International Protection of Foreign Investors in the Matters of Taxation: Apprehension of the Vodafone Case

Shahrima Tanjin Arni
Student of LL.M.
Department of Law, University of Dhaka

Abstract

Bilateral Investment Treaties are both a by-product of and a driver of the significant rise in international investments in the last five decades. These treaties are regularly evaluating the actions of tax authorities in the host states, frequently protecting the foreign investor against host country's uncertain tax administration. Since the power to tax hits at the root of what makes a sovereign authority a sovereign, restrictions on the ability to tax foreign investors threaten that sovereign's very essence. As such, tax provisions in investment agreements, their adjudication and enforcement must be delicately analyzed to protect the sovereign rights of governments to assess and compute tax, to advance their tax policies, and administer the laws of their countries in the best interests of their people and to safeguard the investors against arbitrary and colluded actions not pertaining to international standards. This Article explores significance of the issue in the wake of the Vodafone case, demonstrates the current use of BITs to restrict governments' ability to assess and collect tax within their borders and the international threshold developed by tribunals. The Article reaches at a conclusion that the external regulation of taxation through international investment mechanism is allowed only within the permissible ambit of clarity, transparency, apprehension and rational developed under international law.

1. Introduction

During the second half of 2020, on 25 September, the Permanent Court of Arbitration ("PCA") at the Hague declared that India had breached its obligations under the India-Netherlands Bilateral Investment Treaty ("BIT") (1995)[1] by declaring $2.2 billion tax liability from Vodafone.[2] The cause of action, which commenced in February, 2007 has constantly been a subject matter of debate, national and international dispute and deliberation etc. In terms of the foreign investors', this incident offers a blatant indication to the impeding tax risks and high costs of doing business in India and illustrates how the weak tax structure of the host country can result in a cumbersome cost to both buyers and sellers.[3] Alternatively for the host countries, it is a matter of great economic concern as it undermines the investment friendly environment that the

[1] Agreement between the Republic of India and the Kingdom of the Netherlands for the promotion and protection of investments (1995); available at: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1584/download

[2] ET Bureau, '*Vodafone retro tax case: All you need to know*', Economic Times, India, 25 December, 2020; available at: https://telecom.economictimes.indiatimes.com/news/vodafone-retro-tax-case-all-you-need-to-know/79953553

[3] Troutman Pepper, '*Top 10 lessons learned from the Vodafone, Aditya Birla and other tax cases in India*', Lexology, 29 September, 2011; available at: https://www.lexology.com/library/detail.aspx?g=19568ef4-95d4-4c41-8cfe-4cc2d02e85c5

investors expect and creates an overall setback for foreign investment in the country. However, the decision raises a substantial question which requires jurisprudential analysis and scrutiny. That is, whether BITs take away the right of the host countries to legislate, regulate and control the taxation of foreign investors and their enterprises or transactions and deals entered into by them. This article aims to find an answer to the question raised through an appraisal of the BIT texts, different international standard of protections for investors and different decisions by arbitral tribunals on similar matter. Superficially, this article intends to strike a balance between the investor protection standards and the host states' sovereign right to regulate taxation within its territory based on the global debates and concerns which has evolved before and after the decision in the *Vodafone International Holdings BV v India* ("the Vodafone case").

2. The Vodafone Case

2.1. Preliminary Facts

Hutchison Telecommunication International Limited ("Hutch"), a Hong Kong based company, indirectly owns Hutchison Essar Limited ("HEL") through a series of holding companies in the Cayman Islands and Mauritius including one named CGP Investments (Holdings) Ltd ("CGP"), which approximately held 52% of the share capital of HEL.[4] The trouble started back in February 2007 when Vodafone International Holdings ("VIH"), an Amsterdam-based subsidiary of the UK-based Vodafone group purchased all shares of CGP from Hutch and closed transaction in May.[5] As Hutch owned HEL in India trough CGP, Vodafone's acquisition of CGP resulted in acquiring majority shares of HEL in India by Vodafone. In September 2007, the Indian tax authorities issued a notice to Vodafone to explain as to why it should not be treated as an 'assesse-in-default' for nonpayment of tax on the share purchase price and subsequently, the Indian tax authorities initiated legal proceedings against Vodafone for failing to pay withhold tax on the purchase price amounting to a tax liability of approximately US$2.5 billion.[6]

