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WHEN FOREIGN INVESTMENT AND ITS DISPUTE MECHANISMS WORK AGAINST AFRICAN ECONOMIC ADVANCEMENT: REVENUE AND SUSTAINABLE DEVELOPMENT IMPLICATIONS

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ABSTRACT

This article explores the importance of the disclosure of beneficial ownership in states revenue collection efforts and its implications for sustainable development. It critically analyses the concealment of beneficial ownership and investment tribunals uncritical acceptance of jurisdiction in such cases. The article suggests that this uncritical acceptance increases the risk of money laundering and could potentially breach fundamental principles of transnational policy. These tribunals have also been hesitant to consider the investors failure to pay taxes when awarding damages. In so doing, the tribunal offers a powerful enforcement tool for investors but leaves the state with only limited recourse.

Keywords: Taxation; Beneficial Ownership; Investment Arbitration; Revenue Law Exception; Counterclaims.

1. INTRODUCTION

Foreign direct investment (FDI) has been touted as a fundamental part of the global economy and a primary facilitator for development in emerging and developing economies. Nevertheless, the benefits of FDI do not appear to spread evenly across countries due to several factors like the absence of host country effective investment policy and the historically unfair and contested international rules on investment protection, designed to protect economic interests of foreigners at the expense of host states' development agenda and regulatory space.[1] The special treatment of foreign investors, despite their perceived infractions on host state policies, is further endorsed by the investor dispute settlement mechanism (ISDM) through a lack of arbitrator accountability, lack of predictability and consistency in the arbitral decisions, failure to follow international best practices in areas of global concern and western hegemonic constitution of most arbitral tribunals.[2]

The Permanent Court of Arbitration (PCA) decided case of Sunlodges Ltd v. The United Republic of Tanzania,[3] is particularly instructive on this excessive adulation of a foreign investor's interests at the expense of the host state, notwithstanding the manifest violation of globally sensitive issues such as tax avoidance and beneficial ownership secrecy that is supportive of money laundering and illicit financial flows. The Sunlodges dispute emerged as a result of an arbitral proceeding instituted against the Tanzanian government over its decision in September 2011 to revoke Sunlodges' right of occupancy title to an agricultural estate in Tanzania following

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1 Michelle Raton Sanchez Badin and Fabio C. Morosini, 'Re-conceptualizing International Investment Law from the Global South', in Michelle Raton Sanchez Badin and Fabio C. Morosini (eds), Re-conceptualizing International Investment Law from the Global South (CUP 2017) 3-4.

2 John Nyanje, 'Hegemony In Investor State Dispute Settlement: How African States Need To Approach Reforms' (Afronomicslaw.org, 2020) <https://www. afronomicslaw.org/2020/09/07/hegemony-in-investor-state-dispute-settlement- how-african-states -need-to-approach-reforms> accessed 2 June 2022.

3 PCA Case No. 2018-09, Award (20 December 2019) (herafter 'the Sunlodges case').

Sunlodges' failure to comply with the terms and conditions of occupancy of the Estate.[4] Sunlodges claimed that decision to revoke its occupancy title amounted to an unlawful expropriation of its investments in Tanzania and to other breaches of the agreement between the Government of the United Republic of Tanzania and the Government of the Italian Republic on the Promotion and Protection of Investments and sought compensation for the losses suffered.[5] The case was decided in favour of Sunlodges Limited.

The Sunlodges arbitral decision raises several pertinent issues relevant to sustainable development for developing countries, especially the least developing countries such as Tanzania.[6] It again showcases why several developing economies like South Africa and Indonesia are either renegotiating existing first-generation bilateral investment treaties (BITs) or rescinding them altogether. In the Sunlodges case, the arbitral tribunal appeared to be quite dismissive on relevant issues that may have had a balancing influence on the outcome of case. This article thus aims to identify and analyse the issues of beneficial ownership transparency and its potential use for tax avoidance and illicit capital flight out of developing countries, domestic tax liabilities of foreign investments, and its bearing on resource mobilisation sustainable development in developing countries. This article also provides policy recommendations on the way forward for developing countries like Tanzania to prevent capital flight through treaty shopping investments and protection of their economic development.

This article is divided into seven sections. After this introduction, section 2 discusses the concept of beneficial ownership and the contribution of the concealment of beneficial ownership to tax evasion. Section 3 then analyses the impact of investment treaties on the generation of tax revenues and the protection offered by international investment law to investors who have failed to comply with their tax obligations within the host state this is followed by section 4 which critically evaluates the impact of protecting phantom FDI by these investors. Section 5 then considers the limited recourse that states have against investors to recover outstanding taxes against investors in terms of contemporary investment law where these investors are afforded treaty protection. Ultimately, the article

4 Ibid, para 7.
5 Ibid, para 6.
6 Ibid, para 5.

provides a series of recommendations aimed at addressing the challenges identified throughout the article.

2. BENEFICIAL OWNERSHIP TRANSPARENCY AND TAX AVOIDANCE.

The concept of beneficial ownership has frequently confused arbitrators in settling international investment disputes regarding claims of beneficial ownership. Perhaps, this could be attributed to beneficial ownership being a privilege and not a right, correlated to a third party's absence of right to interfere with the enjoyment of the beneficial owner's privilege.[7] Beneficial ownership is formed when the legal right of a property is vested in another party deemed the legal owner for the benefit of another named the beneficial owner.[8] Therefore, a beneficial owner has an interest in property vested before, or at the time of the claim and enjoys the economic benefits of ownership.[9] For legal persons, a beneficial owner is a natural person who ultimately has a controlling ownership interest in a legal person (with what constitutes a controlling interest determined by the nature of the legal person), either through an ownership interest in the legal person or by other means.[10]

Challenges arise when a previously undisclosed beneficial owner brings a claim before a dispute resolution body, thereby violating the international law principle that the proper party with a locus standi to bring a claim is the party with a real and equitable ownership, barring all others including the beneficial owner.[11]

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[7] Matthias Reinhard-Deroo, Beneficial Ownership: Basic and Federal Indian Law Aspects of a Concept (Springer 2013) 37.

