



CHAPTER II

RECENT POLICY DEVELOPMENTS AND KEY ISSUES



INTRODUCTION

In 2021, the number of investment policy measures returned to pre-pandemic levels (109), decreasing by 28 per cent compared with 2020, signalling an end to the emergency investment policymaking that characterized the first year of the COVID-19 pandemic. The pandemic nevertheless continued to affect the nature of investment policy measures adopted in 2021. Developed countries, in particular, expanded the protection of strategic companies from foreign takeovers, in a continuation of a trend towards tighter regulation of investment, which brought the ratio of measures less favourable to investment over those more favourable to an all-time high (42 per cent). Conversely, developing countries continued to adopt primarily measures to liberalize, promote or facilitate investment, confirming the important role that foreign direct investment (FDI) plays in their economic recovery strategies. Investment facilitation measures constituted almost 40 per cent of all measures more favourable to investment, followed by the opening of new activities to FDI (30 per cent) and by new investment incentives (20 per cent) (section A).

The first quarter of 2022 saw a dramatic increase in the adoption of investment policy measures (75 – a record for a single quarter), largely because of the war in Ukraine. Sanctions and countersanctions affecting FDI to and from the Russian Federation, Belarus and the non-Government controlled areas of eastern Ukraine, constituted 70 per cent of all measures adopted in Q1 2022. The balance points to the continued adoption of measures more favourable to investment in developing countries (13 out of 14) and more restrictive measures in developed ones (5 out of 8).

At the international level, several notable developments in 2021 and 2022 accelerated the trend towards reform of the international investment agreements (IIA) regime. These include the conclusion of new-generation megaregional economic agreements, the termination of bilateral investment treaties (BITs) and multilateral discussions on the reform of investor–State dispute settlement (ISDS) mechanisms. At the same time, greater policy attention to investment facilitation, climate change and human rights is set to recalibrate international investment governance (section B).

Tax policy is one of the key instruments utilized around the world to promote investment, and the pandemic has accentuated the importance of tax incentive and relief efforts in economic recovery and resilience packages adopted worldwide. The ongoing reform of the international tax system may affect the capacity of countries to continue relying on certain types of tax incentives to promote FDI. In this context, section C of this chapter highlights key trends in the taxation of investment. Statutory corporate income taxes have dropped in all regions since 1980, as countries have increasingly engaged in tax competition to promote investment regardless of their size or level of development (section C.1). Beyond reducing the statutory corporate tax rates, countries rely on investment incentives, mainly in the form of tax holidays or reduced corporate tax rates, to attract investors to priority sectors or regions, as highlighted by analysis of tax-related investment policy measures adopted worldwide in the last decade (section C.2).

With respect to tax policy, IIAs impose obligations on States that can create friction with taxation measures taken at the national level. The actions of tax authorities, as organs of the State, and tax policymaking more generally can potentially engage the international responsibility of a State under an IIA when they adversely affect foreign investors and investment. It is therefore important to enhance cooperation between investment and

tax policymakers. The joint expertise of these two policy communities can help improve the coherence between tax and investment policymaking. Equally important is the need to minimize the risk of friction between the IIA regime and the global tax treaty network, with more than 3,000 agreements each (section C.3).

A. NATIONAL INVESTMENT POLICIES

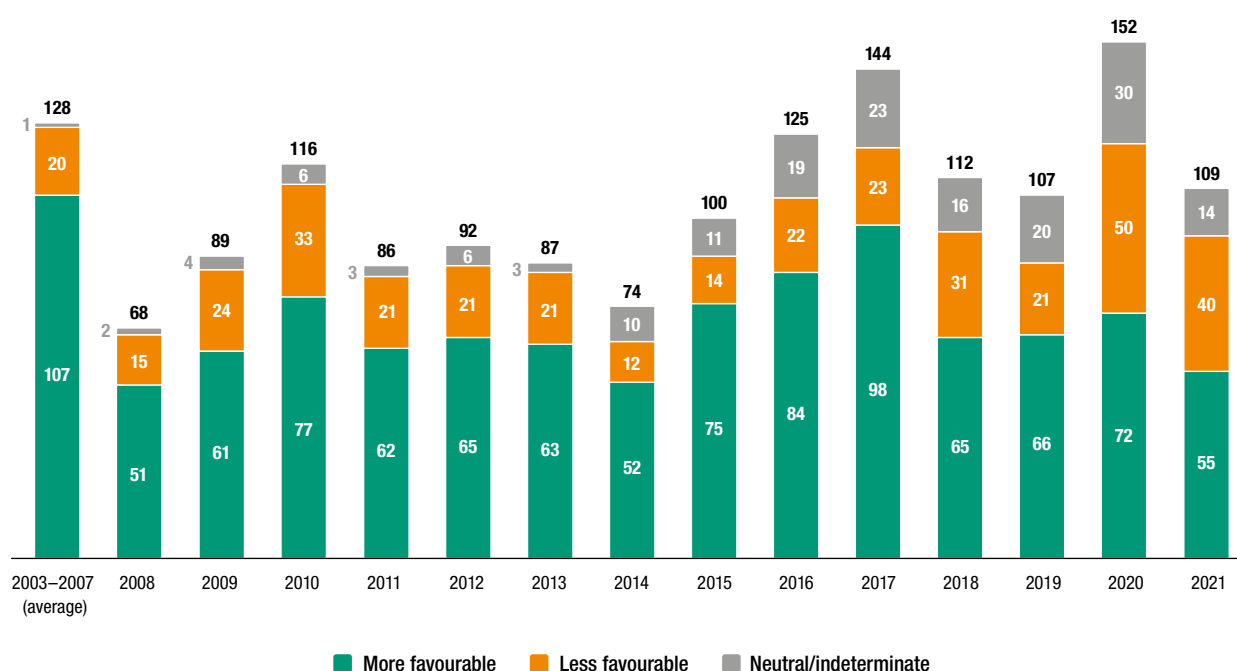
1. Overall trends

The number of investment policy measures adopted in 2021 returned to pre-pandemic levels (109), decreasing by 28 per cent from the number in 2020. However, the trend towards tighter regulation of investment continued, and the ratio of measures less favourable to investment over those more favourable was the highest on record (42 per cent, a point higher than in 2020).

Fifty-three economies introduced an aggregate 109 policy measures affecting foreign investment in 2021 – a decrease of approximately 28 per cent compared with 2020, as the haste to adopt emergency pandemic-related measures has subsided and the total number of investment policy measures has returned to pre-pandemic levels (figure II.1).

Although the number of new measures less favourable to investment declined by 20 per cent (from 50 in 2020 to 40 in 2021), they reached the highest proportion ever recorded (42 per cent of non-neutral measures), as several countries reinforced their screening regimes for investment or extended the temporary regimes introduced in reaction to the pandemic (figure II.2).¹ This surge in measures to tighten control over investor entry and operation continues the policy trend observed since the global financial crisis, which the pandemic accentuated. It started in developed countries but is increasingly extending to developing ones (section A.2).

Figure II.1. | Changes in national investment policies, 2003–2021 (Number of measures)



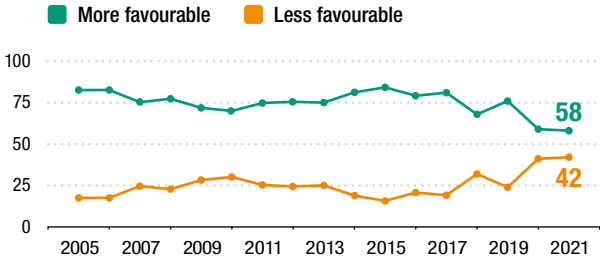
Source: UNCTAD, Investment Policy Monitor.