2.2. Decision of Indian Courts

The matter was heard by the Bombay High Court in 2008. In 2010, it ruled in favor of the Income Tax Department. The rationale being that, "*the transaction was not a mere transfer of shares of a foreign company, but in reality a transfer of a compendium of rights, including effective control and management, which constituted the totality of Hutch's rights into an Indian company"*.[7] Later in 2012, the Supreme Court turned the High Court judgment, stating that the transaction in fact was in the nature of a share sale and not sell of asset.[8]

2.3. The Notorious Amendment of the Income Tax Act

The Supreme Court's judgment caused an administrative grievance and prompted the amendment of the Income Tax Act in March 2012 to restructure the taxation procedure in cases of income arising from the sale of shares. The amendment stated that, "*the income arising from*

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[4] V. Venkatesan, '*The Vodafone Setback at The Hague Is a Serious Loss of Face for India*', The Wire, New Delhi, 28 September, 2020; available at: https://thewire.in/law/interview-surajit-mazumdar-vodafone-india-tax-liability-hague-arbitration
[5] *ibid*
[6] *ibid*
[7] Prabhash Ranjan and Pushkar Anand, '*Vodafone Versus India – BIT by BIT, International Arbitration Becomes Clearer*', The Wire, India, 17 may, 2018; available at: https://thewire.in/business/vodafone-versus-india-bit-international-arbitration
[8] *ibid*

the sale of shares or units shall be deemed to accrue or arise in India even if the transaction had taken place outside India but its value depended primarily on assets in India".[9] The amendment retrospectively resulted in overruling of the Supreme Court's judgment, restoring the tax liability of Vodafone as demanded by the income tax authority leaving Vodafone with no option but to invoke international arbitration.

2.4. Arbitration & Award

The PCA found that India's action flowing from the 2012 Supreme Court was in breach of the fair and equitable treatment ("FET") standard laid down and guaranteed in Article 4(1) of the India-Netherlands BIT (1995).[10] According to the award, India is obliged to withdraw the impugned action and the PCA warned that failure to comply with such obligation will engage "international responsibility".[11] The arbitration award followed by the Indian Supreme Court's decision triggered a nationwide debate regarding the issue of effective control of host state over taxation in order to secure financial interest of the country.

International Investment Law academics including Surajit Mazumdar observed that[12], "the delinking of the share transfer from the transfer of control over real capital assets by the Supreme Court in 2012 which allowed it to treat that transfer as an offshore transaction and outside the jurisdiction of Indian tax authorities, in effect gave 'favourable' treatment to foreign investment and thereby also reinforced incentives for domestic investors to use the round-tripping method to reduce tax burdens". Whereas academics including Dr. Prabhash Ranjan and others noted that[13], the decision of the tribunal ruptures the myth that as the amendment to the law has not been declared unconstitutional, it doesn't violate India's obligations under International Law. He added that, the sovereign right of taxation must be exercised in a manner consistent with the standards set by International Law and that promoting legal certainty and safeguarding rule of law are significant drivers of foreign investment inflow.[14]

In this article, the rationale of the later view will be discussed with a reference to the standards of protection set under International Law governing international investment with regard to tax regulation and administration and the approaches taken by arbitration tribunals in deciding similar matters.

