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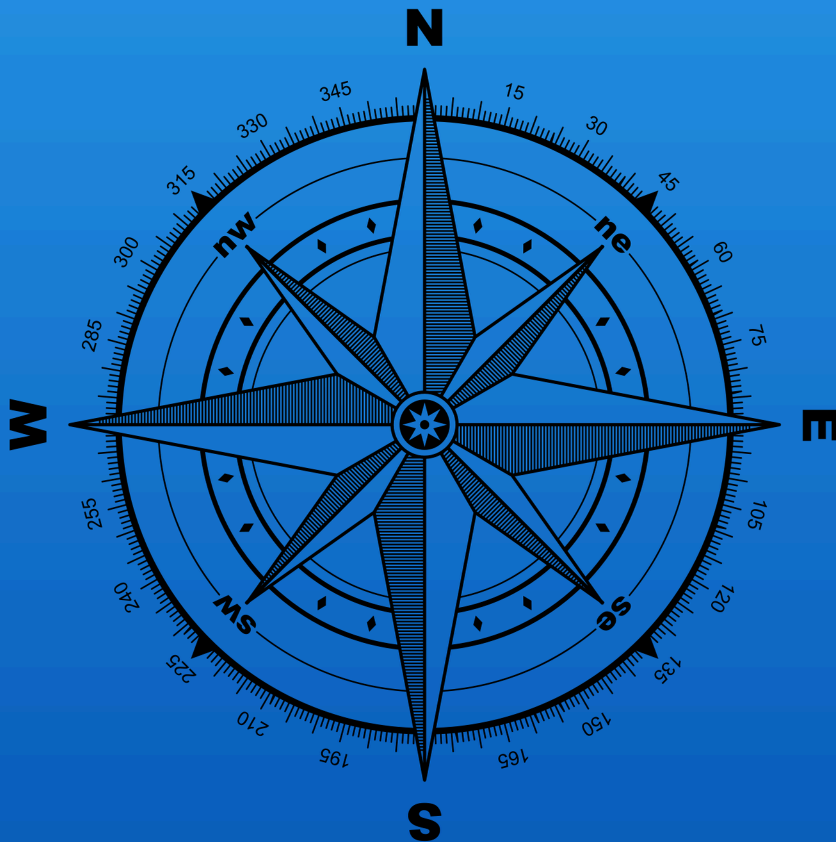

Navigating Through

GLOBAL INVESTMENT FRAMEWORK

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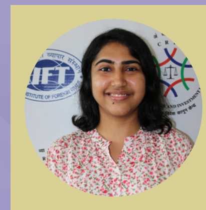

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ARBITRATION AND THE UN FRAMEWORK CONVENTION ON INTERNATIONAL TAX COOPERATION: LESSONS FROM ISDS

I. Introduction

The ongoing negotiations toward a United Nations Framework Convention on International Tax Cooperation (UN FCITC) represent a transformative moment in global fiscal governance. Mandated by the United Nations General Assembly, the Convention seeks to establish a coherent multilateral framework for international tax cooperation, addressing fragmentation, base erosion, and inequities in cross-border tax administration. A central design question concerns dispute resolution: how should disagreements between states or potentially between states and tax payers be resolved under the Convention?

As negotiators consider the inclusion of arbitration mechanisms, including variants of mandatory binding arbitration, the experience of investor–state dispute settlement (ISDS) under international investment agreements provides critical guidance. Although ISDS was designed for investment protection rather than tax governance, its increasing invocation in tax-related disputes offers cautionary lessons. This brief evaluates why ISDS-style mechanisms are ill-suited for international tax dispute resolution and outlines principled alternatives that align with fiscal sovereignty and equitable global tax governance.

II. The Emerging Architecture of Tax Dispute Resolution

Historically, international tax disputes have been addressed through bilateral tax treaties, primarily via the Mutual Agreement Procedure (MAP). MAP operates as a state-to-state consultation mechanism, relying on cooperation between competent authorities rather than adjudication. While MAP promotes diplomatic resolution, it lacks binding enforceability and often suffers from delays, asymmetries in negotiating power, and limited transparency.

In response to these deficiencies, some stakeholders have proposed arbitration as a means to enhance certainty and predictability. Arbitration mechanisms under consideration range from optional binding arbitration between states to more formalized adjudicatory models. In this context, the structure and experience of ISDS—widely embedded in bilateral investment treaties—becomes an important comparative reference point. The critical question is not whether arbitration per se is desirable, but whether ISDS-style adjudication should inform the Convention’s dispute resolution design.