The number of measures more favourable to investment (55) declined by almost 24 per cent to reach the lowest share on record (58 per cent). The large majority of these measures (48, or 87 per cent) were undertaken in developing countries, highlighting that investment attraction remains a key element in these countries' economic recovery strategies. Many countries took further steps towards investment facilitation by simplifying or streamlining administrative procedures, and several others expanded their investment incentive regimes to attract more foreign investment (see section 1.b). The remaining 14 measures were of a neutral or indeterminate nature (figure II.1).

In regional terms, developing countries in Asia once again led the adoption of new investment policy measures (40), followed by countries of Latin America and the Caribbean (18) and Africa (17). Among developed regions, European countries continued to adopt the largest number of measures (19), although these declined by 30 per cent compared with 2020 – a year in which many of them implemented the European Union (EU) regulation on FDI screening of 2019. The number of measures adopted in North America and other developed regions remained stable compared with 2020 (figure II.3).

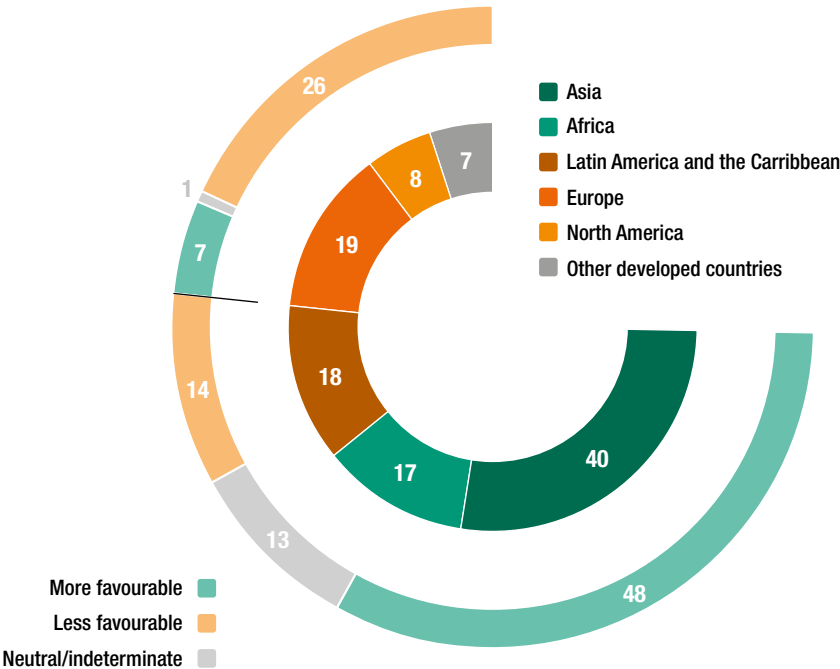
Overall trends mask important regional differences in the nature of the measures introduced. Almost two thirds of the measures adopted in developing economies, including in developing Asia, Africa, and Latin America and the Caribbean, were meant to promote or facilitate investment, continuing a well-established trend (64 per cent, or 77 per cent when excluding policies of neutral nature). In contrast, the majority of the measures adopted

Figure II.2. Changes in national investment policies, 2005–2021 (Per cent)



Source: UNCTAD, Investment Policy Monitor.

Figure II.3. Regional distribution of national investment policy measures in 2021 (Number of measures)



Source: UNCTAD, Investment Policy Monitor.

by developed countries introduced or reinforced investment restrictions (76 per cent, or 79 per cent when excluding policies of neutral nature). All of them related directly or indirectly to national security concerns about foreign ownership of critical infrastructure, core technologies or other sensitive domestic assets. Often, these measures were an extension of the restrictions introduced in the midst of the pandemic and motivated by the desire to protect sensitive domestic businesses against foreign takeovers (section 1.a).

The first quarter of 2022 saw a dramatic expansion in investment policymaking around the world, largely as the result of the war in Ukraine and the flurry of sanctions and countersanctions adopted by several countries. Twenty-seven countries and the EU introduced 75 policy measures affecting foreign investment, the highest level ever recorded in a quarter. Seventy per cent of them (52 measures) represented sanctions adopted in the context of the war in Ukraine. These include primarily measures targeted at prohibiting or otherwise limiting FDI to and from the Russian Federation, Belarus and the non-Government controlled areas of eastern Ukraine, as well as countersanctions adopted by the Russian Federation to impose restrictions on transnational business activities.²

Beyond sanctions that impose outright prohibitions or limitations on FDI, several measures that aim to interrupt a broad range of foreign transactions also have an impact on investment activities. Among them are sanctions targeting Russian banks and their subsidiaries; trade restrictions on inputs, goods, software and technology; and blocking sanctions that target transport companies, which have a significant impact on supply chains for foreign manufacturers in several sectors. Finally, travel bans and asset freezes affecting hundreds of individuals and entities targeted by sanctions have impacts on a broad range of foreign investment.

Among the 23 investment policy measures adopted in the first quarter of 2022 unrelated to sanctions, 60 per cent were adopted by developing countries. All but one aimed to facilitate or attract FDI. Conversely, among the remaining eight measures adopted by developed countries, five aimed to tighten control on FDI. One measure was of neutral nature.

a. Developed countries continued increasing FDI scrutiny for national security concerns

The trend towards increased FDI screening intensified in 2021, with at least four more countries adopting new FDI screening mechanisms and at least twice as many tightening existing mechanisms.

Two thirds of the policy measures less favourable to investment adopted in 2021 concerned the introduction or tightening of national security regulations affecting FDI. Nearly all of them were adopted by developed economies. In particular, at least four additional countries introduced FDI screening mechanisms, including three European countries (Czechia, Denmark and Slovakia) and Saudi Arabia. This brought the total number of countries conducting FDI screening for national security to 36. In addition, at least eight countries and the EU reinforced existing screening regimes for foreign investment. Together, countries that conduct FDI screening account for 63 per cent of global FDI flows and 70 per cent of FDI stock (up from 52 and 67 per cent respectively in 2020).

For example,

- *Australia* amended the Foreign Acquisitions and Takeovers Act to permanently lower to \$0 the monetary threshold for mandatory screening of sensitive national security projects. Accordingly, foreign investors require approval for all investments in land or businesses that are sensitive to national security, regardless of the amount invested.

- *Canada* lowered slightly the thresholds that trigger FDI screening⁹ and strengthened its scrutiny of foreign investment in four areas of heightened risk: sensitive personal data, specified sensitive technology areas, critical minerals and investments by State-owned or State-influenced foreign investors.
- *Czechia* introduced a new FDI screening mechanism in line with the EU Guidance on FDI screening. According to the new law, any non-EU investor must obtain a permit prior to acquiring effective control of a company in the country.
- *Denmark* introduced an FDI screening mechanism through the Investment Review Act. It requires foreign investors to obtain prior governmental approval for an acquisition of at least 10 per cent of shareholding in a Danish company, as well as for establishing a new company in selected sectors.
- *France* included technologies related to renewable energy production in the list of sectors and key technologies subject to the FDI review mechanism.
- *Germany* added 16 high-tech activities to the list of activities covered by the FDI review mechanism, bringing the total to 43, and changed the thresholds that trigger investment screening for different types of acquisitions, depending on their sectors.
- *Italy* expanded the scope of the procedures that require prior government approval for foreign investors to acquire assets strategically important to the national interest. The amendments concern ports, airports, motorways of national interest, national spaceports, railway network within the trans-European network, and broadband and ultrabroadband services.
- *Japan* added a requirement that foreign investors in 34 rare earth metals obtain prior government approval. Accordingly, foreigners who wish to acquire more than 1 per cent of the stock of a listed company or more than one share of the stock of an unlisted company are required to notify the Bank of Japan.
- *Saudi Arabia* established a Standing Ministerial Committee for Foreign Investment Investigation, tasked with identifying sensitive and strategic sectors or companies in which foreign investment might affect national security or public order. Foreign investments in those sectors will be subject to examination and potentially restrictions.
- *Slovakia* established an investment screening mechanism according to which any acquisition of more than 10 per cent of shares or voting rights in an operation of critical infrastructure may be subject to review in light of possible disruption of public order or national security. The governmental power to block acquisitions applies to a list of sectors that includes transport, information and communication technology, energy, mining, postal services, pharmaceuticals and chemicals, metallurgy, health care, water, finance and agriculture.
- *Spain* extended the suspension of the FDI liberalization regime until 31 December 2022. Therefore, investors from the EU or the European Free Trade Association (FTA) buying at least 10 per cent of a Spanish company must notify the Spanish authorities and await approval. This temporary scheme applies if the acquisition or investment in publicly traded companies operating in the strategic sector exceeds €500 million.
- *The United Kingdom* introduced a stand-alone screening regime separate from the merger control regime, to address acquisitions of British companies and assets by both domestic and foreign investors. The screening procedure focuses on evaluating risks to national security associated with such acquisitions. The law introduces a mandatory notification of the Minister for Investment prior to gaining control over a company or an asset.
- *The United States* prolonged the prohibition for its citizens of investing in companies related to China's defence and surveillance technology sector by one year (until 12 November 2022) and extended the ban to eight new companies.