3. Regulatory Interaction between Investment & Taxation

Prima facie, International Investment Agreements ("IIA") and international tax treaty laws are regarded as different legal regimes. However, practically and in terms of applications, they overlap. Currently, there are 3600 plus tax treaties which offer the primary source of rights and obligations in tax matters.[15] Key objective of such treaties are avoidance of double taxation of

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[9] *Supra Note* 4
[10] *Vodafone International Holdings BV (The Netherlands)* v. *India* (2020) PCA Case No. 2016-35 https://jusmundi.com/en/document/decision/en-vodafone-international-holdings-bv-v-india-i-wednesday-1st-january-2014#decision_5254
[11] *ibid*
[12] Supra Note 4
[13] Prabhash Ranjan, '*India's retrospective taxation blunder is still extracting heavy cost*', Hindustan Times, New Delhi, December, 2020
[14] *ibid*
[15] UNCTAD, '*Series on Issues in International Investment Agreements*' Doc. No., UNCTAD/ITE/IIT/16

cross-border income and capital. At the same time, there are more than 2850 investment treaties functioning globally regulating substantive rights of investors with the aim of protecting and promoting foreign investment.[16] These treaties may sometimes cover issues of taxation or directly exclude tax matters from the purview of their application through exclusion clause.

3.1. Exclusion Mechanism of Tax Matters from IIAs

If matters of taxation are not expressly excluded from IIAs, host states' right to regulate taxation can be restricted by tax curve-out provision under IIAs.[17] However, the exclusion mechanism of taxation from IIAs is very complicated and Dr. Julien Chaisse has categorized such exclusion into 7 main types.[18] Firstly, BITs may exclude tax matters entirely from the scope of its application without any reservation. Article 5(2) of the Argentina-New Zealand BIT (1999) taking the above approach provided that:[19] *"The provisions of this Agreement shall not apply to matters of taxation in the area of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties."*

Some BITs provide for taxation matters through limited exclusion with reference to National Treatment ("NT") and Most-Favoured-Nation ("MFN") standards. Taking this approach, Article 3(3) of Austria-India BIT (1999) provided that:[20] "*The provisions of paragraph (I) [i.e. NT and MFN] shall not be construed as to oblige one Contracting Party to extend to the investors of the other Contracting Party and their investments the present or future benefit of any treatment, preference or privilege resulting from […] any matter, including international agreements, pertaining wholly or mainly to taxation*."

Similarly, limited exclusion with regard to FET standard can be provided as done in the North American Free Trade Agreement ("NAFTA"). For example, according to Article 2103(1):[21] "*Except as set out in this Article, nothing in this Agreement shall apply to taxation measures*."

Since NAFTA doesn't explicitly refer to FET, Article 1105 [i.e. FET] has been interpreted by tribunals as not available in matters of tax and that also with regards to Article 1105, tax measures are excluded.[22] Some IIAs also empower tax authorities to 'veto' an allegation of expropriation by an investor arising out of a taxation measure conceived by the host state. As per

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[16] UNCTAD, '*Towards a New Generation of Investment Policies*', (2012) World Investment Report

[17] Diane M. Ring, '*What's at State in the Sovereignty Debate? International Tax and the Nation-State*', 2008, 49(1) Virginia Journal of International Law 155

[18] 6th Meeting of the Asia-Pacific Foreign Direct Investment (FDI) Network, *The Treatment of (National) Taxes in Tax and Non-Tax (International) Agreements* (ICTSD & World Economic Forum, January 2016); available at: https://www.unescap.org/sites/default/files/5.%20Julien%20Chaisse_Tax.pdf

[19] Agreement Between the Government of the Argentine Republic and the Government of New Zealand for the Promotion and Reciprocal Protection of Investments (1999); available at: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/108/download

[20] Agreement between the Government of the Republic of Austria and the Government of the Republic of India for the Promotion and Protection of Investments (1999); available at: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/192/download

[21] North American Free Trade Agreement (1989); available at: http://idatd.cepal.org/Normativas/TLCAN/Ingles/North_American_Free_Trade_Agreement-NAFTA.pdf

[22] Rachel D. Edsall, '*Indirect Expropriation under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare*', (2006) 86 Boston University Law Review 931

Article 2103(6) of NAFTA, "*an investor can submit a claim relating to 'expropriatory' taxation to arbitration only if the competent authorities fail to agree that the measure is not an expropriation*".[23]

Interestingly, BITs which do not expressly exclude taxation from its ambit, may allow priority to taxation treaties over the investment treaty, as 'explicit conflict clauses.'[24] Article 20 of Japan-Iraq BIT (2012) taking the similar approach states that:[25] *"Nothing in this Agreement shall affect the rights and obligations of either Contracting Party under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency*."

