prohibition or exclusion refers only to the dispute settlement arrangements under an IIA. The restriction or exclusion does not extend to the substantive provisions of an IIA— and an investor will remain entitled to invoke the protections set out in such provisions in making its claim to the Courts. Accordingly, while the second sentence disapplies IIA procedural provisions, the substantive IIA provisions are unaffected by this second leg of the extended provision.

75. In the case of disputes that cannot be settled under the Convention (second-sentence disputes), the competent authorities have discretion to allow recourse to the IIA dispute settlement arrangements— but only if the competent authorities both agree to permit such recourse. The prohibition will apply if there is no agreement between the competent authorities to exercise their discretion to allow the use of the IIA dispute settlement arrangement.

76. The second sentence also recognizes the possibility of a dispute about whether a measure is actually a tax measure. A possible example might be in a case where the tax elements of a measure might not be readily separated from significant non-tax elements of a State action: A claimant might wish to dispute the identification of the measure as a tax measure, and if there were no reference to such disputes in the provision an IIA forum could effectively disapply the whole provision by determining the measure was not a tax measure. However, such a dispute cannot be brought to the IIA dispute settlement arrangements unless both competent authorities are agreeable to submission of the matter to such a forum.

77. The provision provides two variants as to its operation, a general coverage, and a targeted or specific coverage.

Variant A – general operation

78. This text represents the preference of some Members for a very broad application of the prohibition of recourse to dispute settlement arrangements under IIAs. Any "other treaty" would be any treaty, such as bilateral or multilateral treaties, other than the Convention concerned. Such a broad coverage would, of course, only be possible with the agreement, in principle, of the other Contracting State concerned.

79. A notable aspect of Variant A is that it would provide for its effect to extend to treaties agreed subsequently to the agreement of the Convention (or protocol to the Convention) concerned. As the interaction of treaties that appear to be in conflict and that have been entered into at different times can be a complex issue, it may be prudent to take advice on the operation in practice of this aspect of the provision.

Variant B – more specific operation

80. Variant B has a more targeted approach that would involve identifying relevant existing bilateral or multilateral treaties, access to the dispute settlement arrangements of which would be restricted under the extended provision. The treaties concerned would be identified through negotiation by the Contracting States.

81. On the agreement of an actual bilateral tax Convention, the italicized brackets and text of Variant B would be replaced by the identified treaties.

Views of Members not favouring the extended provision

82 … [Expression of views by those opposed to the provision to be added]

The importance of whole of government approaches

83. The Committee noted that countries proposing a broader provision should carefully evaluate the potential issues arising from the interaction of such broader provision with their specific network of bilateral and multilateral agreements, in accordance with international law as well as any constitutional or other legal impediments. This, including consultation with other relevant departments or ministries, would be important for avoiding misunderstandings and inconsistencies and for ensuring the effectiveness over time of any such provisions.