- At the regional level, the *European Commission* expanded the list of projects and programmes of “Union interest” to include investments related to the Space Programme, the Digital Europe Programme and the European Defence Fund, as well as the Europe4Health Programme. Accordingly, the Commission may issue an opinion if it considers that such investments pose a threat to the security and public order of more than one Member State or the Union as a whole.

b. Developing economies aimed at reducing the risks of crowding out and increasing FDI’s contribution to local economic development...

In developing countries, most restrictions on FDI are aimed at protecting domestic companies, including SMEs or companies operating in strategic sectors and activities, as well as increasing local content.

For example,

- *Burundi* has introduced an eligibility threshold of \$500,000 for foreign investment that seeks to benefit from incentives under the Investment Code.
- *Indonesia* required foreign investors in a non-bank payment services provider to guarantee a minimum of 15 per cent Indonesian shareholding, with 51 per cent of the voting rights to be held by Indonesian investors.
- *Mauritius* extended the scope of restrictions on the ownership of property by non-citizens. A requirement for prior approval by the Office of the Prime Minister on holding, purchasing or acquiring property was extended to property disposal, which includes burdening a property with a mortgage or charge.
- *Mexico* amended the Hydrocarbon Act to grant the State new powers to exercise regulatory controls over the distribution, storage, import and export of fuels and oil produced by the country.
- *Mozambique* increased the minimum capital requirement for foreign investors to be able to freely repatriate profits and investment capital from \$45,000 to \$130,000.
- *Namibia* amended the rules regarding the transfer, cessation and assignment of mineral licences to foreign companies, requiring the local retention of at least 15 per cent interest in the company.
- *Nepal* required foreign investors to transfer at least 70 per cent of the proposed investment capital before starting a business, and the balance within the following two years.
- *South Africa* introduced a new requirement under which private security companies must be at least 51 per cent owned and controlled by South African citizens.

c. ...but largely continued to embrace policies to promote or facilitate investment

At least 30 developing countries implemented various promotion and facilitation measures in 2021, hoping to attract additional FDI and help overcome the economic crisis caused by the pandemic. Investment facilitation measures accounted for almost 40 per cent of all measures more favourable to investment.

(i) New investment facilitation measures

Many new measures concerned the simplification of administrative procedures for investment. For example,

- *Angola* amended the Private Investment Law to introduce several facilitation mechanisms. For instance, investors who obtain a Private Investment Registration Certificate are now exempt from obtaining provisional licences and other authorizations from public administration bodies.
- *China* simplified the documentation required for company registration in the Shenzhen Special Economic Zone. Applicants can simply provide documents and information when they file applications online.
- *Fiji* introduced a broader range of treatment and protection guarantees for foreign investors and removed the requirement to apply for a Foreign Investor Registration Certificate. It also harmonized reporting obligations on foreign and local investors.
- *India* launched the National Single-Window System, which will become a one-stop shop for approvals and clearances needed by investors, entrepreneurs and businesses.
- *Indonesia* eased the employment licensing process for tech-based start-ups seeking to hire foreign workers by waiving the Foreign Worker Utilization Plan requirement for contracts shorter than three months.
- In the *United Arab Emirates*, Abu Dhabi launched the Virtual Licence, allowing non-resident foreign investors to obtain an economic licence for doing business in Abu Dhabi without any prior residence procedures and from any location outside the United Arab Emirates.

(ii) New investment incentives

At least 15 countries introduced new incentives for investors, most of them in the form of new fiscal benefits for priority sectors or through the institution of special economic zones (SEZs). For example,

- *Angola* introduced the Free Zones Act, focused on developing the agricultural and industrial sectors, labour-intensive industries and high-tech industries. The Act grants a range of tax incentives to companies established in the free zones.
- *Botswana* announced that, in addition to other commercial and fiscal incentives, income accruing to an investor or developer from SEZ-licensed operations is to be taxed at a special rate of 5 per cent for the first 10 years of operation in an SEZ and 10 per cent thereafter.
- *Honduras* created a general rebate of the airport tax for new low-cost operators as well as rebates ranging from 75 to 100 per cent of take-off and landing charges for certain domestic airports.
- *Mauritius* introduced several new tax incentives for investment, including double tax deduction on expenditure incurred for research and development targeting the African market and the acquisition of specialized software and systems, 10 years carry-forward of unrelieved investment tax credit for manufacturing companies and an 8-year tax holiday for new companies in prescribed sectors and activities.
- *Uzbekistan* introduced new tax and customs incentives for both national and foreign investors in capital-intensive sectors including oil, natural gas, gold, copper, tungsten and uranium. The incentives include reduced taxes on subsoil use and customs duty exemptions on equipment, material and technical resources and special equipment not produced in the country.
- *Zambia* reduced the general corporate income tax rate from 35 to 30 per cent and extended the 15 per cent corporate income tax rate for hotel income from lodging and food services through 2022. It also made the mineral royalty levy deductible for corporate income tax purposes.

(iii) Other legal and institutional reforms to promote FDI

Several countries adopted new or enhanced legal and institutional mechanisms to promote FDI in 2021. For example,

- *Cambodia* adopted a new Law on Investment, offering a range of new investment incentives, new investor guarantees (including non-discrimination, guarantees against nationalization and arbitrary expropriation) and improved registration procedures.
- *Ecuador* signed the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, thereby opening the process of Ecuador's return to the multilateral dispute settlement mechanism.
- *Indonesia* established a new Ministry of Investment, thus upgrading the status of the Indonesian Investment Coordinating Board. A key goal of the reform is to enhance the ease of doing business in the country.
- *Panama* created a new Export and Investment Promotion Agency (ProPanamá).
- *Sudan* passed the Public Private Partnership Law, aimed at encouraging private entities to invest and participate in projects alongside public entities.

d. FDI liberalization

Thirty per cent of the policy measures more favourable to FDI introduced in 2021 concerned partial or full liberalization of investment in a variety of industries, including in particular utilities (e.g. telecommunications, electricity), but also transportation, insurance and several manufacturing activities. As in previous years, developing economies in Asia were the most active in liberalizing foreign investment.