This does not exclude jurisdiction of BITs to taxation, but the extent of the application is restricted limitedly through tax treaties as in cases of conflict, the latter shall prevail. However, different exclusions discussed above are not exclusive to each other and can applied collaterally.[26] For example, in *Occidental v Ecuador* (2012)[27] the respondents argued that the claim concerned the non-refund of the VAT, and it was under the scope of the taxation carve-out included in the BIT in question. Moreover, it was also claimed that the rules invoked by the claimants *i.e.*, NT and FET standards were also within the scope of the carve-out. However, the tribunal considered that the first paragraph of the carve-out clause providing that "*With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party*", implied the same obligation as FET and, therefore, the FET standard was outside the scope of the taxation carve-out.

As observed above, many investment treaties cover taxation matters subjecting the host states' sovereign power to taxation to the scrutiny of investment arbitration.[28] Thus, it is submitted that tax and investment cannot and do not exist in quantifiable segregation.

4. Investor-State Arbitration (ISA) & Tax Dispute

Despite clear and handy provisions excluding tax measures in investment treaties, upsurge of arbitral disputes regarding tax matters is a "reality".[29] Many a times, investors have alleged breach of rights granted in IIAs through investor-state dispute settlement ("ISDS") mechanism. Judges have readily adjudicated claims arising from tax related issues irrespective of unambiguous tax carve-out provisions in IIAs. Till date, 42 ISDS procedures have been brought against States by investors in tax related issues.[30] 28 of them were based on BITs and surprisingly all of those BITs contain taxation carve-out clauses.[31] This indicates that, majority

[23] *Supra Note* 21
[24] Saskia Sassen, '*Losing Control? Sovereignty in an Age of Globalization*', Columbia University Press, 1996
[25] Agreement Between Japan and the Republic of Iraq for the Promotion and Protection of Investment (2012); available at: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1663/download
[26] *Supra Note* 24
[27] *Occidental Petroleum Corporation v Ecuador* (2012) ICSID Case No ARB/06/11 (2012)
[28] William W. ("Rusty") Park, 'Tax, Arbitration and Investment Protection' in Catherine A Rogers and Roger P Alford (eds) *The Future of Investment Arbitration* (OUP 2009)
[29] Julien Chaisse, '*International Investment Law and Taxation: From Coexistence to Cooperation*', 10(1) International Economic Review (2016) 1-30
[30] UNCTAD, '*Latest Developments in Investor-State Dispute Settlement (ISDS)*', 2013, IIA Issues Note No.1
[31] *Supra Note* 29

of times, traditionally drafted taxation carve-out clauses are ineffective to preclude stretching of taxation measures to ISDS process. The standards of protection for investors as formulated by such tribunals in various decisions are discussed hereby.

4.1. Matter of Jurisdiction

International tribunals have repeatedly established that tax treatment of investors may fall under the jurisdiction and protection of investment treaties vis-à-vis ISDS tribunals.[32] The International Centre for Settlement of Investment Disputes ("ICSID") Convention itself states that the Centre can exercise its jurisdiction to settle "*legal disputes that arise directly out of the investment*".[33] For tax-related disputes, host state will invoke the defense that the issue being one relating to taxation and not a "legal dispute", the tribunal cannot exercise jurisdiction.[34] However, the early jurisprudence has already indicated strongly that tax disputes in matters of investment are also "*legal disputes that arise directly out of the investment*". For example, tribunal in *AMCO v Indonesia (1992)* observed that tax matters may well be covered by ICSID's jurisdiction. [35] In *Kaiser Bauxite v Jamaica (1975)* the tribunal stated that a dispute over increased taxes would fall under the scope of Article 25 Paragraph 1 of the ICSID Convention which stated that: "*the dispute concerned the alleged rights and obligations stemming from the particular provisions in the agreements between Kaiser and Jamaica and was therefore a legal dispute*".[36]

Hence, there is usually no bar in treating matters of taxation as legal issues by tribunals for the purpose of adjudication under IIAs.