[8] Andres Knobel, 'Complex Ownership Structures: Addressing the Risks for Beneficial Ownership Transparency.' (2022) Tax Justice Network Paper 6-13.

[9] Martin Jimenez 'Beneficial ownership: current trends' (2010) World Tax Journal 37-60; Jan Gooijer, "Beneficial Owner: Judicial Variety in Interpretation Counter acted by the 2012 OECD Proposals." (2014) 42 Inter tax 204; Bruno Da Silva, 'Evolution of the Beneficial Ownership Concept: More Than Half of Century of Uncertainty and What History Can Tell Us'(2017) 12(4) Frontiers of Law in China 501-523.

[10] FATF, 'FATF Guidance: Transparency and Beneficial Ownership' (FATF 2014) 8.

[11] David J. Bederman, 'Beneficial Ownership Of International Claims' (1989) 38 Inter national and Comparative Law Quarterly 935, 936.

This also makes the necessity of beneficial ownership a pertinent issue because it is tied to the nationality of investments/investors to create locus standi to claim benefits regarding an investment treaty. Therefore, the problem of beneficial ownership claim is one of locus standi and in recent times, with the fight against treaty shopping and capital flight, its misuse in aiding tax avoidance and capital flight.

The key danger in beneficial ownership secrecy lies in situations where multinational corporations exploit a lack of transparency around beneficial ownership to reduce their tax liabilities dishonestly. This is done by creating transactions that appear to be between unrelated parties while, in reality, the same beneficial owner controls these transactions.[12] Also, through shell companies set up in tax havens, foreign investors seek to take advantage of investment incentives reserved for foreign investors by making investments while obscuring information on beneficial ownership.[13] In the Sunlodges case, the claimant Mr Pagelieri was the beneficial owner of both Sunlodges Tanzania via the shell company of Sunlodges Limited (BVI), a tax haven location to possibly take advantage of the investment and tax treaty benefit Tanzania offered to investors. Sunlodges Tanzania and Sunlodges Limited (BVI), owned by the same beneficial owner (Mr Paglieri) obscured their common ownership at the time of registration in Tanzania.[14] The disclosure of the beneficial ownership information would aid tax authorities to scrutinise transactions, while identifying tax-avoiding transactions quickly, thereby allowing for more effective tax enforcement.

The arbitral tribunal failed to see the possibility of tax avoidance and promoting treaty shopping by Sunlodges raising the beneficial ownership at the later stage of the arbitral proceeding had on the unfair determination of the case. The tribunal failed to align the

[12] Wilson Pritchard, 'Linking Beneficial Ownership Transparency to Improved Tax Revenue Collection in Developing Countries' (2018) International Centre for Tax and Development at the Institute of Development Studies 3-4. See also Annet Wan yana Oguttu, 'Curbing "Treaty Shopping": The 'beneficial Ownership' Provision Analysed from a South African Perspective.' (2007) 40 (2) The Comparative and International Law Journal of Southern Africa 237–58 for the treaty shopping consequence of beneficial ownership to developing countries.

[13] Ibid.

[14] the Sunlodges case (n 4), para 278.

arbitral reasoning with the current practice in international law in curbing global tax abuse and illicit capital flow-through money laundering, vigorously administered by the Financial Action Task Force (FATF). The uncanny implication of this failure is the violation of the obligation of following the general principles of international arbitration that instructs arbitral tribunal to follow international law principles and the investment treaty in arriving at an arbitral decision. Article 8(4) the Tanzania-Italy BIT permits the arbitral tribunal to have recourse to international law recognised by both parties. Measures against money- laundering are both known to Tanzania and Italy, who are members of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) and the FATF, united in the purpose of combat money laundering by implementing the FATF Recommendations, which include beneficial ownership disclosure.

Investment tribunals are also required to consider transnational public policy when issuing awards. In Belokon v. Kyrgyzstan,[15] the French Cour de Cassation upheld an earlier decision by the Paris Court of Appeal in which the court set aside an arbitral award which could have seen Belokon benefit from money laundering activities.[16] The Paris Court of Appeals held that the prevention of money laundering is a fundamental principle of transnational policy, as reflected in the UN Convention Against Corruption.[17] The court held that a court on annulment is not called upon to determine whether the parties are guilty of money laundering. It must instead simply determine whether recognising the award would obstruct 'the objective of combating money laundering by allowing part of the proceeds to benefit from activities of this nature'.[18] Where recognition would so impede the objective of combatting money laundering, the award should be set aside on this basis alone.[19]

Similarly, other arbitral tribunals in arriving at investment arbitral decisions have considered international law principles and

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15 ass. Civ. 1ère, 23 March 2022, No. 17-17.981.

16 Ibid, para 16.

17 Valeri Belokon v. Kyrgyz Republic, PCA Case No. AA518, Judgment of the Paris Court of Appeal on Application to Set Aside Award (21 February 2017), para 23.

