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Non-discrimination and fair tax treatment in Bilateral Investment Treaties (BIT's) and Foreign Trade Agreements (FTA's)

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In our previous blog we were discussing issues of non-discrimination on the basis of Nationality (article 24.1 MOCDE). Today, it is relevant to point out the fact that the idea of non-discrimination is radically different when the problem is addressed from the perspective of other International Investment Agreements (IIA's) such as BIT's and FTA'S.

Foreign Trade Agreements (FTA'S) and Bilateral Investment Treaties (BIT's) address the issue of non-discrimination by incorporating a wide range of protection measures. Such treaties go far beyond the inclusion of National Treatment and Most Favoured Nation Provisions, in order to solve problems of non-discrimination and related issues by means of Fair and Equitable Treatment and Minimum Standard of Treatment clauses, amongst others. Recent trends in dispute-resolution procedures within International Investment Agreements show that concerns regarding all kinds of discrimination or unfair treatments represent an important agenda of arbitration tribunals. In a globalised world, equal treatment should be one of the bases, perhaps the main one, of a global legal system.

As a result, it is not surprising to find arbitration awards based on very holistic approaches to the ideal of "not being discriminated against", even in tax matters.

Marvin Feldman v. Mexico (1), for example, was a famous case regarding the application of tax laws by said country to the export of tobacco by a company owned and controlled by an American citizen. The claimant alleged that, contrary to the situation of local companies, Mexico refused to rebate excise taxes applied to cigarette exports. The situation was, in general terms, a "de facto" discrimination as the truth was that other similar local exporters were not legally entitled to the rebates either. Even though the law itself did not discriminate, those local exporters had actually been granted such benefits, unlike the treatment given to the claimant. The Tribunal, after several considerations, said that under the North American Free Trade Agreement (NAFTA) it was clear that the Treaty protected not only "de jure" but also "de facto" discrimination and condemned Mexico for its behaviour towards the taxpayer (2).

In Occidental v. Equador, the debate centred on the legitimacy which Equador had to pass an interpreting law stating that oil and gas companies were not entitled to VAT refunds on their exports, since such treatment was only allowed for "producers". According to the law, as oil and gas "is not produced" but "extracted", these kinds of companies had no right to VAT refunds. In

the Tribunal's view, amongst other considerations, Equador violated its duty to grant foreigners a treatment no less favourable than that given to its own nationals. The Tribunal found that other local companies in similar situations, such as exporters of flowers, were being refunded with VAT, unlike Occidental. The Tribunal also implied that it was quite obvious that companies engaged in the oil and gas business were primarily foreign (3).

Similar considerations have been taken into account with respect to other measures taken by Equador, which became famous in the oil and gas industry for imposing windfall taxes on these companies. The philosophy of such taxes is to regulate the "extraordinary income" perceived by oil and gas companies as a consequence of the increase in the foreign price of petrol. Equador, therefore, decided to impose a tax of 50%, which then increased to 99%, over said extraordinary earnings. With respect to this situation, some Tribunals have considered this measure as expropriatory and contrary to their obligation to grant National Treatment (4).

In other cases and far beyond the scope of non discrimination but fairness in taxation in general, BIT's and FTA's have given rise to arbitration awards stating, for example, that changes in the regulatory tax framework would be considered as breaches of the duty to grant fair and equitable treatment "in case of a drastic or discriminatory change in the essential features of the transaction" (5). They have also said that if the ostensible collection of taxes is proven to be part of a set of measures aimed at dispossessing a taxpayer outside the ordinary practices, such measures can be considered expropriatory (6). Moreover, we find statements regarding general anti-avoidance rules (GAAR's) that have taken very strong positions as the one that states that "to characterise behaviour as violating a broad concept of good faith when a taxpayer adopts behaviour precisely to take advantage of tax benefits created with the intention of inducing the corresponding conduct seems extraordinary. It is hard to see why the taxpayer should be blamed for the generosity of those benefits … The Tribunal is unpersuaded … if there are two options, both of which have the same economic substance, the taxpayer is entitled to choose between these options. In other words, the option is exclusively tax driven" (7).

To Conclude, International law is permanently addressing the ideal of non-discrimination and, in general, fairness in taxation. Taxpayers have, certainly, several tools to challenge unequal or unfair treatments resulting from the issuing or implementing of tax regulations.

However, what is probably worrying is that within various IIA's, the approach to the principle of non-discrimination is completely different. Double Tax Treaties (DTT's), on one extreme, address the problem as if non-discrimination were a rule rather than a principle, which is evident from a cursory read over Article 24 of the OECD Tax Model and all the commentaries to said provision. It is clear that this article considers the existence of discrimination, for the purposes of DTT's, only in the five accurate cases described within. Other cases of discrimination which do not match the scope of the rule appear to be unprotected, unless other rules might be applicable.

On the other extreme, there are BIT's and FTA'. It is very difficult to establish a trend amongst BIT's and FTA's as there are more than 3000 agreements around the world which do not follow a set model. In addition, with respect to taxes, these agreements include many possibilities which range from treaties which do not mention the tax issue at all (and, therefore, are applied to tax matters to an unlimited degree) to treaties which include general exemption clauses stating the impossibility to applying the treaty to tax matters; within this spectrum, there are treaties which expressly mention the rules which can be extended to said tax matters. However, by and large, said treaties are applicable to tax matters if there is a controversy over expropriation measures and

without prejudice of they accurate scope, they have evolved in a way in which it is unacceptable to discriminate against aliens as opposed to nationals and where unfair treatments, whatever they mean, can be put into trial.

(1) ICSID case Nº ARB(AF)/99/1
(2) The award states that "Also, given that this is a case of likely de facto discrimination, it does not matter for purposes of Article 1102 whether in fact Mexican laws authorizes SHCP to provide EPS rebates to persons who are not formally IEPS taxpayers and do not have invoices setting out the tax amounts separately, as has been required by the IEPS law consistently since at least 1987 and perhaps earlier"

(3) Final award in the matter of an UNCITRAL arbitration. London Court of International Arbitration Administered Case Nº UN 3467, 1st of July, 2004

(4) See, amongst others, ICSID Case ARB/06/11 (Occidental v. Equador), ICSID Case ARB/08/6 (Perenco v. Equador), ICSID Case ARB/08/10- Settlement between Equador and Repsol, ICSID Case ARB/06/21- Decision on provisional measures between City Oriente v. Equador.

(5) Toto Construzioni Generali S.p.A. v. Republic of Lebanon (ICSID Case No. ARB/07/07/12).

(6) Quasar de Valores SICA S.A. v. Russia. Arbitration Institute of the Stockholm Chamber of Commerce, July 20th 2012.

(7) Ibídem

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