4.2. Taxation as Expropriation

Usually, arbitral tribunals have dealt with the matter bilaterally subject to the wording of BITs.[37] Some tribunals have vouched for a "distinctly higher threshold" for a taxation action to be expropriation keeping in mind the leaning relation between sovereignty and regulation of fiscal action. In *EnCana v Ecuador (2006)*[38], the tribunal first addressed the definition of the term "tax measure", since the BIT did not include and considered that, *"In principle a tax law creates a new legal liability on a class of persons to pay money to the State in respect of some defined class of transactions. In itself such a law is not a taking of property; if it were, a universal State prerogative would be denied by a guarantee against expropriation, which cannot be the case. Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised*."

[32] UNCTAD, *Dispute Settlement: Investor-State* (2003) UNCTAD Series on issues in international investment agreements
[33] International Centre for Settlement of Investment Disputes (ICSID) Convention, Article 25
[34] E. A. van der bruggen, '*Some Notes on the International Protection of Foreign Investors under Bilateral Investment Treaties in matters of Taxation and Tax Administration*', DFDL, 2010
[35] *Amco Asia Corporation and others v. Republic of Indonesia* (1992) ICSID Case No, ARB/81/1 (1982)
[36] *Kaiser Bauxite Company v. Jamaica* (1975) ICSID Case No. ARB/74/3 (1974)
[37] Matthieu Gregoire, '*Taxation and expropriation under bilateral investment treaties: setting the standard*' [2015] 30(1) Butterworths Journal of International Banking and Financial Law; available at: https://3yf6pp3bqg8c3rycgf1gbn9w-wpengine.netdna-ssl.com/wp-content/uploads/2017/11/04-Matthieu-Gregoire-on-taxation-and-expropriation-under-bilaterial-investment-treaties1.pdf accessed on 16 January 2021
[38] *EnCana Corporation v Ecuador* (2006) LCIA Case No UN3481, (2008) s 177

It also emphasized that,[39] "*In the absence of a specific commitment from the host State, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment*." Finally, the tribunal concluded that the tax measure adopted by the host state did not amount to expropriation, and therefore it was not within the exception included in the carve-out clause as provided by the BIT. In *Link-Trading v Moldova (2002)*[40], the tribunal considered that taxation warranted special treatment by the dint of its nature, noting that "*customs policy is a matter that clearly falls within the customary regulatory powers of the state*".

Alternatively, many tribunals have opted to apply the ordinary principles of expropriation while dealing with fiscal measures. Prior to the *EnCana v Ecuador* decision, the tribunal in *Feldman v Mexico (2002)*[41] had considered that a tax measure may amount to expropriation where, "*the investor had an acquired right, with regard to which, the authorities, by virtue of a sufficiently restrictive measure, had behaved in a discriminatory, or arbitrary way"*. In *Occidental v Ecuador (2012)*[42], the tribunal applied general threshold of expropriation[43] set out in *Metalclad v Mexico (2000)*[44], finding that the measure was "tantamount to expropriation". Among the recent decisions some have appeared to focus on the 'effects of the measure' rather than the decision itself. For example, in *Quasar de Valores et al v The Russian Federation (2012)*[45], the tribunal observed that:[46] "*If the ostensible collection of taxes is determined to be part of a set of measures designed to effect a dispossession outside the normative constraints and practices of the taxing authorities", these could amount to expropriation for purposes of the investment protection treaty*."

While it is of no doubt that regulating fiscal measures form a core substance of a nations sovereignty, the trend to heighten the threshold of expropriation by tribunals where the impugned measure is taxation is varying, not uniform and scarce under the international customary law.[47] It is submitted that, the tribunals generally tend to adopt a purposive approach with the apprehension of the purpose of the measure in question and to apply usual standards of expropriation while scrutinizing a taxation measure.

