



Structuring investments to achieve treaty protections and address tax issues

Kiev Arbitration Days 2011

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November 18, 2011

An Offshore Paradise

- According to UNCTAD, the British Virgin Islands received US\$61,578,000,000 in inward foreign direct investment stock in 2007—more than Pakistan, the Philippines and Panama, combined—and amounting to 2.3 million dollars per BVI resident. This, as we know, wasn't because of the beaches.



Roadmap

- Point 1: Historical overview of jurisdiction selection as a part of investment structuring
- Point 2: Structuring considerations regarding taxation and investment treaties
- Point 3: Surveying a volatile investment treaty landscape

Historical Overview

- Investors have traditionally structured their investments through corporate intermediaries for several purposes:
 - Tax considerations
 - Corporate governance
 - Liability concerns

Historical Overview: Tax Considerations

- Avoid double taxation
 - Same dividend subject to home state and host state tax
- Optimize tax exposure
 - Avoid tax exposure in ultimate home jurisdiction
 - American companies have exacted significant savings:
 - Blackstone group: 0.4% tax rate
 - Carnival Corporation: 1.8% tax rate
 - First Solar: 2.0% tax rate

Lower Capital Gains Taxes

- Even today, significant disparities in capital gains tax rates
 - Zero CG tax in Belgium
 - Zero CG tax (with very limited exceptions) in Hong Kong
 - Zero CG tax in Singapore
- By comparison
 - United States: 15%
 - France: 27%
 - Sweden: 30%
 - Denmark: 50%

Structuring Investments: Locations

- Prevalent jurisdictions include Netherlands, BVI, Hong Kong
- Comparative advantages:
 - Netherlands: low tax rate, reliable legal system
 - BVI: Zero income tax, zero capital gains tax
 - Hong Kong: low tax rate, reliable legal system, relaxed international reporting requirements

Stumbling into Treaty Protection: the Dutch Story



BITs as a Bonus

- Many Dutch intermediaries were formed for the tax treatment, but there was incidental – and great – benefit from BITs
- Netherlands has extensive web of BITs: 105 treaties in place, mostly in developing world
- Broad definitions of “investor” and “investment”

Structuring considerations for tax and investment treaties

	Tax treaties	Investment treaties
Timing	Structuring must take place before levy of tax	Generally speaking, structuring must take place before putative violation
Applicable test	Varies: emphasis usually on substance/economic functions of intermediary company	Varies: intermediary company often needs some economic activity; cannot exist solely to advance a claim
Forum	Municipal courts or, less frequently, international arbitration	International arbitration commonly, but not always, available
Applicable law	Municipal law tends to play important role	Primarily treaty text

Structuring: Timing

- **Tax treaties:** Structuring must take place before levy of tax to benefit from tax treaty
- **Investment treaties:**
 - “[A]n international investor cannot modify *downstream* the protection granted to its investment by the host State, once the acts which the investor considers are causing damages to its investment have already been committed.”
(Phoenix Action v. Czech Republic)

Structuring: Applicable test

- **Tax treaties:** Many laws differentiate between conduit and *bona fide* entities
 - Cannot be “a mere fiduciary or an administrator” (OECD’s Conduit Companies Report)
 - Beneficial owner must generally engage in “substantive business activities” and have some controlling or disposal rights to income and assets (China's State Administration of Taxation, *Circular on Interpretation of "Beneficial Owners" Under Tax Treaties*)

Structuring: Applicable test

- **Investment treaties:**

- “The Claimant manifestly did not create Tokios Tokelès for the purpose of gaining access to ICSID arbitration under the BIT against Ukraine, as the enterprise was founded six years before the BIT between Ukraine and Lithuania entered into force.” (*Tokios Tokelès v. Ukraine*)
- “...if the sole purpose of an economic transaction is to pursue an ICSID claim, without any intent to perform any economic activity in the host country, [it] cannot be considered as a protected investment.” (*Phoenix Action v. Czech Republic*)

Structuring: Applicable forum and law

- **Tax treaties:** With limited exceptions, municipal courts interpret treaty text and apply municipal law
 - *Income Tax Conventions Interpretations Act of Canada:* Undefined treaty terms, except to the extent that the context otherwise requires, should have an ambulatory meaning and evolve with changes made to Canadian tax law.
- **Investment treaties:** International arbitral panels interpret the treaty, relying more on international law for gap-filling

Structuring: Additional considerations

- Pay careful attention to language of treaties, as clauses with additional restrictions exist:
 - Belgo-Lux-Croatia BIT—Article 2(b):
 - a legal person ... having its seat and performing business activity in the territory of the same Contracting Party
 - Belgo-Lux-Ukraine BIT—Article 1(1)(b):
 - les sociétés ... et ayant son siège social sur le territoire (translation: having its “feet” or head office in the contracting party)

Structuring: Additional Considerations

- Stay informed of developments to applicable treaties
 - Many countries rely on protocols and “technical explanations” to amend or interpret existing tax treaties
 - Countries may also withdraw themselves from treaties
 - United States repealed BVI tax treaty in 1981

Surveying a volatile treaty landscape

- Effect of Lisbon treaty on existing EU bilateral investment treaties
 - Affords EU Commission the authority to control investment treaties within the EU
 - Speculation that EU Commission withdrawal of some treaties



Surveying a volatile treaty landscape

- Withdrawal from ICSID in parts of Latin America
 - Venezuela
 - Bolivia
 - Ecuador limiting scope of consent
 - May be reflective of greater trend in the region



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