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Mining Arbitration Report

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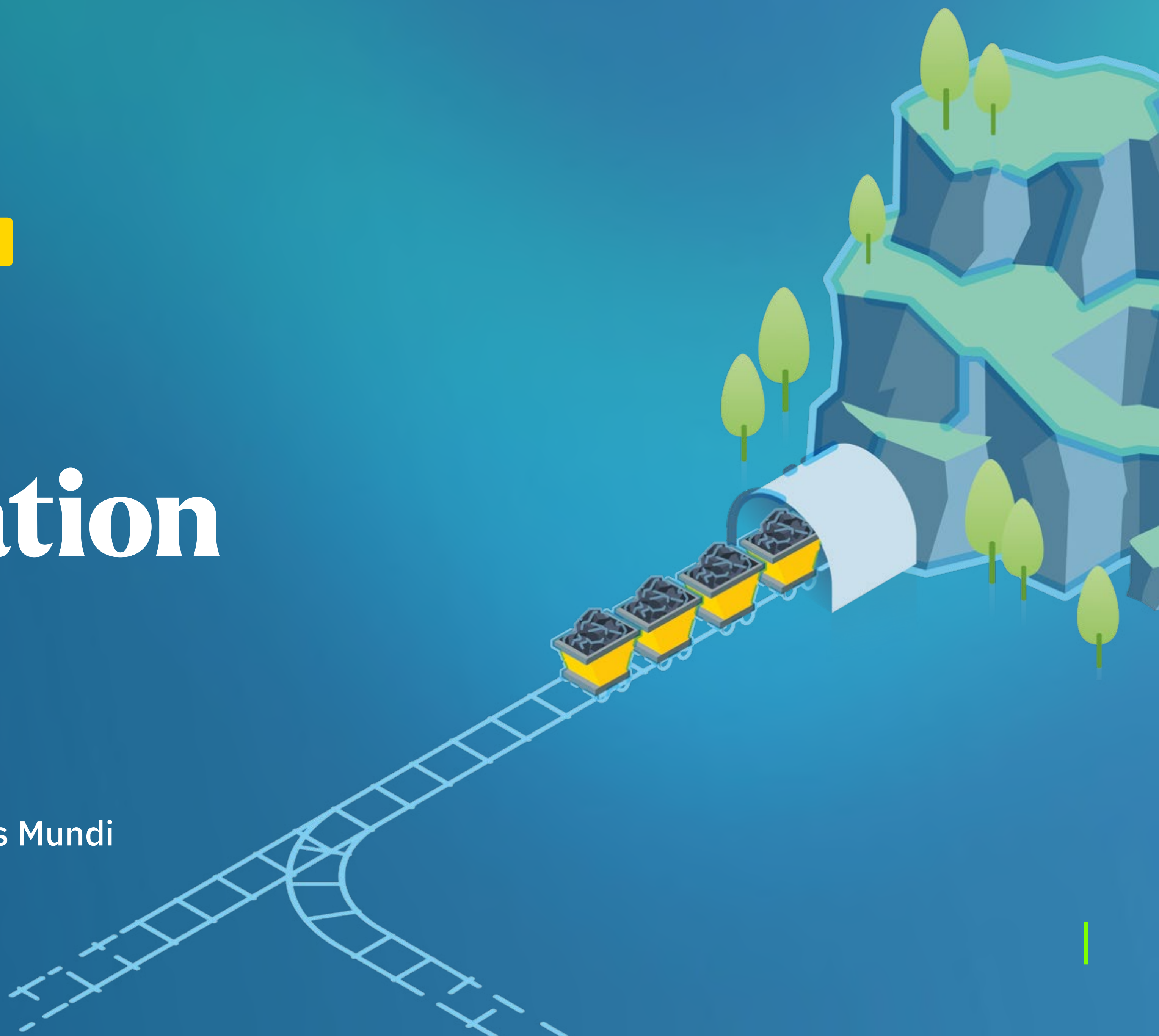

Digging Deeper: Explorative Perspectives in Mining Arbitration

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MINING PROJECTS AND TAX DISPUTES: WHAT REMEDIES CAN BE ACHIEVED THROUGH INTERNATIONAL ARBITRATION?

International arbitration is a go-to means used by investors to challenge tax measures implemented in breach of contracts and licenses, as well as of international investment agreements (IIAs). Such measures may include tax reforms, abusive adjustments, unreasonable or discriminatory audits, etc.

The mining sector is not immune to these types of measures. In fact, the nature and scope of mining projects, the size and timing of required investments, and the stakes for the budgets of mineral-rich States, make it a regular target for tax authorities. Recently, some States have, for example, sought to address the general minerals price downturn by increasing contributions to State budgets arising out of mining projects.[1] An increased rate of tax audits and adjustments has also allowed States to recover a larger share of the revenues generated by mining operations. However, tax measures can often jeopardize, or even destroy, mining investments by affecting their profitability or operability.

International arbitration proceedings involving tax measures and mining projects are therefore on the rise. This short overview seeks to map out their salient features and the remedies available to mining operators.

1. Other tax and customs measures can take the form of increases in taxes on mining exploration, capital gains taxes on transfers of mining titles, changes in underground or open pit mining royalty rates, in financial incentive schemes, and increased requirements on repatriation of income deriving from mineral exports.

Resolving Tax Disputes Under Mining Contracts

Mining contracts or conventions can take different forms, depending on the type of operators involved, the region where the project is implemented and its advancement stage. Tax authorities often get involved with mining projects at the exploitation stage, once resources and reserves have been confirmed and mining is bound to start or has started. Tax authorities are also involved throughout the commercialization of the extracted resources, by collecting taxes on the resulting revenues.