4.3. Taxation and FET Standard

The FET standard has served as a basis to bring claims against tax measures in a number of cases including the Vodafone case. The relationship between FET and foreign investors' expectations as to tax regulation is of upmost importance as a good number of ISDS claims are being based on the guarantee FET standard,[48] even where no specific commitments were made in relation to

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[39] *EnCana Corporation v Ecuador* (2006) LCIA Case No UN3481, (2008) s 173
[40] *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova* (1976) UNCITRAL
[41] *Feldman v Mexico* (2002) ICSID Case No ARB(AF)/99/1 (2002)
[42] *Supra Note* 27
[43] *ibid*
[44] *Metalclad Corporation v The United Mexican States* (2000) ICSID Case No ARB(AF)/97/1) (2000) s 103
[45] *Quasar de Valores et al v The Russian Federation* (2012) SCC Award (2012)
[46] *ibid* s, 48
[47] *Supra Note* 36
[48] *BV v. Kingdom of Spain* (2013) SCC Case V2013/153; *Charanne B.V. and Construction Investments S.a.r.l. v. Spain* (2012) SCC Case No. 062/2012

foreign investors.[49] Different tribunals have recognized that the FET provisions demand a minimum standard of treatment to be guaranteed to foreign investors[50], violation which would result in "*a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons*".[51]

OEPC v. Ecuador (2004)[52] is remarkable for directly tying a FET clause of a BIT to the particular language of the preamble, i.e. "fair and equitable treatment is desirable in order to maintain a stable framework for investment and maximum utilization of economic resources ...." In conjunction with the standard read with this part of the preamble, the tribunal directly concluded that: "*The stability of the legal and business framework is thus an essential element of fair and equitable treatment*."

The tribunal subsequently returned to the "need for this stability" as emphasized by various other tribunals, citing to the famous language of *Metalclad Corporation v Mexico (2000)*[53] requiring "*a transparent and predictable framework*" and an "*orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly*."[54] Fundamental to the application of FET in above cases are the "basic themes of stability of the law" and seen from the investor's perspective, "predictability of the requirements to be met and the rights to be granted".[55] In line with the observation in *TECMED v Mexico (2003)*[56], "*the thrust of the concern in FET standard is the foreign investor's ability to know beforehand*."

Thus, the basic application of FET standard doesn't isolate tax measure from the purview of investment agreements if such measures are devoid of the standards of predictability and transparency.

4.4. NT Standard in Tax Matters

Under international law, it is rather arguable whether the law controls a state's power to tax foreigners more onerously than nationals.[57] Usually, the state is allowed to tax as per its understanding of the needs and demands of the nation.[58] However, entering into an investment

[49] Ivaylo Dimitrov, '*Legitimate Expectations in the Absence of Specific Commitments According to the Findings in Blusun v. Italy: Is there Inconsistency among the Tribunals in the Solar Energy Cases?*' Kluwer Arbitration Blog, 18 August 2017; available at: http://arbitrationblog.kluwerarbitration.com/2017/08/18/legitimate-expectations-absence-specific commitments-accordingfindings-blusun-v-italy-inconsistency-among-tribunals-solarenergy-cases/
[50] UNCTAD, Fair and Equitable Treatment, p 62
[51] *Glamis Gold Ltd. v. United States of America* (2009) UNCITRAL Award (2009) p 627 and 762
[52] *Occidental Exploration and Production Company (OEPC) v. Ecuador* (2004) London Ct. Int'l Arb Case No. UN 3467 (2004) p 185
[53] *Metalclad Corporation v Mexico* (2000) ICSID Case No, ARB(AF)/97/1 (2011)
[54] *ibid*
[55] Rudolf Dolzer, '*Fair and Equitable Treatment: A Key Standard in Investment Treaties*', [2004] 39(1) The International Lawyer; available at: https://core.ac.uk/download/pdf/216910288.pdf accessed on 13 January 2021
[56] *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (2003) CSID Case No. ARB (AF)/00/2 (1999)
[57] Rutsel Silvestre J. Martha, '*The Jurisdiction to Tax in International Law : Theory and Practice of Legislative Fiscal Jurisdiction*' Kluwer Law International, 1989, 17
[58] Asif H Qureshi, '*The freedom of a State to legislate in fiscal matters under general international law*', 1987, 41 Bulletin for International Fiscal Documentation, p 14

treaty that offers NT to investors of the investing state, the host state arguably limits that freedom.[59]