18 Ibid, para 27.

19 Ibid.

practices. This is as a result of arbitrators being more conscientious of foreign investors abusing the system through treaty shopping and bad faith investment claims.[20] Also, arbitral panels try to exercise scrutiny over actual ownership interests to determine the real nature of legal and beneficial ownership structure in a claim to ascertain the bona-fide covered investors and the quantum of compensation to be made in cases where damages have occurred. This was demonstrated in the case in Occidental Petroleum Corporation v. The Republic of Ecuador,[21] where the ICSID ad hoc Committee partially annulled the US $1.769 Billion award of damages issued on 5 October 2012 by the majority of the arbitral tribunal, over the strong opposition on the beneficial ownership claims of the Chinese company as coming under covered investors.[22] The Committee treated the Chinese company, Andes/AEC's beneficial ownership of around 40% of the expropriated assets as outside the scope of its jurisdiction over covered investors protected under the US-Ecuador BIT in contention.[23] The Committee justified its decision by stating that a BIT proscribed limits under the law of investor-State claims where an arbitral panel's authority to adjudicate is derived from the creation and consent of States, with a contracted accessibility of the investor-State treaty arbitral system to treaty-covered investors, therefore investors holding beneficial ownership enjoy the protection granted under the treaties which benefit their nationality.

In the Sunlodges case, Mr Paglieri claim of beneficial ownership through complex ownership structure to gain the treaty benefits should have raised a red flag for the arbitral panel. Although the Tanzanian-Italian BIT is silent on the definition of a beneficial ownership like other investment treaties, it was quite easy to see that the question of beneficial ownership was raised with the intention to claim treaty benefits through the nationality nexus

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[20] Diane Desierto and others, 'Beneficial Ownership And International Claims For Economic Damage: Occidental Petroleum V. Ecuador And Restoring Limits To Investor-State Arbitral Tribunals' Jurisdiction Ratione Personae' (Ejiltalk.org, 2015) <https://www.ejiltalk.org/beneficial-ownership-and-international-claims-for-economic-damage-restoring-limits-to-investor-state-arbitral-tribunalsjurisdiction-in- occidental-petroleum-v-ecuador /> accessed 2 June 2022.

[21] ICSID Case No. ARB/06/11, Decision on Annulment (2 November 2015).

[22] Ibid, para 586.

[23] Ibid, para 205.

with the beneficial owner of Sunlodges. This is because there were several defining features present such as the beneficial owner, a national of Italy, not residing in the Contracting State, Tanzania, or the British Virgin Island where Sunlodges, the conduit company was created. Sunlodges Limited (BVI), the majority shareholder of Sunlodges Limited (Tanzania), appeared not to have any economic activity and or has a minimal presence in the Contracting States of Tanzania or Italy.[24]

While it is trite that arbitral tribunals should limit themselves to the stipulations of a contract or agreement made by disputants, some implications arise from ignoring international global law principles in resolving disputes. Specifically, a failure to investigate beneficial ownership in investment arbitral claims may have several policy implications for host countries. First, it contributes to undermining the policy fight against tax haven secrecy that affects national development policies intended to support good governance for the wider benefit of societies.[25] Second, disguising beneficial ownership information through anonymous company ownership contributes to financial concealment that enables grand corruption, money laundering while contributing to the global economic inequality. A lack of beneficial corporate transparency aids harmful corporate tax avoidance, reducing potential fiscal revenues that can be used to fund vital public services.[26] The

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24 These factors are expanded on in V Krishna, 'Using Beneficial Ownership to Prevent Treaty Shopping' (2009) Taxnet Pro

25 Anthony Ginsberg, International Tax Havens (1997) 5-6; Javier Garcia-Bernardo and others, "Uncovering offshore financial centers: Conduits and sinks in the global corporate ownership network" (2017) 7 Scientific Reports; Hsun Chu, Chu-Chuan Cheng & Yu-Bong Lai, "The political economy of tax havens" (2014) 6 International Tax and Public Finance 956-976.

26 Jenik Radon & Mahima Achuthan, "Beneficial ownership disclosure: the cure for the Panama papers ills" (2017) 70 (2) J. Int. Aff 85-108 & A Cobham, Petr Janský & Markus Meinzer, "The financial secrecy index: Shedding new light on the geography of secrecy." (2015) 91 (3) Economic geography 281-303. See The ONE Campaign, The Trillion Dollar Scandal (2014) 3-32 https://s3.amazonaws.com/one.org/pdfs/Trillion_Do llar_Scandal_report_EN.pdf, accessed 27 July 2022, indicating how $3.2 trillion of undeclared assets are estimated to have originated from developing countries including Africa, depriving the affected developing coun tries of $19.5 billion of lost tax revenues per annum. Similarly, the AU & UNECA Report estimated Africa's revenue loss at US$ 50bn from illicit outflows from cor porate beneficial ownership secrecy. See, African Union/Economic Commission for Africa, Track it! Stop it! Get it! Illicit financial flows, Report of the High-Level Panel on Illicit Financial Flows from Africa (2015) 1-30 www.uneca.org/sites /default/files/PublicationFiles/iff_main_report_26feb_en.pdf, ace ssed 27 July 2022

reduction of revenue in turn puts pressure on the public through the government's reliance on indirect taxes such as VATs which exacerbates economic inequality, especially for people at the lower end of the socio economic spectrum and gender inequality through excessive taxation.

Transparency of beneficial ownership will help ensure that conduit structures can no longer operate in secrecy and impede development through tax avoidance by hiding behind an intermediary. The timely identification of ultimate beneficial owners of shell corporations is critical in detecting, tracking, and averting illicit financial flows, by enabling authorities to follow capital flows and their usage more effectively (for anti-money laundering and counter-terrorism financing purposes), in the global fight against terrorism.[27] Likewise, Owen & McDonell argue that many national corporate/banking secrecy laws, privacy and data protection laws foster harmful beneficial ownership secrecy.[28] Owen and McDonell stress the importance of closing enforcement gaps in ultimate beneficial ownership disclosure for purposes of preventing the mistreatment of corporate vehicles for money laundering or terrorist activities

Some scholars like Forstater affirm the potential role of beneficial ownership transparency in strengthening tax collection is clear yet express substantial uncertainty about whether disclosure gains are likely to be realised in practice by low-income countries.[29] This is

[27] Andrea Ottavi, "Shell corporations and beneficial owners. current criticalities and future developments from a multilevel perspective." (2019) 40 (3) Business Law Review 116-123; WH Muller, CH Kalin & JG Goldsworth, Anti-Money Laundering: International Law and Practice (2007) 15-37, 69 on various national and international initiatives to combat money laundering through beneficial ownership secrecy.