For example,

- *Angola* authorized the privatization of 51 per cent of the capital held by MS-TELCOM in NetOne Telecomunicações, SA, through a limited tender by prior qualification open to national and international investors.
- *Brazil* allowed a partial privatization of the electricity company EletroBras. Accordingly, the State's stake in the company is expected to be reduced from approximately 61 to 45 per cent.
- *China* continued to open its economy to FDI. Among the main measures: the number of sectors restricted or prohibited for foreign investors was reduced from 33 to 31; comprehensive pilot programmes were approved on the opening of 12 services sectors to FDI in the Tianjin, Shanghai and Chongqing municipalities and in Hainan Province; and foreign investors are now encouraged to establish regional headquarters in China for fund management, procurement and sales.
- *India* shifted to allow 100 per cent foreign participation in the telecommunication services industry, including all services and infrastructure providers, through the Automatic Route. Thus, non-resident investors or Indian companies do not require any approval from the Government of India for the investment. The FDI ceiling in insurance companies was also raised, from 49 to 74 per cent.
- *The Philippines* shifted to allow 100 per cent foreign ownership of select public services, including telecommunications, airlines, shipping and railways and up to 40 per cent in the operation of a public utility, including electricity distribution and transmission, airports, seaports, water pipeline distribution and sewerage, tollways and expressways, and public utility vehicles. The Government also reduced the minimum paid-up capital requirements for foreign retail enterprises from \$2.5 million to \$1 million and

removed the pre-qualification requirements for foreign retailers of having engaged in the retailing industry for the preceding five years or of holding at least five retailing branches in the world.

2. M&A controls affecting foreign investors

In 2021, the number of merger and acquisition (M&A) deals valued at over \$50 million that were withdrawn by the parties for regulatory or political concerns remained stable (14 deals), but their value quadrupled, to over \$47 billion.

At least 14 large M&A deals were terminated by the parties in 2021 for regulatory or political reasons. While the number of such deals remained stable (15 were terminated in 2020), their aggregate value almost quadrupled, from \$12.4 billion in 2020 to \$47.1 billion in 2021. The terminated deals concerned a variety of industries, including extractive industries, semiconductors, automotive and aviation, financial services, trading and media (table II.1).

Table II.1.

Foreign acquisitions withdrawn for regulatory or political reasons in 2021 (Illustrative list)

For national security reasons

Shandong Gold Mining Co Ltd – TMAC Resources Inc	On 5 January 2021, Shandong Gold Mining (China) withdrew from its definitive agreement to acquire the entire share capital of TMAC Resources Inc. (Canada) for \$144 million. The Canadian Government blocked the sale of TMAC Resources and its Hope Bay gold-mining project to Chinese State-owned company Shandong Gold following a national security review under the Investment Canada Act.
TMH International AG – Bergen Engines AS	On 25 March 2021, TMH International (Switzerland), a unit of Transmash Holding JSC (Russian Federation), cancelled its plans to acquire Bergen Engines, based in Norway and owned by Rolls-Royce (United Kingdom), for \$180 million, after indication from the Norwegian Government that the deal would be blocked on national security grounds, on the basis of concerns that the engine maker would have been of significant military strategic interest to the Russian Federation.
China Oceanwide Holdings Group Co Ltd – Genworth Financial Inc	On 6 April 2021, China Oceanwide Holdings Group (China) withdrew its bid to acquire the entire share capital of life insurance company Genworth Financial (United States) for an estimated \$2.7 billion, fearing that the United States might stall it over concerns about Chinese access to sensitive data of United States citizens.
TransDigm Group Inc – Meggitt PLC	On 7 September 2021, TransDigm Group (United States) announced the cancellation of its plans to acquire the entire share capital of the aerospace and defence company Meggitt (United Kingdom) for \$9.7 billion, over concerns of increased scrutiny by the Government of the United Kingdom of defence company takeovers after a flurry of M&As in the sector.
Alimentation Couche-Tard Inc – Carrefour SA	On 16 January 2021, Alimentation Couche-Tard (Canada) decided to drop its merger plan for \$19.7 billion with the food retail corporation Carrefour (France), because the French Finance Minister had voiced objection to the deal on the grounds that it would present risks to France's food sovereignty.

For competition reasons

Kina Securities Ltd – Fiji business of Westpac Banking Corp	On 22 September 2021, Kina Securities (Papua New Guinea) abandoned its plans to acquire the entire share capital of the Fiji business of the bank and financial services corporation Westpac Banking Corp (Australia), following a decision by Papua New Guinea's Independent Consumer and Competition Commission to deny authorization for the proposed acquisition.
Aquiline Capital Partners LLC – Aon PLC	On 26 July 2021, Aquiline Capital Partners (United States) withdrew its bid to acquire the United States retirement business of Aon PLC (United Kingdom), concerned that the Justice Department of the United States had filed a lawsuit aimed at stopping insurance broker Aon's \$30 billion acquisition of Willis Towers Watson because it would reduce competition and could lead to higher prices.
Arthur J Gallagher & Co – Willis Towers Watson PLC	On 26 July 2021, Arthur J. Gallagher (United States) terminated its plans to acquire the reinsurance brokerage business of Willis Towers Watson (United Kingdom), after the planned merger of Aon PLC and Willis Towers Watson was scrapped. Willis Towers Watson agreed to divest Willis Re Ltd and certain corporate risk, broking, and health and benefits businesses to Gallagher for \$3.6 billion to allay competition concerns about its terminated merger with Aon.

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Table II.1.

Foreign acquisitions withdrawn for regulatory or political reasons in 2021

(Illustrative list) (Concluded)

For other regulatory reasons

Chijin International Ltd – Mensin Bibiani Pty Ltd	On 23 April 2021, Chijin International (Hong Kong, China), a unit of Chifeng Jilong Gold Mining Co Ltd (China), withdrew from its agreement to acquire the entire share capital of Mensin Bibiani, a gold ore mine operator based in Ghana, from Resolute Mining Ltd (Australia) for \$108.9 million. In a filing, Chifeng Jilong said that Resolute did not disclose that the Ministry of Lands and Natural Resources of Ghana had terminated the mining lease.
VI Investment Corp – JT Savings Bank Co Ltd	On 31 March 2021, VI Investment Corp (Republic of Korea) abandoned its proposed acquisition of the entire share capital of J Trust Savings Bank (Japan) for \$129 million, as it failed to get approval from the Financial Supervisory Service of the Republic of Korea.
Remus Horizons PCC Ltd – FAR Ltd	On 21 April 2021, private investment fund Remus Horizons (United Kingdom) withdrew its tender offer of \$158.8 million for the entire share capital in oil and gas exploration company FAR (Australia), because Remus had its registration as a private investment fund suspended by the Guernsey Financial Services Commission.
Pershing Square Tontine Holdings Ltd – Universal Music Group BV	On 19 March 2021, Pershing Square Tontine (United States) walked away from its plans to acquire a 10 per cent stake in Universal Music Group (France) for \$4 billion, after the Securities and Exchange Commission of the United States raised issues with several elements of the proposed transaction – in particular, whether the structure of the initial business combination qualified under New York Stock Exchange rules.

While waiting for host-country approval

Applied Materials Inc – Kokusai Electric Corp	On 29 March 2021, Applied Materials (United States) cancelled its plans to acquire the entire share capital of semiconductor manufacturing company Kokusai Electric (Japan) for \$3.5 billion, announcing that the amended Kokusai Electric Corporation share purchase agreement with KKR HKE Investment LP was terminated as of 19 March 2021 as Applied Materials did not receive confirmation of timely approval from the regulator in China.
Wise Road Capital Ltd – Magnachip Semiconductor Corp	On 13 December 2021, Wise Road Capital Ltd (China) withdrew its bid for power and display chipmaker Magnachip Semiconductor Corp (Republic of Korea). Wise Road offered \$1.4 billion in cash in March 2021. According to Magnachip, the offer was withdrawn because after months of effort the companies had failed to obtain approval of the merger by the Committee on Foreign Investment in the United States. The company also withdrew the application for approval of the merger submitted to the Korean Ministry of Trade, Industry and Energy.

Source: UNCTAD, based on media and company reports.