As multi-faceted as mining projects can be, so are mining contracts. The contracting parties are generally the entity owning the resources (usually the State) and the entity looking to exploit them, most often a local entity in which the State holds an interest, often together with a foreign partner.

These contracts generally ratify the conditions expressed in the relevant permits or authorizations issued for the exploration and exploitation. They also address the economic, legal, administrative, financial, tax, customs, mining, environmental and social conditions for the exploration or exploitation.

In relation to taxes specifically, mining contracts usually provide for the tax regime applicable to the operation, in accordance with local legislation. They may provide for specific tax rates, breaks, exemptions, or credits (*e.g.*, VAT credits). They may also include specific tax stabilization clauses, which provide that no subsequent legislative or regulatory changes may adversely impact the tax regime applicable at the time of the contract's signing. Instead of tax specific stabilization clauses, mining contracts may also include general stabilization clauses, which cover all issues considered by the contract.

Other key features may include:

the State party's obligation to facilitate the issuance of authorizations, permits, or approvals necessary for operations;

the State party's obligation not to hinder the operations by, for example, imposing additional restrictions on the movement of goods; and

international dispute resolution clauses, providing for technical determination, mediation, conciliation and/or arbitration of disputes relating to the contract (generally under ICC, LCIA, or ICSID rules).

Regardless of such protections, tax audits are frequent in the mining sector, and can be triggered by a host of (more or less legitimate) reasons, including legislative amendments, new interpretations of existing tax rules, or political considerations. Since these audits and resulting adjustments can have serious consequences on the exploiting party's cashflow and ability to continue the exploitation of the mine, they must be considered carefully.

Notably, even before considering resorting to international dispute resolution, affected entities must focus on expressly preserving their rights to challenge the rightfulness of any tax adjustment, in all ensuing discussions/negotiations with tax authorities. This can prove difficult given the length and complexity of these procedures, that often include several layers of administrative and judicial review. However, settling tax disputes does not require or imply agreeing to the rightfulness of a tax adjustment, and any such concessions may to the contrary be damaging to the miner's ability to enforce rights under the relevant contract, notably as regards its ability to subsequently recover the full amount of the tax adjustment through international arbitration. Further, even during the arbitration procedure, a frank dialogue with the State and its tax authorities can be useful to pursue a fair settlement of the dispute. Lastly, documenting any adverse effect of tax measures is of paramount importance to preserve the operator's ability to enforce its rights before an arbitral tribunal.

Resolving Tax Disputes Under International Investment Agreements (IIAs)

Another source of protection for mining investments is the web of thousands of bilateral and multilateral IIAs (BITs, FTAs, etc.), which include procedural and substantive protections for qualifying investments made by foreign investors.

A significant hurdle to the use of IIAs in tax disputes may be the presence of a tax exception or carve-out, *i.e., a provision totally or partially excluding tax measures from the treaty's scope of protection.* Other treaty provisions may affect the admissibility of claims, such as the need to consult with tax authorities of the host State or to organize joint consultations between the States' tax authorities before any arbitration proceedings can be initiated (see, *e.g.*, Art. 21 of the ECT or Art. XII of the now-terminated 1996 Canada-Ecuador BIT).

On the merits, foreign investors may bring claims for breaches of the standards and protections found in the IIAs. The most common protection is the prohibition against direct or indirect expropriation (i.e., through measures equivalent to expropriation), without payment of prompt and adequate compensation (among other requirements). For example, in Oxus Gold v Uzbekistan (paras. 748-750), the tribunal assessed whether one of the challenged tax audits and VAT regime change had caused the "effective destruction of the value of the investment". In Burlington v Ecuador (paras. 391-402), the tribunal addressed the notion of "confiscatory taxation", noting that a taxation becomes an expropriation if it meets the test of substantial deprivation.

Foreign investors may also argue that they were subjected to a differing tax treatment without justification, and thus in breach of the prohibition against discrimination usually found under national treatment or most favored nation (MFN) clauses of IIAs. For example, a tribunal found a breach of the national treatment standard in the case Occidental v Ecuador (paras. 167-179), in relation to denied VAT refunds.

The manner and timing of the host State's introduction of the litigious tax measures may also breach the host State's obligation to provide fair and equitable treatment (FET), including the prohibition against arbitrary measures or lack of transparency. The retroactive imposition of a capital gains tax was thus found to breach the FET provision of the UK-India BIT in the Cairn v India case (para. 1816), because such measure did not adequately balance the foreign investor's "protected interest of legal certainty / stability / predictability" with the host State's "power to regulate in the public interest". In Oxus Gold v Uzbekistan (paras. 824-825 and 827), a tax regime change, including the revocation of various tax privileges applying to the export of precious metals, was found to breach the foreign investor's legitimate expectations and breach the host State's obligation to afford FET.

Before international arbitration tribunals, foreign investors have thus sought restitution or damages to compensate for the loss incurred.

Injunctive and declaratory relief has also been claimed, for instance by requesting the withdrawal of a tax demand (see, e.g., Cairn v India, paras. 1870-1878).

Stabilization clauses in contracts with the host State, or in regulations specifically directed at the foreign investor, have also proven useful before international investment tribunals to mitigate risks stemming from tax regime changes (see, e.g., Oxus Gold v Uzbekistan, para. 823).

The paper contains general views of the authors without regard to any specific underlying facts or circumstances. As such, it does not constitute legal advice. Any liability for the content, completeness or accuracy of the paper is excluded.

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