[28] JP Owens &R McDonell, "Creating mechanisms to get good access to beneficial ownership information in international context." (2018) 2nd High-Level Confe rence on High Net-Worth Individuals: The Challenge They Pose for Tax Admini strations, FIUs and Law Enforcement Agencies 83-94.

[29] Maya Forstater, "Beneficial openness? Weighing the costs and benefits of financial transparency." (2017) CMI Working Paper 1-32. The Hidden danger both for governments and civil society is that transparency measures may run the risk of providing 'form' rather than the 'function' in seeking to solve beneficial ownership secrecy problems. See generally on the subject, M Moore & W Pritchard, How Can Governments of Low-Income Countries Collect More Tax Revenue? In (eds) K Hujo, The Politics of Domestic Resource Mobilization for Social Development (2020) 109-133.

because these countries may struggle to access and deploy newly collected information while bearing the costs of participating financially and in terms of scarce human resources. Beneficial ownership transparency is explicitly designed to attack ownership benefit secrecy. Effective beneficial ownership may only realistically work with a robust exchange of information mechanism. According to Pritchard, beneficial ownership information will only be helpful to developing country tax authorities if it is shared by the countries hosting wealth held abroad, while any exchange of information can function effectively if beneficial owners of wealth can be identified.[30] Despite this drawback, it may still pay developing countries to have a beneficial ownership disclosure law and basic structure in place, while improving the law and structure as it gains more expertise and experience.

3. INVESTMENT TREATIES BEARING ON TAXATION

Investment treaties in themselves appear to have no bearing on taxation. This could be because some investment treaties do not usually directly reference taxation. In practice, however, investment treaties strongly impact the generation of corporate tax revenues. Investment treaties have many more consequences on taxation than have been acknowledged particularly for developing countries because that rely on tax revenues for funding public services.[31] Investment treaties sway domestic tax policy and countries' ability to reshape their tax policies as their socio-economic requirements change over time.[32] Studies indicate that trade and investment treaties have a positive fiscal impact for rich countries, a neutral impact on middle-income countries, and a negative fiscal impact for less developed countries.[33] This is

[30] Pritchard (n 12) 2-3.

[31] Sonia Roland, 'The Impact of Trade and Investment Treaties on Fiscal Resources and Taxation in Developing Countries and Taxation in Developing Countries' (2020) 21 Chicago Journal of International Law 48.

[32] Ibid, 66.

[33] Devika Dutt, Kevin P. Gallagher and Rachel D. Thrasher, 'Trade Liberalization And Fiscal Stability In Developing Countries: What Does The Evidence Tell Us?' (2020) 11 Global Policy.

because least developed countries like Tanzania can typically not offset multinationals' tax planning strategy losses with increased revenue from income and profit taxation or broad-based consumption taxes.

The inability to make up for lost revenue has also been attributed to the informal nature of businesses in host economies, poor governance; limited administrative, judicial, and enforcement infrastructure; limited resources to create, administer, and enforce a tax system; and a small tax base, amongst other factors.[34] In addition, several arguments favour placing limits (by host governments) on the use of tax breaks as incentives for investors in the global competition for investment.[35] The presence of allowable taxation avoidance mechanisms in many investment and tax treaties already ensure that taxation by host countries do not impose an undue burden on investors, who are potentially taxed in other jurisdictions- especially their home jurisdictions. This however should not be used as a license foreign investor to use the instrument of BITs claims to avoid tax liability in host countries using FET claims.

Most old-generation IIAs do not contain exclusions from their substantive scope for taxation, which means that tax-related measures, whether of general or specific application, are covered by IIAs.[36] This includes tax measures that fall within the scope of a double taxation treaty (DTT) between the two countries.[37] Even where exclusions exist, ISDS tribunals adopt their own interpretation or definition of "taxes" and do not necessarily rely on domestic law guidance. Policy options for reform include carve-outs for tax measures from all or certain IIA provisions as

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34 Roland (n 31) 52.

35 Reuven S. Avi-Yonah, "Globalization, Tax Competition, and the Fiscal Crisis of the Wel fare State." (2000) 113 (7) Harvard Law Review 1573–676. Transparency and pre dictability comprising regulations and their implementation are more important to investors as a reflection of the overall interaction between MNCs and host governments than tax incentives. See also, P Kusek & A Silva "What Matters To Investors In Developing Countries: Finding from Global Investment Compe titiveness Survey in World Bank, Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications 19-27

36 Cairn Energy PLC and Cairn UK Holdings Limited (CUHL) v. Republic of India, PCA Case No. 2016-07, Award (21 December 2020), para 814.

37 Ibid.

well as procedural mechanisms for joint determinations involving decision-making by the competent domestic authorities.

For instance, the tax treaty between Tanzania and Italy applies to residents of one or both states.[38] Article 2 clearly states that taxes imposed shall cover taxes on income imposed on behalf of each Contracting State irrespective of how they are levied. Article 4 of the tax treaty clearly defines fiscal domicile, which determines the incidence and allocation of taxing rights between both countries to mean any person who, under the law of a state, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of similar nature. The arbitral tribunal failed to read the tax treaty in determining the tax aspects of the case. Perhaps, it might arrive at a more balanced and fairer decision if it had done so.