At least five deals were formally prohibited by the host country for national security reasons, up from three in 2020, confirming that national security concerns underpin increased screening of foreign investment. Such deals concerned the defence sector, involving the manufacturing of aircraft parts and auxiliary equipment (United States); food trading, raising the issue of food sovereignty (France); life insurance, mortgage financing and investment services, raising concerns related to access to sensitive data of host-country citizens (United States); the maritime industry, aimed at avoiding foreign influence in maritime engine making (Norway); and the mining sector, highlighting risks of increased foreign influence in the Arctic (Canada).

At least three deals were discontinued because of concerns from competition authorities in the industries, including denial of banking business by a foreign entity (Papua New Guinea), and withdrawal of plans to acquire businesses in the insurance industry (United States). Another four deals were withdrawn for various regulatory reasons, and one planned acquisition was terminated because of delays in receiving approval from the host country (China).

It should also be noted that the actual number and value of deals screened out by governments worldwide for national security reasons, though not available, is likely to be significantly higher, particularly in light of the extended adoption of FDI screening mechanisms discussed in the previous section. The adoption or announcement of tighter screening of M&A deals is also likely to have had a chilling effect on the number of deals in a number of strategic sectors.⁴

B. INTERNATIONAL INVESTMENT POLICIES

1. Trends in IIAs: new treaties and other policy developments

Several notable developments in 2021 and 2022 accelerated the trend towards reform of the international investment agreement (IIA) regime. These include the conclusion of new-generation megaregional economic agreements, the termination of bilateral investment treaties (BITs) and multilateral discussions on the reform of investor–State dispute settlement (ISDS) mechanisms. At the same time, greater policy attention to investment facilitation, climate change and human rights is set to recalibrate international investment governance.

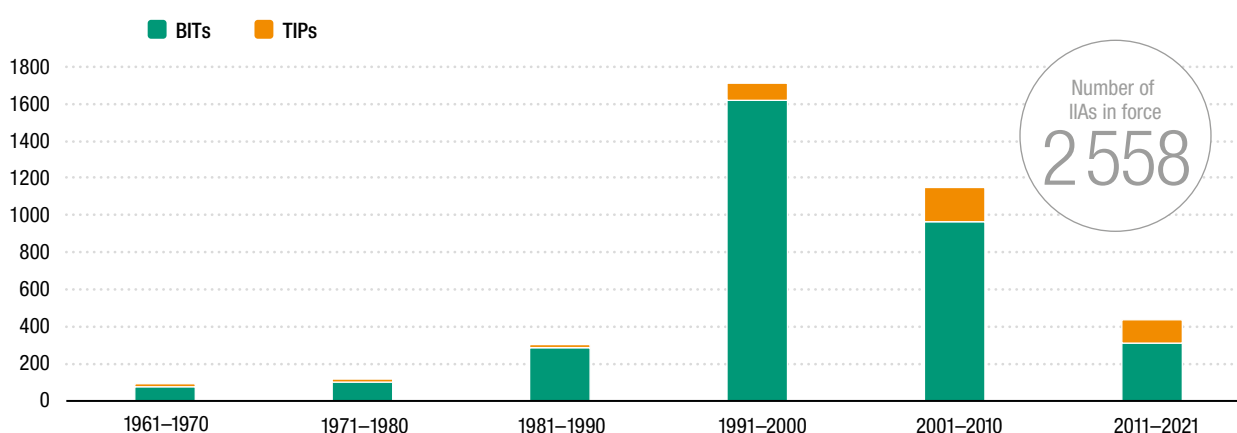
a. Developments in the conclusion and termination of IIAs

In 2021, countries concluded 13 IIAs. As in 2020, the number of effective treaty terminations exceeded that of new IIAs, with 86 terminations.

In 2021, countries concluded at least 13 new IIAs: 6 BITs and 7 treaties with investment provisions (TIPs). This brought the size of the IIA universe to 3,288 (2,861 BITs and 427 TIPs).⁵ In addition, at least 13 IIAs entered into force in 2021, bringing the total of IIAs in force to at least 2,558 by the end of the year (figure II.4).

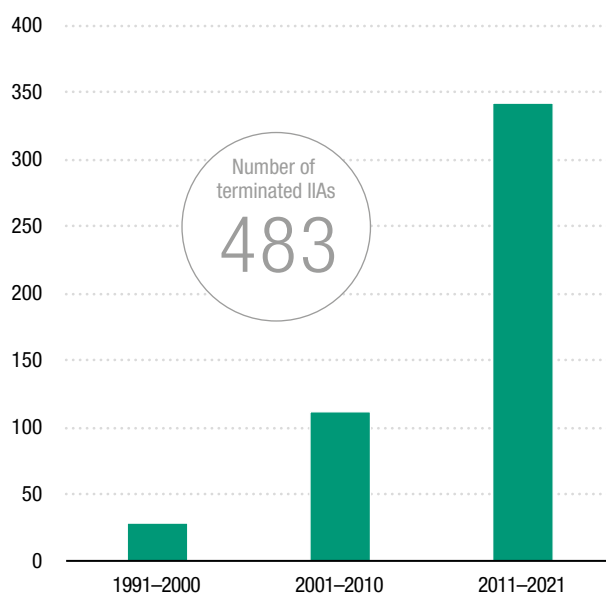
The number of terminations in 2021 exceeded the number of newly concluded IIAs: At least 86 IIA terminations entered into effect (“effective terminations”), of which 75 were terminations by mutual consent, 4 were unilateral terminations, 4 were replacements (through the entry into force of a newer treaty), and 3 expired. Of the 75 terminations by mutual consent, 74 were based on the agreement to terminate intra-EU BITs; the remaining termination concerned the BIT between Malta and the United Kingdom. By the end of the year, the total number of effective terminations reached at least 483, with 69 per cent of them terminated in the last decade (figure II.5).

Figure II.4. | Number of IIAs signed, by decade, 1961–2021



Source: UNCTAD, IIA Navigator.

Figure II.5. Number of terminated IIAs, by decade, 1991–2021



Source: UNCTAD, IIA Navigator.

The TIPs concluded in 2021 can be grouped into two categories:

1. Agreements with obligations commonly found in BITs, such as substantive standards of investment protection:

- Australia–United Kingdom FTA
- Israel–Republic of Korea FTA

2. Agreements with limited investment provisions (e.g. market access, national treatment (NT) and most-favoured-nation treatment (MFN) with respect to commercial presence, an institutional framework to promote and cooperate on investment) but do not contain substantive investment protection provisions:

- Cambodia–Republic of Korea FTA
- Cameroon–United Kingdom Economic Partnership Agreement
- Chile–Paraguay FTA
- Ghana–United Kingdom Interim Trade Partnership Agreement
- India–Mauritius Comprehensive Economic Cooperation and Partnership Agreement

The four substantive IIAs concluded in 2021 for which texts are available feature many reformed provisions aimed at preserving regulatory space while granting investor protection.⁶ All four clarify the fair and equitable treatment (FET) standard and the scope of indirect expropriation. Three IIAs contain general exceptions for the protection of human, animal or plant life or health (Australia–United Kingdom FTA, Georgia–Japan BIT, Israel–Republic of Korea FTA). All four include clauses on “not lowering of standards” (e.g. for laws or measures related to labour and the environment) and two of them also incorporate provisions on the promotion of corporate social responsibility standards (Australia–United Kingdom FTA, Colombia–Spain BIT). Three IIAs provide for ISDS subject to certain limitations, e.g. in the form of limited periods in which to submit claims (Colombia–Spain BIT, Georgia–Japan BIT, Israel–Republic of Korea FTA); one IIA omits ISDS altogether (Australia–United Kingdom FTA). One, the Australia–United Kingdom FTA, contains a dedicated chapter on gender equality and women’s economic empowerment in the context of trade and investment.

b. Other developments relating to investment rulemaking

Other notable developments continued the trends towards reform of the international investment regime. This includes greater attention to investment facilitation, climate change, anti-corruption, due diligence and human rights.