III. Structural Risks of ISDS in the Tax Context

1. Fiscal Sovereignty and Democratic Accountability

ISDS grants private investors direct standing to challenge sovereign regulatory measures before international tribunals, bypassing domestic courts. In tax matters, this raises acute concerns. Taxation is an essential attribute of sovereignty and a primary instrument of redistributive justice, macroeconomic stabilization, and public welfare financing. Allowing private actors to contest tax measures outside domestic constitutional frameworks risks subordinating democratically enacted fiscal policies to arbitral scrutiny.

Experience shows that even where tax carve-outs exist in investment treaties, tribunals have asserted jurisdiction over tax-related claims framed under expropriation or fair and equitable treatment standards. Large compensation awards can significantly constrain public budgets and influence fiscal decision-making. Transposing such a model into the UN FCITC framework would risk institutionalizing a mechanism that privileges investor protection over sovereign tax authority.

2. Cost, Duration, and Resource Asymmetry

ISDS proceedings are typically lengthy and expensive. Multi-million-dollar legal costs, extensive evidentiary proceedings, and protracted timelines can impose disproportionate burdens on developing countries. For many states, defending a single complex arbitration can strain limited fiscal and institutional capacity.

In the tax sphere where disputes often concern intricate transfer pricing adjustments, anti-avoidance measures, or allocation of taxing rights complexity is likely to increase procedural costs further. A dispute resolution model that replicates ISDS's resource intensity would undermine the inclusivity and developmental objectives underpinning the UN tax negotiations.

3. Inconsistency and Absence of Precedent

ISDS tribunals operate without a formal doctrine of binding precedent. As a result, jurisprudence on similar treaty standards has evolved inconsistently across tribunals. In tax-related cases, divergent interpretations of legitimate expectations, indirect expropriation, or discrimination have produced legal uncertainty rather than clarity.

In the tax domain where certainty and predictability are paramount for both states and taxpayers the absence of a coherent interpretive hierarchy would be particularly problematic. A fragmented jurisprudence could generate conflicting outcomes on similar fiscal measures, thereby undermining the Convention's objective of harmonized and stable international tax governance.

4. Regulatory Chill and Strategic Litigation

The threat of high-value arbitral claims can generate "regulatory chill," particularly in states with limited fiscal resilience. Governments may hesitate to implement anti-avoidance rules, digital services taxes, or progressive fiscal reforms if such measures could trigger costly arbitration.

Moreover, the rise of third-party litigation funding in ISDS has amplified incentives for speculative claims. In the tax context, this dynamic could encourage opportunistic challenges to legitimate enforcement actions. Embedding ISDS-style rights within the UN FCITC architecture would risk incentivizing strategic litigation rather than cooperative tax compliance.

IV. Designing a Sovereignty-Respecting Alternative

The lessons from ISDS do not imply that arbitration must be rejected outright. Rather, they underscore the need for careful institutional design that respects fiscal sovereignty while promoting effective dispute resolution.

First, dispute settlement under the UN FCITC should remain fundamentally state-centric. Tax disputes concern the allocation of taxing rights between jurisdictions; they are not primarily investor protection claims. A state-to-state model preserves diplomatic space and avoids privatizing the adjudication of fiscal policy.

Second, any arbitration mechanism should be clearly delimited, tax-specific, and subject to robust safeguards. Optional or staged arbitration triggered only after exhaustion of cooperative procedures such as consultation or mediation may enhance certainty without replicating ISDS's structural flaws. Transparency requirements, conflict-of-interest rules, and limits on damages or remedies would further distinguish such mechanisms from investment arbitration.

Third, special consideration must be given to the interests of developing countries. Capacity-building support, cost-sharing mechanisms, and procedural flexibility are essential to ensure that dispute resolution does not reinforce existing asymmetries in global economic governance.

V. Implications for Multilateral Tax Governance

The UN FCITC represents an opportunity to recalibrate the relationship between sovereignty and cooperation in international taxation. Importing ISDS-style mechanisms would risk entrenching a model widely criticized for inconsistency, high costs, and democratic deficit. At a time when many states are reassessing their exposure to investment arbitration, replicating its features in the tax domain would be normatively and institutionally incongruent.

Instead, the Convention should articulate a dispute resolution framework grounded in sovereign equality, procedural fairness, and fiscal policy autonomy. Effective tax cooperation requires predictability but not at the expense of the sovereign right to tax.

VI. Conclusion

The design of dispute resolution under the UN Framework Convention on International Tax Cooperation will shape the legitimacy and durability of the emerging global tax order.

The experience of investor–state dispute settlement offers a cautionary narrative: mechanisms that empower private actors to challenge sovereign measures in high-cost, fragmented adjudicatory settings can distort regulatory space and strain public resources.