As for the Investment Agreement, Art 4 of the BIT defined a legal person as an entity having its head office in one of its resident states and recognised by the agreement and relevant institutions. Article 5 goes further to describe what income is. Article 1(7) defines an investment agreement as an agreement that regulates a specific legal agreement that, by implication, includes tax agreements because a tax agreement governs the tax treatment of income arising from the investment relationship. Most importantly, Article 6 (1) provides that contracting parties can repatriate their investment "only" after all fiscal obligations have been met. This fiscal obligation covers the fiscal liability under domestic law, which falls within the scope of the investment treaty. Unfortunately, the tribunal failed to see this important angle that works as a counterclaim against Sunlodges Limited. Also, Sunlodges Tanzania being a Tanzanian company is a tax resident of Tanzania, and as such liable to tax liabilities arising. The Arbitral Tribunal failed to realise the link between Article 6, the DTA and the Tax Residency of Sunlodges to establish fiscal rights. This ended costing Tanzania heavily in financing its development goals, which provides a useful lesson to other countries.

[38] Convention Between Tanzania and Italy for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income (Signed 31 January 1979, entered into force 6 May 1983).

4. DOMESTIC TAX REVENUE, PHANTOM FDI AND SUSTAINABLE DEVELOPMENT

The United Nations in 2004 set highly ambitious targets for countries to end all forms of poverty, eliminate socio-economic inequalities. While these lofty targets are commendable, attaining them entail huge domestically sourced financial resources.[39] One of the sustainable means of domestically sourcing for development financial apart from loans is taxation. For developing countries in particular, this would require adopting new approaches to its taxation processes and making requisite changes- through strengthening the effectiveness of domestic tax systems to produce the domestic income to foster inclusive economic growth that drives the attainment of the SDGs.

Developing countries need fiscal revenue to build their infrastructure, achieve security and environmental sustainability, and provide social services necessary for human development. The UN's Sustainable Development Goals 17.1 and 17.4 enshrine the need to improve tax mobilisation. The mobilisation and effective use of domestic resources are central to the achievement of sustainable development.[40] The presence of a sustainable domestic and international fiscal policies is also vital in decreasing inequalities and promoting positive sustainable development patterns.[41] This can be seen through the performance of sustainable consumption that drives economic growth, incentivising key areas of the economy and preventing massive loss of development finance through tax judgment debt as witnessed in the Sunlodges case.[42]

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[39] United Nations Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) 2015 A/RES/69/313.

[40] Belay Begashaw, 'Strategies to deliver on the Sustainable Development Goals in Africa', in Brahima S. Coulibaly and Christina Golubski (eds) Foresight Africa: Top priorities for the continent 2020-2030 (Brookings 2020) 8.

[41] United Nations Official Summary of the Sixth Biennial High-Level Meeting of the Development Cooperation Forum (United Nations Headquarters, New York, 21-22 May 2018): E/2018/73.

[42] United Nations The Role of Taxation and Domestic Resource Mobilization in the Implementation of the Sustainable Development Goals Committee of Experts on

FDI is regarded as a vital component of long-term global economic integration, intended to stimulate economic growth, job creation, and improve host country (mostly developing countries) productivity through relocations of capital, skills, and technology. To this end, various countries have adopted FDI-friendly policies to attract more of investment inflows without consideration of the hidden cost or the phantom investment inflows of investment especially from investors with disguised ownership structures, without duly accessing the negative impact of undisclosed ownership structure FDI on their fiscal resources especially on taxation.

The IMF estimates global phantom investments at $15 trillion.[43] Although a fair amount of phantom FDI is held in tax havens, low-income countries are more exposed to it. A good reason is that most low-income developing countries lack the human and detective resource capacity to identify and deal with phantom FDI/investors.[44] This also compounded by the competition to attract foreign investment through a race to the bottom investment policies—making these countries more vulnerable and attractive for phantom investments.[45] Sunlodges Company is a shell company in Tanzania with phantom investment that cost the Tanzanian fiscus a fair amount of lost tax revenue. Investments in empty foreign shells have been revealed to indicate that multinationals present in developing countries employ all kinds of tax avoidance schemes to avoid taxes. Similarly, foreign-controlled empty shell entities like Sunlodges BVI try to avoid paying taxes in host country. Sunlodges Limited through the instrument of the arbitral panel avoided the payment of tax in Tanzania, with huge development cost associated with this 'judgement tax avoidance

International Cooperation in Tax Matters Seventeenth session 16-19 October 2018 E/C.18/2018/CRP https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-04/CRP19-The-Role-of-Taxation-and-Domestic-Resource-Mobilization-in-the-Implementation-of-the-Sustainable-Development-Goals.pdf accessed 27 December 2021.

4. Jannick Damgaard, Thomas Elkjaer, and Niels Johannesen, 'The Rise of Phantom Investments', (2019) 56 (3) Finance & Development 11, 12. See also Philip R. Lane and Gian Maria Milesi-Ferretti, 'The External Wealth Of Nations Revisited: Inter national Financial Integration In The Aftermath Of The Global Financial Crisis' (2018) 66 IMF Economic Review.

[44] Jannick Damgaard, Thomas Elkjaer and Niels Johannesen, 'What Is Real And What Is Not In The Global FDI Network?' (2019) 19 IMF Working Papers.