African Continental Free Trade Area negotiations on the Investment Protocol:

The negotiations on investment of the African Continental Free Trade Area (AfCFTA) commenced in March 2021, and subsequent rounds of discussions started in March 2022. The AfCFTA Protocol on Investment will aim at promoting, facilitating and protecting intra-African investment that fosters sustainable development while safeguarding the State Parties’ right to regulate. The Negotiating Principles for the Protocol recognize UNCTAD’s work on IIA reform and refer to its Investment Policy Framework for Sustainable

Development (UNCTAD, 2015) and its IIA Reform Accelerator (UNCTAD, 2020b). UNCTAD continues to provide technical support to the African Union and the AfCFTA Secretariat in the process leading to the conclusion of the Protocol. The Investment Protocol is expected to be finalized and adopted in September 2022.

EU agreement for the termination of intra-EU BITs: The termination agreement entered into force for 19 EU member States and effectively terminated over 110 intra-EU BITs as of March 2022.⁷ The termination agreement was signed by 23 EU member States on 5 May 2020 and came into effect on 29 August 2020, following receipt by the Depository of the second instrument of ratification.

EU corporate sustainability due diligence directive: On 23 February 2022, the European Commission adopted a proposal for a directive on corporate sustainability due diligence, which has been submitted to the European Parliament and the Council for approval.⁸ The proposed directive aims to foster sustainable and responsible corporate behaviour and to anchor human rights and environmental considerations in companies' operations and corporate governance. Under the new due diligence rules, certain groups of EU and non-EU companies will need to address adverse impacts of their activities, including in their value chains inside and outside the EU. The proposal builds on concepts set out in the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights. Encouraging corporate social responsibility and responsible business practices also plays a role in EU investment policymaking and related negotiation processes, including the modernization of the Energy Charter Treaty (ECT).

International Centre for Settlement of Investment Disputes approves amended rules: On 21 March 2022, ICSID member States approved the amended rules of the International Centre for Settlement of Investment Disputes (ICSID). The amendments reflect extensive dialogue with ICSID's membership and the public. ICSID launched the amendment process in 2016 and published proposals in a series of six working papers. The updated rules incorporate greater transparency in the conduct and outcome of proceedings, new disclosure requirements for third-party funding, expedited arbitration rules for parties wishing to shorten further the procedural calendar, and broadened access to ICSID's procedural rules and administrative services.⁹ The updated rules will come into effect on 1 July 2022.

Investment Facilitation for Development negotiations at the World Trade Organization: Over 110 members of the World Trade Organization (WTO) are participating in the Joint Initiative on Investment Facilitation for Development. On 25 September 2020, participants in the structured discussions on investment facilitation for development began formal negotiations. On 10 December 2021, members drafted the Joint Statement on Investment Facilitation for Development, which sets the goal to finalize an agreement by the end of 2022.¹⁰ In February 2022, participants agreed to establish a Working Group of international organizations that work on investment facilitation (including UNCTAD) to develop a Self-Assessment Guide to help developing and least developed countries assess their needs in terms of implementing the future agreement. A negotiating meeting on 15–16 March 2022 focused on definitions of “authorization”, the provisions on MFN treatment/non-discrimination, responsible business conduct, and special and differential treatment, among other topics.

Modernization of the ECT: Six rounds of negotiations on the modernization of the ECT were held in 2021. The Modernization Group held its 11th round of negotiations on 1–4 March 2022, making progress on investment protection (e.g. denial of benefits, MFN clause, right to regulate), dispute settlement (e.g. frivolous claims, third-party funding, valuation of damages), sustainable development and corporate social responsibility.

The negotiations also addressed the principle of flexibility in the definition of “economic activity in the energy sector”. Two more rounds of negotiations are scheduled in 2022, with the objective of reaching an agreement in principle.

OECD work programme on the future of investment treaties: In March 2021, the OECD launched a two-year work programme on the future of investment treaties, to address issues relating to climate change, the pandemic and digital transformation, with concerns about the climate crisis at its core. The work programme has discussions in two tracks: Track 1 addresses challenges facing future IIAs and changes to the current treaty regime, and Track 2 discusses the possible modernization of provisions found in old-generation IIAs (Gaukrodger, 2021).

UNCITRAL Working Group III on investor-State dispute settlement reform: In February 2021, Working Group III of the United Nations Commission on International Trade Law (UNCITRAL) held its 40th session in Vienna, Austria and then resumed virtually on 4–5 May 2021. Discussions revolved around establishing a workplan for the next five to six years. The Working Group held its 41st session in Vienna on 15–19 November 2021. In this session, the Working Group deliberated on the draft code of conduct for adjudicators in international investment disputes and the working agenda on the draft provisions in 2022. The 42nd session took place on 14–18 February 2022 in New York. Topics discussed at this session included the multilateral advisory centre, the standing multilateral mechanism (selection and appointment of ISDS tribunal members and related matters) and the draft code of conduct for adjudicators in international investment disputes (UNCITRAL, 2022).

UNCTAD Annual IIA Conference: On 19 October 2021, UNCTAD held its annual IIA Conference as part of the World Investment Forum 2021, gathering high-level representatives from government, the private sector, civil society and academia. Experts took stock of IIA and ISDS reform efforts and agreed on the need to accelerate IIA reform in the public interest. The IIA Conference 2021 provided a platform to engage in IIA reform and made concrete steps toward a more coherent and consolidated process of modernizing old-generation IIAs.

United Nations Working Group on Business and Human Rights: In its 2021 report to the United Nations General Assembly (United Nations, 2021), the United Nations Working Group on Business and Human Rights highlighted the imbalances of the IIA regime. The report urges States to ensure that all existing and future IIAs are compatible with their international human rights obligations. Building on recommendations made by UNCTAD and other organizations, the Working Group outlines five reform pathways for States to harness the potential of IIAs in encouraging responsible business conduct on the part of investors, in line with the United Nations Guiding Principles on Business and Human Rights. In its 10th Annual Forum on Business and Human Rights, the United Nations Working Group included a session dedicated to the reform of the IIA regime.¹¹ The session presented the recommendations made in the 2021 report and discussed the role of UNCTAD and other international and regional organizations in supporting States in carrying out structural and systemic reform of the international investment regime.

United Nations Office on Drugs and Crime–UNCTAD work on Corruption and International Investments: In December 2019, the Conference of the States Parties to the United Nations Convention against Corruption adopted Resolution 8/9, in which it noted “the positive role of international investments and the importance of minimizing opportunities for corruption and transfer of proceeds of crime”. In this context, the United Nations Office on Drugs and Crime (UNODC) partnered with UNCTAD in May 2021 to organize an Expert Group Meeting on Corruption and International Investments. Participants in the meeting called for strong and coherent anti-corruption provisions in IIAs and a better balance between the interests of investors and host States, to enable host States to regulate for the

public interest, including preventing and fighting corruption. In December 2021, UNODC and UNCTAD organized an expert-level event during the Conference of the States Parties to the United Nations Convention against Corruption, which took place in Sharm el-Sheikh, Egypt. Participants reported to the Conference on the activities and progress made by the Expert Group Meeting on Corruption and International Investment.

2. Key investment-related issues in megaregional agreements

Megaregional agreements have been proliferating, covering a broad range of economic issues beyond investment disciplines. These agreements' comprehensive nature and geostrategic relevance are increasingly shaping international investment rulemaking and policy.

Megaregional agreements are broad economic agreements among a group of countries that together carry significant economic weight and in which investment is only one of several subjects addressed. Among the other subjects are, for instance, trade in goods and rules of origin, trade in services, competition, e-commerce, intellectual property (IP), public procurement, regulation of State-owned enterprises (SOEs) and small and medium-sized enterprises (SMEs). The multitude of economic issues covered in megaregional agreements may have a more substantial positive impact on FDI flows and greater geopolitical relevance than BITs (table II.2). Most megaregional agreements liberalize market access and, more generally, foster regional integration among the contracting parties, stimulating additional investment flows.