A forward-looking UN FCITC should therefore avoid embedding ISDS-style arbitration within its architecture. By prioritizing state-centric, calibrated, and development-sensitive mechanisms, negotiators can ensure that the Convention strengthens international tax cooperation without compromising fiscal sovereignty. The objective must not simply be dispute settlement, but dispute resolution consistent with equitable and sustainable global governance.

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ECUADOR’S REFERENDUM REJECTS ISDS: IMPLICATIONS FOR INVESTMENT LAW AND SOVEREIGNTY

On 21 April 2024, the citizens of Ecuador delivered a decisive verdict in a national referendum by voting to retain Article 422 of the Constitution of 2008, which expressly prohibits the use of international arbitration, including investor–state dispute settlement (ISDS), to resolve disputes between the state and foreign investors or private individuals under international treaties and instruments. The referendum outcome underscored strong public support for Ecuador’s sovereign strategy to distance itself from ISDS, reflecting deep domestic concern about the costs and implications of investor-state arbitration.

Ecuador’s constitutional ban emerged from years of painful experience with ISDS. Historically, the country faced several costly arbitration awards. Notably, in 2012 a ISDS tribunal ordered Ecuador to pay more than USD 1.5 billion to a U.S. oil company, a sum equivalent to a significant proportion of the state’s education, healthcare, and annual budget prompting widespread criticism of ISDS as an instrument that could undermine public policy autonomy and fiscal sovereignty.

In response to these exposures, Ecuador withdrew from the International Centre for Settlement of Investment Disputes (ICSID) Convention and terminated its bilateral investment treaties that contained ISDS provisions.

The referendum's reaffirmation of Article 422 sends a clear signal that Ecuador's electorate and civil society reject the return of ISDS, perceiving it as a mechanism that privileges investor rights at the expense of state regulatory space. This perspective aligns with broader critiques of ISDS for potentially hindering states' ability to pursue ambitious climate, social justice, and public interest policies, especially in sectors like mining, oil, and gas where foreign investment is significant and the risk of high arbitration awards remains acute.

For the international investment law community, Ecuador's referendum has important policy implications. First, it underscores a sovereign choice to prioritize domestic judicial remedies and constitutional protections over reliance on international arbitration for investor disputes. Second, the public rejection of ISDS within a popular vote highlights growing scepticism toward investor-state arbitration globally a scepticism mirrored in ongoing reform debates at the United Nations Commission on International Trade Law Working Group III, which is examining ISDS reform to address systemic concerns such as excessive damage awards and lack of predictability.

Ecuador's experience also illustrates that public opinion and participatory democracy can exert significant influence on national investment policy. The electorate's decision may constrain future treaty negotiations and compel policymakers, both domestically and regionally, to consider alternative frameworks for investor protection that respect sovereign regulatory autonomy and ensure equitable outcomes.

As countries reassess the balance between attracting foreign investment and safeguarding public interest mandates, Ecuador's referendum outcome may serve as a reference point in ongoing dialogues about the legitimacy and future role of ISDS in international economic law.

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LAOS' TAX INCENTIVES REFORM: STRENGTHENING SUSTAINABLE INVESTMENT AND REVENUE MOBILIZATION

Laos has undertaken a significant overhaul of its investment tax incentive regime to better align foreign investment promotion with sustainable development and fiscal stability. Historically, the country's tax incentives designed to attract foreign capital in sectors such as hydropower, mining, and infrastructure were overly generous and poorly targeted, resulting in substantial revenue leakagewithout commensurate socio-economic benefits. These incentives contributed to a persistently low tax-to-GDP ratio around 13%, one of the lowest in Southeast Asia

thereby constraining public investment in essential services such as healthcare and education and exacerbating fiscal vulnerability following post-pandemic economic pressures.

In response, the Ministry of Planning and Investment's Investment Promotion Department (IPD) initiated a comprehensive reform of the Investment Promotion Law, with technical support from the International Institute for Sustainable Development. This partnership, building on longstanding collaboration, culminated in a reformed law passed in June 2024 and enacted in August 2024. The reform's core objective was to make tax incentives more strategically targeted, transparent, and conducive to sustainable development while safeguarding the state's revenue base.

Key elements of the reform include narrowing eligibility for tax incentives to well-defined activities aligned with national development priorities such as environmentally sustainable agriculture and value-added manufacturing replacing broad sectoral categories that previously allowed misuse. Importantly, incentive durations have been capped at defined periods (e.g., a 10-year term), with renewals tied to compliance and performance benchmarks. Enhanced screening and due-diligence processes were introduced to ensure that tax incentives are granted only to projects that meet clear economic, social, and environmental criteria. Additionally, the updated law mandates rigorous reporting and monitoring by investors, enabling the government to assess actual outcomes and adjust policy as needed.