[45] Damgaard, Elkjaer and Johannesen (n 42) 12.

scheme'. Sahilu et al advocate that developing countries should consider the residual value of foreign direct investment and the looming presence tax avoidance, through phantom investment, vis-a-viz its economic development goals when entering investment agreements.[46]

Oxfam reports that if multinational companies did not dodge taxes, developing countries could raise an extra $ 100 billion to bring down inequality.[47] Tax avoidance especially in arbitral decisions derail the global effort to stop tax haven multinationals from avoiding taxes and deprive developing countries like Tanzania the chance to tackle rising inequality that drives extreme poverty. Arbitral decisions like the Sunlodges case with flimsy rationale for its tax avoidance encouragement stance stalls the domestic resource mobilisation goal of developing countries struggling to raise sufficient revenue to provide basic services such as healthcare and public safety, especially since the onset of the COVID-19 pandemic. Research shows that 15 per cent of GDP in tax revenue is necessary to finance the provision of basic public services, however about ¼ of the world's 75 poorest countries miss the 15 per cent mark.[48]

Arbitral tribunals have a critical role to play in supporting and giving credence to development-oriented tax policies and supporting the collaboration around creating a more progressive tax global system. Tribunals by ensuring that shell companies like Sunlodges are not given the opportunity to avoid taxes through undisclosed ownership structures and misinterpretation of investment treaties help the fight against tax abuse. Investors should only be allowed to repatriate their investment after all fiscal obligations have been met under domestic law.

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[46] Ibrahim Aramide Salihu, Hairul Azlan Annuar and Siti Normala Sheikh Obid, 'Foreign Investors' Interests And Corporate Tax Avoidance: Evidence From An Emerging Economy' (2015) 11 Journal of Contemporary Accounting & Economics 138, 145.

[47] 'Inequality And Poverty: The Hidden Costs Of Tax Dodging | Oxfam Inter national' (Oxfam International) <https://www.oxfam.org/en/inequality-and-pover ty-hidden-costs -tax-dodging> accessed 2 June 2022.

[48] OECD News Countries must strengthen tax systems to meet Sustainable Development Goals 14 February 2018 https://www.oecd.org/ctp/countries-must-strengthen-tax-systems-to-meet-sustainable-development-goals.htm accessed 30 November 2021.

5. ENFORCEMENT OF INVESTORS TAX OBLIGATIONS THROUGH COUNTERCLAIMS

It is important to define SOEs because this is the context in which the analysis in this section proceeds. It is difficult to define SOEs because there is no universally accepted definition for these entities. However, within the BHR context, this chapter, consistent with the UNGPs Working Group,[49] adopts a working definition of SOEs developed by the Organization for Economic Co-operation and Development (OECD) to mean:

In Saluka v Czech Republic,[50] the tribunal determined that states can pursue counterclaims against investors as long as the counterclaim is substantially connected with the primary claim.[51] It has been argued that counterclaims can serve as an important tool for host states in counterbalancing 'the procedural privilege of investors in investment arbitration'.[52] These commentators encourage international tribunals to allow counterclaims to ensure multinational businesses' international accountability.[53] According to Bose, the cases of Aven v Costa Rica,[54] and Urbasser v Argentina,[55] shows that even where there is a lack of explicit obligations imposed on an investor within the investment agreement itself, such obligations may nonetheless exist under

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49 See the UNGPs Working Group Report, online: United Nations<www.ohchr.org/EN/HRBodies/HRC/RegularSessions/Session32/Documents/ExSummary-WGBHR-SOE_ report-HRC32.pdf>.

50 Saluka Investments BV (The Netherlands) v. Czech Republic, PCA Case No.2001-04, Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004 (Saluka).

51 Ibid. paras 39 and 76.

52 Xuan Shao, "Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law" 2021(24) Journal of International Economic Law 157 158.

53 Ibid., 159; Louis Koen, "Covid-19 related claims The final nail in the coffin for international investment law?" in Murdoch Watney (ed), The Impact of Covid-19 on the Future of Law (UJ Press 2022) 60.

54 David R. Aven and others v. Republic of Costa Rica, ICSID Case No. UNC T/15/3, Final Award, 18 September 2018

55 Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic, Award, 8 December 2016.

international law.[56] In the event that investors fail to uphold these obligations, the state may lawfully file a counterclaim against the investor to recover damages.[57] Shao disagrees with the views of scholars such as Bose and argues that counterclaims would almost invariably be based on domestic law.[58] Shao opines that this domestic law foundation severely restricts the viability of counterclaims in investment arbitration.[59] This contribution agrees with Shao and argues that the Sunlodges case represents a perfect example of the constraints alluded to by him within the field of tax obligations.

5.1 Tax counterclaims in international investment law

Tanzania brought a counterclaim concerning outstanding corporate tax liabilities owed to it by Sunlodges.[60] Tanzania argued that international law permits it to bring a counterclaim for the purposes of set-off if the tribunal has jurisdiction over it.[61] It argues that the counterclaim is closely connected to the primary claim considering that the tax liabilities arose as a result of the investment relationship between the parties.[62] Sunlodges agreed with Tanzania that counterclaim are, in principle admissible. However, it argues that the counterclaim must have its legal basis in international law and that tax claims are not permitted in investment arbitration.[63]

Sunlodges relies on the case of Paushok v Mongolia,[64] in support of its argument that an investment tribunal does not have jurisdiction over tax counterclaims.[65] In that case, the tribunal ruled that an investment tribunal does not have jurisdiction over such counterclaims as these matters fall exclusively within the

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56 Debadatta Bose, "David R Aven v Costa Rica:1 The Confluence of Corporations, Public International Law and International Investment Law" 2020(35) ICSID Review 20 28.

57 Ibid., 28.

58 Shao (n 52) 159.

59 Ibid.

60 the Sunlodges case (n 4),para 503.