But the fine line of applying NT to the tax treatment of investors, among other things is complex because "*de jure* discrimination" is rare in matters of taxation.[60] Interestingly, in the discourse of NT, international tribunals recognize *de facto* discrimination even if *de jure* discrimination is absent [61] For example, in *ADM v Mexico (2007)*[62], the arbitral tribunal found that the tax in question reduced claimant's profits resulting in United States producers and distributors receiving less favourable treatment than that accorded to Mexican sugar producers.[63] The tribunal found that the tax imposed dissimilar taxation on directly competitive products which was discriminatory and contrary to the national treatment principle and that was the underlying intent of the enactment of the tax. Thus, tribunal here recognized both *de jure* and *de facto* discrimination.

Again, in *Feldman v Mexico (2002),*[64] the tribunal dissented with the tax authority and considered as follows:[65] "*Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors. Thus, if [excise tax law] Article 4 invoice requirement is ignored or waived for domestic cigarette reseller/exporters, but not for foreign owned cigarette reseller/exporters, that de facto difference in treatment is sufficient to establish a denial of national treatment under Article 1102 [national treatment NAFTA*]"

Thus, the law in question was not discriminatory on the face of it, but the law was applied in a discriminatory manner, i.e. there was *de facto* discrimination. The tribunal decided that, where there is *de facto* discrimination in the application of the tax law, it is irrelevant whether the law is *de jure* discriminatory and *de facto* difference in treatment was sufficient to establish a denial of national treatment.[66] More importantly, tribunal also held that the claimant need not prove the discrimination was based on his nationality because that would "*tend to excuse discrimination that is not facially directed at foreign owned investments".*[67]

To conclude, the question of *de facto* discrimination in the administration of taxation may in theory arise in every matter where the tax authorities have discretion in the application of tax laws and regulations.[68] The decision in *Feldman v Mexico (2002)* corresponds to the *Occidental v Ecuador (2012)*[69] decision in which there was also no *de jure* discrimination in Ecuador's tax laws. This approach is appreciable because determining otherwise would let legislators and their

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[59] *Cook v. Mexico* (1926) 4R, Int. Arb, Awards (1926) p. 593
[60] *Supra Note*, 38, p 21
[61] Alexander R. Albrecht, '*The taxation of aliens under international law*', 1952, 29 BYIL p. 172
[62] *Archer Daniels Midland and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States* (2007) ICSID Case No. ARB(AF)/04/5
[63] *Supra Note* 61, para 211
[64] *Supra Note* 49
[65] *Supra Note* 40, para 169
[66] *Supra Note* 64
[67] *Supra Note* 40, para 164
[68] George C. Christie, '*What constitutes a taking of property under international law?*', 1962, 38 BYIL p. 339
[69] Supra Note 41

actors sway to discriminate and get away with it because the written words of the law is de jure non-discriminatory.

