Tax Arbitration: Protection for Foreign Investors from Unforeseen Tax Claims

Edwin Vanderbruggen

Auckland, 23 January 2013

VDB | Loi

We are a specialized law and tax advisory firm in Southeast Asia with over 60 transaction lawyers and tax advisors.

We provide the highest quality solutions for transactions and taxation.

6 countries

More than 60 transaction lawyers and tax advisors

Transactions

Investment
M&A
Resources
Real estate
Energy

Taxation

Structuring
International
Compliance
Customs
Controversy

VDB | Loi

Senior partner

Edwin Vanderbruggen

Formerly with Loyens & Loeff and a partner at DFDL, Edwin has 20 years of experience as a tax lawyer, academic, author and government adviser. He has worked 15 years in Southeast Asia. Edwin taught international tax law at six different universities in Europe and Asia, including delivering a number of lectures at the prestigious International Tax Center in Leyden. He published seven treatises on international and Asian taxation and over 50 scholarly articles, some winning scientific awards. He is an adviser to the Minister of Economy and Finance of Cambodia on double taxation agreements, and provided training on tax issues to government officials in a number of Southeast Asian countries . Edwin supplied expert testimony to tax courts on tax treaty interpretation, and consulted for the World Bank and the ADB on tax policy and administration.

Edwin Vanderbruggen is a tax lawyer, academic, author and government adviser in Southeast Asia. He is based in Yangon, Myanmar.

VDB | Loi

Can the law of a state levy any tax at all on foreign investors?

Tax Policy	Tax Administration
Who is taxed and who is not?	Who is targeted for tax audits and how are these conducted?
What is the tax rate?	How are appeals treated?
How is the taxable basis determined?	What enforcement measures can be taken and when?
What are the conditions for a refund?	Is there an independent judicial review possible?

Can States Tax Investors However They Like?

Committments on taxation under international law

1. Commitments in an investment contract -> Tax stabilization clause
2. Commitments in (Bilateral) Investment Treaties (BIT)

- "Each Contracting Party shall ensure **fair and equitable treatment** of the investments of the nationals of the other Contracting Party"
- "Neither Contracting Party shall subject investments in its territory owned or controlled by nationals or companies of the other Contracting State to **treatment less favorable than it accords to investments of its own nationals or** companies or to investments of nationals or companies of **any third state**".
- "A State shall **not expropriate** or nationalise a covered investment either directly or through measures equivalent to expropriation or nationalisation ("expropriation"), except: (a) for a public purpose (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law"

VDB | Loi

.

The Case of the Tax Free Merger

Duke Energy v. Peru

- In 1999 a US energy company called Duke invests in power plants in Peru by purchasing a holding company which holds various operating companies.
- At the end of 1996, one of the operating companies that Duke indirectly acquires had been merged with a newly established company, Newco. The merger took place so that the assets of the power plant could be revalued for tax purposes without however paying any taxes on that revaluation in the company that owned the assets, based on a tax exemption in the "Merger Revaluation Law".
- In 2001, the Peruvian tax authorities assess taxes on the merger, in essence claiming that the merger was a sham and does not qualify for the tax exemption.
- Duke invokes the "Legal Stability Agreement" that was concluded with Peru for a period of 10 years, which includes a tax stabilization clause.

VDB | Loi

The Case of the Tax Free Merger

Duke Energy v. Peru

- What is the legal effect of a stabilization clause?
- **When is a tax situation "stabilized"?**
    - New laws or regulations
    - New interpretation
    - Clear case law or writings
    - Statements from the Government that merely imply a certain interpretation
- Impact of anti-evasion measures?

Outcome: Investor wins the case

VDB | Loi

The Case of the Duty Free Shop

Link Trading v. Moldavia

- A US company, called Link Trading, operates a duty free retail operation in a Free Economic Zone Moldova has created.
- Customers have the right to buy US$600 worth of duty-free goods in the Free Zone and take these out of the Zone.
- The US$600 limit is later reduced by the authorities and ultimately abolished.
- The company argues this is contrary to the legal stabilization clause that exists for investors in the Free Zone, as created by Moldovan law, and a violation of the relevant Bilateral Investment Treaty (BIT).
- Foreign Investment Law contains a 10 year stabilization clause.
- Free Economic Zone Law has stabilization clause as well.