61 the Sunlodges case (n 4), para 505.

62 the Sunlodges case (n 4), para 506.

63 the Sunlodges case (n 4), para 511.

64 Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Government of Mongolia, Award on Jurisdiction and Liability, 28 April 2011 (Paushok).

65 the Sunlodges case (n 4), para 514.

jurisdiction of national courts and cannot be considered as indivisible from claims brought exclusively under a BIT.[66] The tribunal in that case went on to find that there is a general principle against the extraterritorial enforcement of public laws, and in particular tax laws, which precludes it from exercising jurisdiction over any failure by a claimant to pay their taxes in a host state.[67] The Paushok tribunal also quoted the Computer Sciences award where it was held that:

"Such a claim is essentially a request that this tribunal enforce the tax laws of a sovereign state [...] It is a 'universally accepted rule that public law may not be extraterritorially enforced'. Tax laws are manifestation of jus imperii which may be exercised only within the borders of a state. In addition, revenue laws are typically enormously complex, so much so that their enforcement is frequently assigned to specialised courts or administrative agencies. For those reasons, actions to enforce tax laws are universally limited to the domestic forum (…..) The tribunal thus had no jurisdiction over the [tax claim]."[68]

The finding that the extraterritorial enforcement of tax law is prohibited as a general principle of international law seems somewhat dubious. Shao correctly notes that while it is true that many countries refrain from enforcing foreign revenue laws this does not hold true universally.[69] He notes that in several jurisdictions such as Switzerland the public law nature of certain laws does not in itself prohibit the enforcement of such laws by the courts in question.[70] In states where the prohibition does exist, some have also questioned the origin and normative status of this rule.[71] The tribunals in both the Paushok and Computer Sciences cases failed to set out any evidence in support of its conclusion

66 Paushok (n 64) para 694.
67 Paushok (n 64) para 694.
68 Paushok, supra note , para 695 citing Computer Sciences Corporation and The Govern ment of the Islamic Republic of Iran, et al., Award No. 221-65-1, April 16, 1986, 10 Iran-U.S. C.T.R. 269, pp. 55-56.
69 Shao (n 52) 170.
70 Shao (n 52) 170.
71 Bobby Lindsay, "Re-Evaluating the Revenue Law Rule and the Non-Enforcement of Foreign Tax Claims" (2020) University of Glasgow School of Law Working Paper <http://eprints.gla.ac.uk/227215/1/227215.pdf> accessed 27 August 2022.

that the so-called revenue rule amounts to a general principle of international law.

Nevertheless, these cases reflect the general position in international investment law in terms of which tribunals have declined jurisdiction over tax counterclaims. The tribunal in the Sunlodges case also did not depart from the established position and agreed with the claimant that it has no jurisdiction over the tax counterclaim brought by Tanzania.[72] It finds that the tax obligations arise from Tanzanian law and "just as an investor may only bring claims arising under the Treaty, the respondent State may only bring counterclaims arising under the Treaty".[73] While the finding that the obligation must arise from international law is entirely consistent with existing investment law jurisprudence, the statement that the counterclaim must be based in the investment treaty itself seems more restrictive than existing case law. If this were indeed correct, the argument by Bose that the absence of an explicit obligation in the treaty does not preclude counterclaims where the investor has other obligations arising from international law,[74] would no longer hold true.

The tribunal in the Urbaser case also did not limit the extent of an investors' obligations to the investment treaty itself. It found the legal connection between the counterclaim and the main claim because the counterclaim was not "based on domestic law only".[75] The tribunal indeed considered the extent to which investors could be subject to obligations under instruments such as the Universal Declaration of Human Rights and the International Covenant on Civil and Political Rights i.e instruments other than the investment treaty itself.[76] The tribunal in Aven also did not limit its consideration to the investment treaty itself and considered other international instruments. The Sunlodges decision is accordingly incorrect in as far as it suggests that the counterclaim must be exclusively based on the investment treaty.

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72 the Sunlodges case (n 4), para 521.
73 the Sunlodges case (n 4), para 521.
74 Bose, supra note , 28.
75 Urbaser (n 55) para 1151.
76 Urbaser (n 55) para 1196.

The utility of sourcing the investor's obligation from outside of the investment treaty is nevertheless limited in a tax context. Ultimately, this would only prove valuable if an investor's responsibility to pay taxes arises from international law rather than the state's domestic law. This is problematic because although there has been a remarkable proliferation of bilateral tax treaties, these treaties generally only create rights and obligations between the parties. While these treaties establish important rules on taxing jurisdiction, they do not directly impose any tax obligations on investors. The role these treaties could play in providing states with an international law basis for a tax counterclaim accordingly seems limited.

These treaties value in addressing other reasons tribunals have advanced for declining jurisdiction over tax counterclaims also seems limited. For example, suppose a tax treaty contains a provision on mutual legal assistance in enforcing tax obligations. In that case, it may at first glance appear to suggest that the prohibition on the enforcement of foreign revenue laws is more difficult to uphold. The English courts have confirmed this in the case of Revenue and Customs Commissioners v Ben Nevis Holdings,[77] in which the court held that the revenue rule has always been subject to abrogation by a treaty.[78] Where a treaty provides for mutual legal assistance in enforcing tax obligations, a person cannot rely on the revenue rule to resist enforcement of the foreign tax liability.[79] Yet, the provisions on mutual legal assistance do not generally provide the state with a right to bring a claim directly. It must instead seek the cooperation of its treaty counterparty in enforcing the obligation.[80] In contrast, counterclaims in investment arbitration are brought directly by the state to whom revenue is owed and not by its treaty counterparty. Therefore, the provisions on mutual legal assistance in a bilateral tax treaty with the claimant's home state would not aid the host state in overcoming the prohibition on the enforcement of foreign revenue laws within investment arbitration.