4.5. Stabilization Clause and Taxation

Tax disputes discussed above clearly states that exclusion of tax matters from the application of BITs or IIAs, is many times not sufficient. Thus, while negotiating stabilization clause in BITs, states stabilization clause by nature could fill the gap and protect investors from adverse changes in tax regimes rather in ease, therefore making tax carve-out clauses inadequate.[70] The aim of stabilization clauses in BITs is to limit the right to change or modify the existing legislative regime of a state. This ensures the predictability of the regulatory environment in the state which is a prerequisite of sustainable investment.[71]

Interestingly, many believe modern stabilization clauses to only act as a catalyst of triggering compensation even in absence of any substantive and reasonable drawback for investors.[72] This approach undermines the clause's power to limit the right of a state to legislate. However, in practice stabilization clause has served as a tool to challenge regulatory reforms which would otherwise cater the interest of developing countries and many tribunals in fact have recognized that commitments made in favor of foreign investors are binding under international law, notwithstanding the power of the parliament and other state organs under the domestic jurisdiction to override or nullify them.[73]

5. Significance of the Vodafone case

While deciding in favor of Vodafone, the tribunal held that India's decision to retrospectively amend the law was without any justification and as such created an uncontemplated tax burden on Vodafone. Jurisprudentially, the amendment of the law hindered and ripped off Vodafone's ability to plan its activities keeping in mind the legal consequences of its actions. This action of the Indian Parliament disproportionately undermined the principles of legal certainty and apprehension which as discussed above, are core to the protection of the FET standard.

The Vodafone saga also highlighted another principle of international law addressed in Article 4(1) of the International Law Commission (ILC) Articles on State responsibility, *i.e.,*:[74] "*The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the Central Government or of a territorial unit of the State*."

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[70] Thomas Childs, '*Challenging a Host State's Tax Measures Through International Arbitration*' in Eberhardt, Olivet and Steinfort (eds), One treaty to rule them all (tni 2018)
[71] Annalise Nelson, '*Investments in the deep freeze? Stabilization clauses in investment contracts*', Kluwer Arbitration Blog, 9 November, 2011; available at: http://arbitrationblog.kluwerarbitration.com/2011/11/09/investments-in-the-deep-freeze-stabilization-clauses-in-investmentcontracts/
[72] Katja Gehne and Romulo Brillo, '*Stabilization Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment*', Swiss National Centre of Competence in Research, NCCR Trade Regulation, Working Paper No. 2013/46, 2013
[73] *Revere Copper & Brass, Inc. v. OPIC*, (1978) 17 ILM 1978
[74] Draft articles on Responsibility of States for Internationally Wrongful Acts (2001) Yearbook of the International Law Commission, 2001, vol. II, Part Two

This underlines a core principle of the jurisdiction of arbitral tribunals in adjudicating upon a law enacted by the Parliament. That is, Parliamentary actions may very well resonate as actions by state. As such, the arbitral tribunal has full powers to adjudicate upon a law enacted by a competent Parliament of a sovereign nation and examine whether such law breaches the country's international law obligations or not. While the Vodafone case has reiterated many conceptual legal issues pertaining to BIT arbitration, it has also drawn our attention to issues that travel beyond law. As rightly observed by Dr. Prabhash Ranjan, the Vodafone case and the facts leading to it points out how a third world state, often portrayed as a victim, can abuse its public power and undermine treaty based protections, thus undermining international rule of law.[75]

6. Conclusion

Regulation of cross border relations such as double taxation is not primary to the goal that IIAs aim to achieve. In spite of this bare understanding, IIAs and BITs have exercised a crucial control over the interpretation and implication of tax matters which have shaped the standard of protection of investors in such matters. Arguably, IIAs were originally not intended to craft regulatory obligations on states; nevertheless they do set a standard for all kinds of treatment of foreign investors which rest upon the state. Yet, such treaties in general, do not function as armor for investors as long as any change or modification of the tax law or regulations or directions is introduced as a matter of normal fiscal and economic policy of the state. It is also to be remembered that IIA offers protection only to the extent that is covered by its provisions. Similarly, municipal courts will always exercise their prior jurisdiction in the interpretation and application of any tax law or any provision of such law, unless and until a violation of the treaty obligation is in play.

Thus, the Vodafone case urges the governments, especially of host states with high potential to attract foreign investors to note that, irrespective of the dilemma of right to regulate and being regulated under the IIAs, promoting rule of law and upholding legal certainty are the preconditions that must be ensured in order to drive sustainable foreign investment inflows.

[75] *Supra Note* 7