VDB | Loi

The Case of the Duty Free Shop

Link Trading v. Moldavia

- The guarantees in domestic law do not apply to these customs rules.
- Tribunal: "Customs regulations are subject to annual change, and the investor should have known that". Also: "Governments…frequently change their laws and regulations…those changes may well make certain activities less profitable or even uneconomic to continue" (Feldman v Mexico, par. 112)
- "Not dissimilar to the policies of many countries in the world, not abusive, arbitrary or discriminatory"
- "The tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favored, with others less favored or even disadvantaged" (Feldman v Mexico par. 113)
- **Are there limits to this sovereign freedom?**

Outcome: Government wins the case

VDB | Loi

The Case of the Oil Company VAT Refund

Occidental v. Ecuador

- In 1999, an oil company called Occidental concludes a Production Sharing Contract (PSC) with Ecuador for the exploration of oil. It contains a tax stabilization clause.
- Between 1999 and 2001, Occidental claims and receives refunds for VAT it incurs on supplies made to the company, such as VAT on drilling services.
- Starting from 2001, the tax authorities refuse refunds and reclaim refunds that were already paid based on the view that VAT refunds are already included in the company's production share, and that VAT refunds are not possible for oil producing companies as per internal law ("manufacturing for export").
- Occidental files lawsuits in Ecuador, which are still pending in 2002 when the company starts the arbitration procedure.

VDB | *Loi*

The Case of the Oil Company VAT Refund

Occidental v. Ecuador

- "Fork in the road"
- No evidence that VAT refund is in factor X
- **"The stability of the legal and business framework is thus an essential element of fair and equitable treatment"**.
- The Tribunal must note in this context that the framework under which the investment was made and operates has been changed in an important manner by the actions adopted by the [tax authorities]. … **The tax law was changed without providing any clarity about its meaning and extent and the practice and regulations were also inconsistent with such changes",** resulting in a breach of fair and equitable treatment

Outcome: Investor wins the case

VDB | Loi

The Case of the Cigarette Exporter

Feldman v. Mexico

- A foreign invested company in Mexico called CESMA buys and exports cigarettes. There are only two companies in this business, one foreign and one domestic.
- CESMA is refused excise tax refunds for exported cigarettes while domestic competitors were able to receive the refunds.
- In 1991, the laws were changed to exclude cigarette exporters from refunds, but this was later deemed unconstitutional by the Mexican Supreme Court.
- In 1993, the tax authorities again denied refunds to CESMA this time based on regulations stating the information to be included on invoices that entitle to the refund. These regulations were in place since 1987.
- CESMA is unable to buy from whole-sellers and thus has no such invoices, but argues that these regulations were in practice waived or ignored for domestic cigarette resellers.

VDB | *Loi*

The Case of the Cigarette Exporter

Feldman v. Mexico

- Difficulties in dealing with tax officials is not enough: "**Unfortunately**, **tax authorities in most countries do not always act in a consistent and predictable way"**
- "Act in accordance with due process and with domestic laws, regulations and internal procedures" (**Tza Yup Sum vs. Peru**)
- **Which international obligations must the tax official observe, and are these different from domestic obligations**? Due process, good faith (reasonableness, fair, honest), transparency.

In this case:

- Evidence of **discrimination**: tax rebates were indeed paid to domestic competitors of CESMA + burden on the Government
- "Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner"

Outcome: Investor wins the case

VDB | Loi

The Case of the Transfer Pricing Audit

Tza Yap Shum vs. Peru

- In 2002, Mr. Tza Yap Shum establishes TSG with an investment of US$400,000.
- TSG purchases raw fish, delivers this fish to third-party factories to process it into fish meal, and exports the finished product. Sales reach US$20M per year.
- In 2004, the Peruvian tax authorities “SUNAT” conduct a routine audit of TSG after TSG had requested sales tax refunds.
- TSG has not properly declared the amounts and values of raw materials
- The SUNAT issued a new tax assessment based on “presumed basis” of 4M$.
- SUNAT “interim measures”: banks in Peru are directed to retain any funds passing them related to TSG and redirect them to the SUNAT.
- TSG’s business becomes inoperable
- TSG commenced proceedings in Peru to have the tax claim lifted. An appeal to the SUNAT was rejected, although the amount of back taxes was reduced.
- TSG’s challenge before the Peruvian Fiscal Tribunal was rejected as well.