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77 [2013] EWCA Civ 578
78 Ibid. para 53.
79 Ibid.
80 Ibid.

The host state is effectively precluded from setting-off any taxes the investor owes it against any compensation that it may owe the investor. This once again highlights the asymmetrical relationship between investors and the state within international investment law. The investor is provided with an effective tool for the enforcement of the state's obligation towards it with an award that can be granted recognition and enforcement under the New York Convention or the ICSID Convention. However, the host state has only limited recourse against the investor for unpaid tax liabilities outside of its domestic legal system and would need to settle the award in full. This presents significant challenges where the investor has liquidated all of its investments in the host state and cannot effectively be compelled to settle outstanding taxes.

6. RECOMMENDATIONS

While the problems of Investment agreements, beneficial ownership structures, tax avoidance and their effects on countries require a collective effort, states do have a primary responsibility to ensure their development goals remain at the top of its agenda when dealing with foreign investors. Investment treaties should contain provisions to preserve the autonomy of states' policies setting responsibilities apropos tax law and policy. This Section assesses what these provisions are and how they operate to maintain a state's ability to raise tax revenue. It also offers some perspective on strengthening tax policy autonomy in future trade and investment agreements.

a. Use of Tight Tax Protective Clauses in Tax and Investment Agreements

Tax and Investment Treaty Safeguards, Carve-Outs and Exceptions offer a way for states to assert and protect and firmly assert their taxing powers and sovereignty. These provisions should be geared towards tax policy and domestic fiscal mobilisation protection, especially as the investment dispute settlement system is biased towards foreign. Going forward, developing countries especially low-income countries like Tanzania should include in both their tax agreement and investment agreements especially with capital exporting countries explicit domestic law/policies compliance provisions. The inclusion of this provision emphasises foreign investors' obligations to comply with local law, including tax law. It also gives the host state a lifeline to counter-sue the foreign investors for breach of its domestic laws without complications. Investment and tax treaties should also contain taxation exclusion clauses that would restrict investor claim not to avoid tax payment on trumped-up indirect expropriation claims, which are the most challenging for states to defend themselves against.

b. Reform of Covered Asset Classes and Persons in Investment Agreement

The definitions of investment and investor sets out the types of assets and persons covered by the IIA. Old-generation IIAs frequently rely on broad definitions, covering an open-ended list of assets held by foreign investors. A major challenge for government agencies in a host country is to know whether an investment is a foreign investment and by which (if any) IIA International Investment Agreements and Their Implications for Tax Measures it could be covered. Tax administrations and tax policymakers cannot necessarily ascertain whether certain actions or measures are affecting a foreign investor covered by an IIA. The ownership chains behind a local investment through a foreign controlled shell company may be complex and designed to gain access to IIA benefits through indirect ownership stakes. Reformed IIA clauses should be used going forward by developing countries like Tanzania. New and reformed IIAs should narrow the scope of covered investments and investors and solidify sophisticated tax planning around this, through the inclusion of a general denial-of benefits clause in both investment and tax treaties and cross referencing/mentioning these clauses.

c. Domestic Law Incorporation of FAFT Recommendation 24 & 25.

Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Developing Governments should ensure that there is adequate, precise and timely information on beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares or bearer share warrants, or which allow nominee shareholders or nominee directors, should take effective measures to ensure that they are not misused for money laundering or terrorist financing through adequate transfer checks. Countries should consider measures and a system that captures investors' beneficial ownership as well as enable access to beneficial ownership. Developing Countries should also facilitate Transparency and beneficial ownership disclosure of legal arrangements. Domestic measures to prevent the misuse of legal arrangements for money laundering or terrorist financing, which is rife through the use of shell companies like Sunlodges BVI Limited should be prioritised. Developing countries prone to tax avoidance should ensure that its companies and tax registries are kept regularly updated on all forms of legal entities including trusts, companies and their structure of ownership. It is also vital for this information to be accessed in a timely manner by the public. Countries should also adopt the FATF approaches for legal entity beneficial ownership transparency which are- the use company-based beneficial ownership registers; centralised beneficial ownership registries; and the use of existing beneficial ownership information approach.

d. Abolishing the revenue law exception

The inclusion of compliance with domestic law provisions should also be supported by an explicit recognition that the revenue law exception would not preclude enforcement of a tax counterclaim. While this article has questioned whether the revenue laws exception truly amounts to a general principle of international law, the fact remains that the majority of arbitral tribunals has applied it as such. The inclusion of a specific clause indicating that tax counterclaims are not barred by the revenue law exception would avoid the risk of a tribunal finding that it does not have jurisdiction to enforce revenue laws even in the presence of a clause requiring compliance with domestic law.

7. CONCLUSION

By allowing a wide range of claims by direct and indirect shareholders of a corporation claimed to be prejudiced by host states, the international investment dispute system rules become unwittingly rigged in favour of the foreign investor and encourages the complex structuring of investment through multi-tiered corporate structures. Every undisclosed beneficial shareholder is a potential plaintiff under a different type of treaty and should be seen for what they really are- a development risk. Developing countries should endeavour to curb the excitement of foreign investment inflows and carefully evaluate the impact of investment and tax treaty terms/incentives on all its stake and interested parties as part of their overall investment treaty policy. So far, many developing countries' standing treaties are obsolete, short, unrealistically simplistic- presenting uncurbed avenues for abuse especially through the dreaded and widely interpretable fair and equitable treatment of IIAs. Finally, arbitrators in ad hoc arbitration tribunals while exercising their broad discretionary powers to interpret treaties should temper this power with regard for global standards and comity.