Crucially for legal and investment policy frameworks, the reform removed provisions that permitted investors to automatically access international arbitration in disputes related to investment incentives. Instead, disputes must first be addressed through domestic legal and administrative channels before any escalation, preserving Laos' sovereign control over fiscal matters and reducing legal exposure.

The adjustment of minimum investment thresholds based on scale, environmental risk, and social impacts further ensures that incentives are proportionate and directed toward high-value, sustainable projects.

These reforms mark a substantive shift toward balancing the need to attract quality investment with the imperative of fiscal sustainability. By aligning tax incentives with national development goals and strengthening governance mechanisms, Laos aims to promote responsible investment that contributes to long-term prosperity without unduly eroding its revenue base. The reform also enhances transparency and accountability in investment governance, setting a precedent for other developing economies grappling with similar trade-offs between investment attraction and sustainable revenue mobilization.

In sum, Laos’ tax incentive reform demonstrates the effectiveness of evidence-based policy design and international cooperation in refining investment law to support sustainable development objectives while maintaining sovereign fiscal safeguards.

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INDIA SUCCESSFULLY DEFENDS AGAINST KOREAN UTILITY'S US$400 MILLION TREATY CLAIM

In a significant development for international investment law, an UNCITRAL tribunal has dismissed a US $400 million treaty claim brought by a subsidiary of a South Korean state-owned utility against India. The claim, initiated by Korea Western Power Co (Kowepo) a subsidiary of the Korea Electric Power Corporation arose from its 40 % stake in the Pioneer Gas Power Plant Limited, a 388 MW gas-based power project in Maharashtra. Kowepo alleged that India breached its obligations under the India–Korea Bilateral Investment Treaty (BIT) 1996 and the Comprehensive Economic Partnership Agreement (CEPA) 2009, asserting that India's failure to provide promised fuel supplies left the plant idle and constituted treaty breaches. The dispute was seated in Singapore and administered under the UNCITRAL Arbitration Rules.

On 2 February 2026, the tribunal dismissed all claims in their entirety, marking a clear victory for India's defence. The tribunal's reasoning was grounded in a rigorous interpretation of jurisdiction and treaty standards. Key among the legal findings was that several contested actions by local or sub-national entities could not be attributed to the state in a manner that would trigger treaty protections, thereby undermining the tribunal's jurisdiction over those aspects of the claim. Additionally, under the CEPA, the claimant bore the burden of establishing "actual and non-speculative damages" directly resulting from any alleged breach. The tribunal concluded that Kowepo failed to demonstrate this causal link, determining that the absence of natural gas supply reflected commercial and policy risk inherent to the investment rather than a breach of enforceable treaty obligations. Moreover, India successfully asserted its sovereign regulatory discretion in allocating natural gas as a policy function not constrained by specific binding commitments to the investor.

This outcome reinforces several critical principles in investor–state dispute settlement. First, it highlights the importance of precise treaty language and causation thresholds in assessing treaty claims particularly the requirement for investors to prove clear, non-speculative losses tied to treaty violations. Second, the dismissal on jurisdictional and merits grounds underscores that sovereign regulatory actions, especially in sectors such as energy allocation, will not automatically constitute treaty breaches absent explicit commitments. Finally, the tribunal's decision contributes to a broader jurisprudential trend emphasizing that investment treaty protections do not extend to every frustration of commercial expectations, particularly where states exercise discretion in public policy domains.

For India, this defence win adds to a track record of favourable outcomes in investment disputes, where robust legal strategy and treaty interpretation have mitigated exposure. It also reinforces India's evolving approach to investment treaties, which in recent years has placed greater emphasis on preserving regulatory autonomy and calibrating investor protections in line with sovereign policy space. The case will likely inform future treaty negotiations and dispute resolution strategies, particularly as states balance investment attraction with the preservation of policy prerogatives in essential public sectors.

In conclusion, the dismissal of Kowepo's US $400 million claim affirms the strength of well-argued state defences in investor–state arbitration, especially where treaty protections are rigorously interpreted and sovereign regulatory functions recognised. For policymakers, it highlights the importance of clear treaty drafting, careful delineation of jurisdictional thresholds, and the primacy of substantive evidence in investment treaty disputes.

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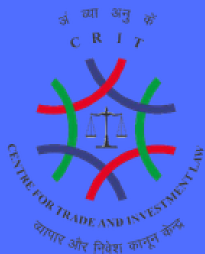

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