VDB | Loi

The Case of the Transfer Pricing Audit

Tza Yap Shum vs. Peru

- TSG first maintained that the tax audit itself was an expropriation. The Tribunal did not agree to this. The Tribunal found that the audit appeared to have been routine. Peru has the right to conduct tax audits on enterprises, so the tax audit in and of itself cannot be seen as an expropriation.
- The Tribunal determined that the interim measures taken by the SUNAT did in fact amount to an expropriation.
  - The interim measures significantly interfered with the operation of TSG:
  - SUNAT imposed the interim measures in an arbitrary manner: The SUNAT did not respect the internal rules and guidelines for its own interim measures, which state that these measures are exceptional, need to be justified and accompanied by evidence, and that efforts must be made to mitigate harm to the taxpayer's business.

Outcome: Investor wins the case

VDB | Loi

Some Concluding Remarks

- The big questions
- In practice
- Quo vadis?

VDB | Loi

Are You on My Mailing List?

VDB | Loi
Analysis
13 September 2012

Salient Details of Myanmar's New Foreign Investment Law

Edwin Vanderbruggen, Cynthia Herman & Thida Cho Win

A new Foreign Investment Law ("FIL") has passed the Union Parliament of Myanmar (the "Parliament"), an important step in Myanmar's economic liberalization. The FIL clears up many mysteries related to Myanmar's investment environment. To begin, The FIL provides a framework for designating special areas of economic activity, both those that are encouraged and those that are restricted. The FIL also contains other instructions for foreign parties interested in investing, such as foreign ownership thresholds in joint ventures. The FIL contains a generous tax holiday and other special benefits afforded to those foreign companies that follow the rules. Finally, the FIL describes the permission to use land for persons who are not Myanmar citizens.

We have based our analysis on the text of the FIL as passed by the Upper House of the National Assembly. The text is however still subject to changes as the National Assembly will reconsider changes suggested by the President. We have commented at this time only on the provisions which we understand will remain in the FIL, even after revisions, but it cannot be excluded that also these provisions will be changed.

Which sectors are encouraged, which are restricted?

Encouraged Activities

Chapter 2 of the FIL stipulates notification that the

ABOUT THE AUTHORS

Edwin Vanderbruggen is a tax lawyer, academic, author and government adviser w... over 20 years of experience structuring some... the largest acquisitions, investments and property deals in Southeast Asia.
edwin@vdb-loi.com

Cynthia Herman, who has more than five ye... of experience with Ernst & Young, DFDL and VDB Loi, is based in Yangon. She has advised companies, oilfield service providers, distribution companies and private equity funds on Myanmar tax and investment matte...
cynthia.herman@vdb-loi.com

Thida Cho Win is a qualified CPA with 25 ye... of experience with a specialized audit and ta... firm in Myanmar, which joined VDB Loi in 20...
tdcho.win@vdb-loi.com

ABOUT VDB LOI

VDB Loi is a regional legal and tax services firm w... more than 50 outstanding local and internatio... lawyers and tax advisers. We provide the highest qual... integrated solutions for structuring investment a... business transactions in Cambodia, Indonesia, La... Myanmar, Singapore and Vietnam.

VDB Loi provides expert analysis on legal and ... regulations across Southeast Asia. To read this analy... please visit
www.vdb-loi.com/vdb-loi-analysis

VDB | Loi
Insider
Number 1, 05 October 2012
www.vdb-loi.com
Cambodia | Indonesia | Laos | Myanmar | Singapore | Vietnam

Upcoming Events

2nd New Myanmar Investment Summit
17-18 October, Yangon

Malaysia Business Chamber Business Luncheon
8 November, KCMC

Myanmar Real Estate Summit
28-30 November, Yangon

Inward and Outward Mining Investment
29 November, The Crowne Plaza St Terrace Road Perth

Tax alchemy: Turning silver into gold
23-25 January, 2013, The University of Auckland Business School, Auckland

VDB Loi in the News

International Tax Review online – VDB Loi gears up for more tax and customs litigation in Myanmar

Asian Legal Business online – VDB Loi adds senior lawyer in Myanmar

AmCham Singapore e-news – Former Director of the Myanmar Supreme Court joins VDB Loi

International Tax Review – VDB Loi Partner Edwin Vanderbruggen explains some international aspects of Myanmar's tax system

Asian Legal Business – Top legal magazine ALB publishes a big profile on VDB Loi

Thought Leadership

Salient Details of Myanmar's Upcoming New Foreign Investment Law Update

13 September – This analysis includes the following information about Myanmar's new Foreign Investment Law:

- Encouraged and restricted sectors
- Changes to the minimum capital Requirement
- The Employment of expatriates
- The Level of Foreign ownership Allowed
- A Comprehensive Guide to Tax Incentives
- Ability of Foreigners to Lease Land