Table II.2. Selected recent megaregional agreements at a glance	
Megaregional IIA	Selected provisions with impact on investment (other than the investment chapter)
AfCFTA	<ul style="list-style-type: none"> • Protocols on competition, IP rights and investment are under negotiation • ROOs to be harmonized across the continent • Pan-African Payments and Settlements System operational • Will cater to African SMEs • Liberalization of services sector, which accounts for 75 per cent of greenfield investment in Africa, with specific commitments to be concluded in 2022 • Trade and investment facilitation measures to be concluded in 2022
CPTPP	<ul style="list-style-type: none"> • Regulatory coherence and business facilitation (e.g. implementation mechanisms, simplified customs procedures) • E-commerce (e.g. validity of e-signatures, prohibition of data localization and requirements to disclose software source codes, customs exemptions for digital products, online consumer protection) • SMEs (e.g. special committee, dialogue mechanism, transparency and information-sharing) • IP rights (e.g. goes beyond TRIPS, regulates criminal procedures and remedies, regulates geographical indications) • SOEs (progressive provisions aimed at reducing unfair competition) • Innovative regulation of the ROOs (designed specifically for each tariff line to allow for less costly and more integrated regional value chains) • Liberalization of services (uses negative list with two types of measures) • Public procurement (e.g. increased transparency, clear criteria for selection procedures, reduced barriers to foreign bidders) • Environmental and labour standards (comprehensive e.g. to adopt and maintain laws and practice governing "acceptable conditions of work"; obligation to combat the illegal take of, and trade in, wild flora and fauna)
EU-UK TCA	<ul style="list-style-type: none"> • Investment liberalization (e.g. similar to the WTO, based on national treatment and MFN; various sectoral carve-outs; no automatic access to the EU single market; no country-of-origin principles and passporting; removal of the economic-needs test and quantitative restrictions; four modes of market access) • State aid, labour and environmental standards (e.g. streamlined procedure for countermeasures, progressive provisions on the environment and labour) • Competition (e.g. requirement of similar standards in labour, environment, tax and State aid) • Public procurement (e.g. accessibility to public procurement markets, including for smaller contracts) • Digital trade (e.g. prohibition of data localization; high consumer protection)

/...

Table II.2.

Selected recent megaregional agreements at a glance (Concluded)

Megaregional IIA	Selected provisions with impact on investment (other than the investment chapter)
RCEP	<ul style="list-style-type: none"> • ROOs harmonized across the member States (threshold for regional value content is approximately 40 per cent; gradual move towards self-certification) • Liberalization of services (combined positive and negative lists; commitments in financial, telecommunication and professional services) • IP rights (comprehensive coverage, e.g. enforcement against pirate and counterfeit goods by allowing rights holders to apply for suspension of the release of suspicious goods) • E-commerce (e.g. validity of e-signatures, removal of customs duties for electronic transmissions, limited prohibition of data localization) • Competition, SMEs and public procurement (e.g. transparency in procurement regulations and tenders)
USMCA	<ul style="list-style-type: none"> • ROOs commitments with a threshold for regional value content at 60 per cent as a general rule and 75 per cent in the automotive industry and other thresholds for specific product lines • Provisions on labour costs ("high-wage factory" requirement for tariff-free qualification) • Liberalization of services (e.g. expanded market access in agriculture and financial services) • Increase in de minimis value for tariff-free imports • Streamlined customs procedures • E-commerce provisions (e.g. prohibits data localization and requirements to disclose software source codes, offers customs exemptions for digital products, provides protection from lawsuits related to content posted on digital platforms) • IP rights (strong and extensive protections) • Labour (complex provisions, e.g. Rapid Response Labour Mechanism to address complaints related to violation of labour rights) • Special provisions on SMEs • Currency regulation (e.g. reaffirms market-determined exchange rates and prohibits currency manipulation)

Source: UNCTAD.

Note: IP = intellectual property, MFN = most-favoured nation, ROOs = rules of origin, SMEs = small and medium-size enterprises, TRIPS = Trade-Related Aspects of Intellectual Property Rights, WTO = World Trade Organization.

The following sections summarize selected key non-investment provisions found in five recently concluded megaregional agreements that indirectly affect investment flows and policy. The five agreements are the following:

- African Continental Free Trade Agreement (AfCFTA), in force since 30 May 2019
- Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), in force since 30 December 2018
- EU–United Kingdom Trade and Cooperation Agreement (EU–UK TCA), in force since 1 May 2021
- Regional Comprehensive Economic Partnership Agreement (RCEP), in force since 1 January 2022
- United States–Mexico–Canada Agreement (USMCA), in force since 1 July 2020

The investment chapters of these megaregional agreements were discussed in the *World Investment Report 2021*.

Liberalization of trade in services

Services liberalization may affect investment inflows. It may induce investors in the services sector to establish their presence in host countries and by lowering or removing regulatory barriers may provide new opportunities for firms to offer services. Compared with regulations in the General Agreement on Trade in Services (GATS), the services regulations in the new megaregional agreements provide a broader set of disciplines (e.g. investment liberalization, domestic regulation, competition policy). They generally provide additional levels of market access and NT commitments, either covering additional sectors or deepening GATS obligations in this area.

The megaregional agreements approach the regulation of services in various ways, and the level of access depends on how the service is supplied. For instance, the CPTPP is based entirely on a negative list, such that all services, except those specifically excluded,

are liberalized. The negative list contains two types of exclusions (non-conforming measures): (i) a standstill and ratchet mechanism, which covers areas that cannot become more restrictive in the future and, once liberalized, cannot be reversed; and (ii) reservations, under which member States have complete discretion to regulate and are free to change domestic liberalization measures. The EU–UK TCA contains four modes of service provision with concomitant regulations. In Mode 1, the service crosses the border (e.g. Internet); in Mode 2, a consumer uses the service while abroad (e.g. a tourist purchasing service in another country); in Mode 3, a company establishes a branch to supply services in another country; and Mode 4 refers to the mobility of professionals for business purposes. The RCEP uses both positive and negative lists, depending on the Contracting Party. The AfCFTA uses a positive list, with schedules that are to be completed in 2022.

Regarding the sectors covered, the services liberalization commitments commonly found relate to telecommunications (RCEP, USMCA), financial services (CPTPP, EU–UK TCA, RCEP, USMCA), energy (EU–UK TCA) and professional services (CPTPP, EU–UK TCA, RCEP). Modern megaregional agreements often include specific regulations on digital services as well.

Supply chains and the rules of origin

The megaregional agreements under review aim at making global and regional supply chains more effective by simplifying and harmonizing the rules of origin (ROOs). The ROOs in these agreements regulate the regional value content required for goods to qualify for tariff-free (or lower-tariff) treatment, and they facilitate the administrative procedures connected with cross-border trade. In this way, the agreements have an important effect on investment flows between the parties.

For example, the RCEP harmonizes ROOs across its 16 member States, which are at different levels of economic development. They include import- and export-oriented economies, services- and goods-based economies, and landlocked and island States, as well as countries with large differences in population. The RCEP ROOs set a relatively low threshold for regional value content (40 per cent), which, in combination with the move towards self-certification of origin, removal of non-tariff barriers and other trade facilitation measures, is likely to boost the integration of global supply chains across the region. This may contribute to encouraging foreign investment inflows. The USMCA ROOs, by contrast, include a relatively high threshold for regional value content (60 per cent as a general rule and 75 per cent for the automotive industry), incentivizing companies to locate their production facilities in the region. This is complemented by a provision requiring that 40–45 per cent of the parts of any tariff-free vehicle must come from a “high-wage factory” (i.e. pay a minimum of \$16 per hour on average). The CPTPP uses an innovative approach to ROOs, which are designed specifically for each tariff line. This makes trade easier, as once the ROOs are satisfied for one product tariff line, there is no need for further modifications. For instance, the CPTPP regulates smartphone supply chains that cover components and materials sourced in many countries.

