Spillover Effects in International Law: The Case of Tax Planning and Investor-State Dispute Settlement

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The classic ISDS case:
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“Proxy Arbitration” w/o standing - 16% of all ISDS cases
“Proxy arbitration” w/standing - 10% of all ISDS cases
Indirect investment w/o proxy arbitration - 14% of all ISDS cases
Proxy arbitration increases **scope** of investment treaty regime, as well as host state liability.

May undermine already tenuous legitimacy of ISDS.

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Recent work suggests that investors engage in strategic, *ex ante* BIT shopping (Betz, Pond and Yin 2020; Gray 2020).
My argument:

1. BIT protection does not justify costs of indirect investment; tax avoidance does.
2. Proxy arbitration is actually a **spillover effect** from int’l tax treaty regime.
3. Investors use intermediate subsidiaries to access other states’ tax treaties — as a side benefit, they gain access to other states’ investment treaties.
Road map

1. **Theory**: Tax Planning and ISDS
2. **New data**: Ownership structures of ISDS claimants, 1987-2015
3. **Research design + results**: Investors choose conduit locations that maximize tax treaty access, not investment treaty access.
Theory: tax planning

- Multinational firms want to (legally) minimize their tax burdens
- Two common tax planning techniques to achieve this:
  1. Minimize income tax by profit-shifting
  2. Minimize withholding tax using network of bilateral tax treaties
- Both techniques typically involve investing *indirectly* through conduit subsidiaries
- Conduit subsidiaries created for tax planning can be repurposed for ISDS if a dispute arises
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Example: *B3 Croatian Courier v. Croatia*, ICSID 2015

- Home State: United States (35%)
- Conduit State: Netherlands (25%)
- Host State: Croatia (15%)

States:
- United States
- Netherlands
- Croatia
Observable implications

- Indirect investors should choose conduit locations that:
  - **H1** Offer access to the tax treaty network.
  - **H2** Offer lower withholding tax rates.
  - **H3** Have lower corporate income tax rates.

- In contrast, BIT/IIA-shopping investors should choose conduit locations that:
  - **H_A** Expand the investor’s BIT portfolio.
To test hypotheses, I need data on the ownership structures of ISDS claimants. For 1,000+ claimants in 726 cases filed between 1987-2015, I collect data on:

1. The name and nationality of the claimant's owner/controller, if any
2. Whether the claimant held ownership of the host state assets through a conduit

Consulted business databases, corporate registries, offshore leaks, and host of other sources.
How does proxy arbitration affect distribution of ISDS claimants?
Research design: conduit location models

- Limit to observed cases of indirect investment.
- Do tax planning concerns influence conduit **location**?
- Key tax variables:
  - H1 Tax treaty between host-conduit and conduit-home [predicted sign: +]
  - H2 Effective interest and dividend WHT rates [predicted sign: −]
  - H3 Conduit state CIT [predicted sign: −]
- Controls:
  - H_A Conduit-Home BIT dissimilarity
  - Conduit state GDP per cap, Year+Case FE, Netherlands dummy
## Data structure: conduit location models

<table>
<thead>
<tr>
<th>Case ID</th>
<th>Home</th>
<th>Host</th>
<th>Conduit (observed)</th>
<th>Conduit (potential)</th>
<th>Chosen</th>
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</tbody>
</table>
Results: conduit location (all indirect)
Takeaways:

1. Structure of tax treaty network affects functionality of investment treaty network
2. Overlapping, bilateral treaty regimes for regulating MNCs → spillover effects
3. Importance of firm-centric approach to regime complexity

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Investing indirectly for tax purposes: proof of concept
Results: conduit location (most-likely IIA shopping)
Results: conduit location (tax haven models)