[Read full article]

Vietnam and Singapore Amend their Tax Treaty Update

12 September – Vietnam and Singapore signed a second protocol to amend their tax treaty. We highlight the following notable changes:

- **Capital gains on shares of companies that hold property**
  With respect to the capital gains tax on the sale of shares, previously, Vietnam does not have the right to tax on gains of a Singaporean resident seller. Under the second protocol, this rule has been limited and provides that Vietnam may tax in the event that the Vietnamese entity's value consists of more than 50% of immovable property.
- **183 days Service PE introduced**
  Permanent establishment (PE) concept: The tax treaty did not provide any particular length of time for which a service would constitute a PE. As such, there have been several different interpretations on service PE, which have been controversial. The second protocol now provides in a 183 day time test, reproduced from the UN Model tax treaty.

[Read full article]

Outbound Payments from Laos: VAT, Withholding Tax, or Both? Update

5 August – Under Lao tax regulations, the VAT rules on place of supply are more complex and detailed than the rules for the withholding of Income Tax and Profit Tax. The VAT rules are very specific in determining where the place of supply is considered to have occurred and hence whether that is within Laos or not – to determine if VAT is applicable. The withholding of Income Tax and Profit Tax rules are much broader in context and will generally catch any income derived within Laos, including foreign persons that carry on business or make a living on a permanent or temporary basis in Laos, as well as those that reside or have a place of business in Laos but carry on activities in a foreign country that generate income... [Read full article]

VDB | Loi
Analysis
(restricted circulation)

Questions on the Myanmar Taxation of Oilfield Services under Its Double Taxation Agreements with Malaysia, Singapore and Thailand

Edwin Vanderbruggen, Cynthia Herman and Thida Cho Win

This analysis focuses on the international tax treatment of oil & gas field service income derived from Myanmar, with particular reference to services performed from three major hubs in the region, notably Malaysia, Singapore and Thailand. All three jurisdictions have tax treaties (here referred to as "double taxation agreements" or DTAs) in force with Myanmar[1].

Myanmar has considerable onshore and offshore oil and gas reserves, estimated at 2.1 billion barrels oil and 25 trillion cubic feet of gas, according to an energy ministry's presentation in June 2012[2]. Interest remains high in the development of Myanmar's oil and gas blocks. In July 2011, nine onshore blocks were awarded to oil companies from various countries, including CIS Nobel Oil from Russia, GeoPetrol from Switzerland, EPI Holding Ltd from Hong Kong, Jubilant Oil from India, Malaysia's Petronas and Thailand's PTTEPI. With EU sanctions suspended and certain US sanctions on investment lifted, potential demand for the remaining interests, which include 23 new offshore blocks, can only increase.

[1] Currently, Myanmar has DTAs with: India (Concluded 30 January 2009; Effective 1 April 2009); Korea (Concluded 31 July 2003, Effective 1 April 2004); Malaysia (Concluded 21 July 2008; Effective 1 April 2009); Singapore (Concluded 23 February 1999, Effective 26 June 2009); Thailand (Concluded 9 January 2002; Effective 1 January 2012); United Kingdom (Concluded 13 March 1950, Effective 4 April 1951); and Vietnam (Concluded 8 May 2008, Effective 1 April 2009).

[2] http://www.mizzima.com/business/7552-call-for-foreign-companies-to-explore-new-offshore-blocks-official.html

IMPORTANT NOTICE

This topic will be covered at our upcoming
MYANMAR TAX & INVESTMENT WORKSHOP
25 September 2012, 8.00AM – 5.00PM
The Fullerton Hotel Singapore
More Detail

ABOUT VDB LOI

VDB Loi is a regional legal and tax services firm with more than 50 outstanding local and international lawyers and tax advisers. We provide the highest quality integrated solutions for structuring investment and business transactions in Cambodia, Indonesia, Laos, Myanmar, Singapore and Vietnam.

ABOUT THE AUTHORS

Edwin Vanderbruggen is a tax lawyer, academic, author and government adviser with over 20 years of experience structuring some of the largest acquisitions, investments and property deals in Southeast Asia.

Cynthia Herman, who has more than five years of experience with Ernst & Young, DFDL and VDB LoI, is based in Yangon. She has advised oil companies, oilfield service providers, distribution companies and private equity funds on Myanmar tax and investment matters.

Thida Cho Win is a qualified CPA with 25 years of experience with a specialized audit and tax firm in Myanmar, which joined VDB Loi in 2012.

VDB | Loi