Competition

Competition policies are also likely to have an impact on foreign investment. The new megaregional agreements commonly include chapters that regulate competition. These provisions generally require parties to adopt and maintain laws and procedures against anti-competitive activities, and enforce those laws accordingly, generally through a competition authority (e.g. RCEP Chapter 13, CPTPP Chapter 16, USMCA Chapter 21). Moreover, other provisions affect competition; for instance, the requirement for similar standards in labour, environment, tax and State aid. For the AfCFTA, negotiations on the Competition Protocol are under way and will continue into 2022.

Regulating competition will be particularly important for African SMEs (90 per cent of African businesses). UNCTAD has been highlighting the linkage between investment, competition and industrial policies in Africa (UNCTAD, 2021a). Competition policies protect market participants, including SMEs, from monopolies and other anti-competitive practices and by facilitating access to credit they increase productivity, among other benefits.

E-commerce and the digital economy

The new agreements reflect the continuing turn towards a digital economy. Although they regulate e-commerce through specially dedicated chapters, their provisions on services liberalization and investment are equally relevant for a digital economy. Their provisions on e-commerce regulate various aspects of trade in data, such as prohibition of data localization measures, commitments to allow cross-border data transfers, protection of online consumers, regulations on customs duties, and fees and other charges on electronic transmissions and digital products (e.g. CPTPP Chapter 14, USMCA Chapter 19, EU–UK TCA Part Two Title III). In addition, some of these agreements protect businesses by prohibiting the disclosure of software source code as a condition for the import, sale, or use of the software (e.g. CPTPP, USMCA). Some agreements, while regularizing cross-border transfer of data, do not include a general prohibition of data localization requirements (e.g. RCEP). Finally, some protect online platforms from lawsuits related to content posted on the online platforms (e.g. USMCA).

IP rights

The new megaregional agreements strengthen the protection of IP rights. Strong IP rights may influence investment decisions, especially for knowledge-based FDI and projects with high research and development components. By and large, the IP commitments in these agreements go beyond the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights. The new megaregional agreements, for example, extend the time frame of copyright protection (e.g. USMCA), provide for procedures and remedies for enforcement of IP rights against pirate and counterfeit goods (e.g. RCEP, CPTPP, USMCA), and contain extensive protections for a wide variety of IP rights including comprehensive coverage of geographical indications (e.g. CPTPP).

Public procurement

Megaregional agreements may affect investment by opening government procurement markets to economic actors from other contracting parties. Their commitments generally require fair and transparent selection procedures, such as making laws and regulations on procurement publicly available (e.g. RCEP, CPTPP, USMCA), and may cover small government contracts as well (e.g. EU–UK TCA). Transparent and non-discriminatory government procurement policies in megaregional agreements can also lead to greater competition between domestic and foreign investors for government procurement contracts and fewer market distortions leading to economic inefficiencies, and more generally to a more favourable, transparent and attractive investment environment for foreign investors.

Small and medium-size enterprises

The new agreements will also affect the business environment and investment in the contracting parties, as they include specific chapters on SMEs. These provisions aim to make it possible for SMEs to take full advantage of the opportunities that the agreements create. Generally, they do so by fostering cooperation and collaboration to promote SMEs, through information-sharing tools, rules on transparency that reduce administrative costs, and exchange of best practices related to such concerns as access to capital and credit.

For instance, the USMCA and the CPTPP include chapters on SMEs that create SME committees and dialogue mechanisms (USMCA Chapter 25, CPTPP Chapter 24).

The RCEP contains provisions on information-sharing and creates contact points to facilitate cooperation and information-sharing related to the Agreement (RCEP Chapter 14). In addition, various provisions on regulatory coherence, trade facilitation, public procurement and business facilitation further assist SMEs in taking full advantage of the opportunities that these agreements create and making supply chains less costly.

State-owned enterprises

The new megaregional agreements also regulate SOEs to address the risks of unfair trade practices, unfair competition and obstacles to trade. The commitments require SOEs to act according to commercial considerations. Complex regulations of SOEs can be found in the USMCA and the CPTPP; they include traditional non-discrimination and commercial considerations disciplines from the General Agreement on Tariffs and Trade but also a legal framework on Non-Commercial Assistance (USMCA Chapter 22; CPTPP Chapter 17). The framework addresses effects that are adverse to the interest of other State parties because of the advantages that SOEs may gain through their government relationships.

3. Trends in ISDS: new cases and outcomes

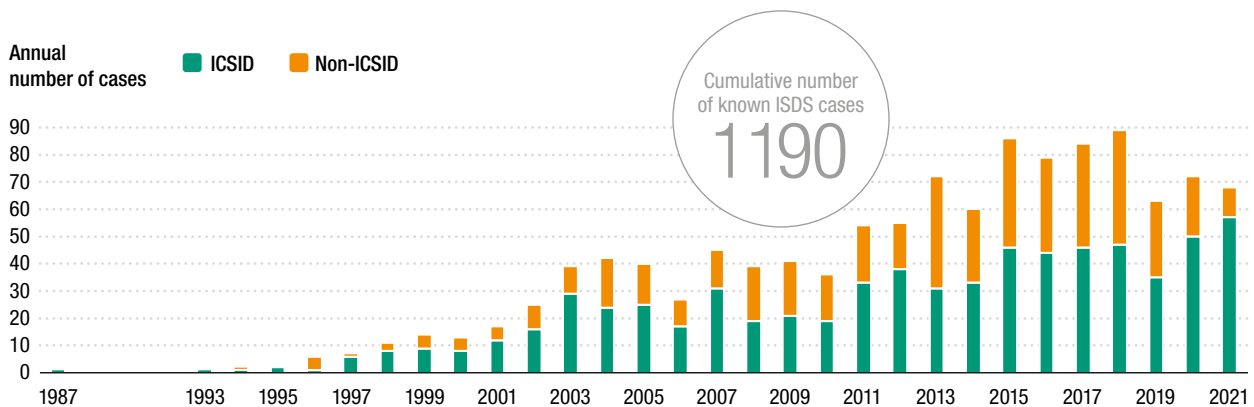
The total ISDS case count had reached 1,190 by the end of 2021, with at least 68 new arbitrations initiated in 2021. Two IIAs signed in the 1990s – the ECT and NAFTA – continued to be the instruments invoked most frequently.

a. New cases initiated in 2021

In 2021, at least 68 new treaty-based ISDS cases were initiated. Five countries faced their first known ISDS claims.

In 2021, investors initiated 68 publicly known ISDS cases under IIAs (figure II.6). As of 1 January 2022, the total number of publicly known ISDS claims had reached 1,190. As some arbitrations can be kept confidential, the actual number of disputes filed in 2021 and in previous years is likely higher. To date, 130 countries and one economic grouping are known to have been respondents to one or more ISDS claims. In 2022, the war in Ukraine brought into the spotlight past and potential future ISDS claims relating to armed conflict (box II.1).

Figure II.6. Trends in known treaty-based ISDS cases, 1987–2021



Source: UNCTAD, ISDS Navigator.

Note: Information has been compiled from public sources, including specialized reporting services. UNCTAD's statistics do not cover investor-State cases that are based exclusively on investment contracts (State contracts) or national investment laws, or cases in which a party has signalled its intention to submit a claim to ISDS but has not commenced the arbitration. Annual and cumulative case numbers are continually adjusted as a result of verification processes and may not match exactly case numbers reported in previous years.

ISDS cases can arise out of events related to war and armed conflict. In the past, at least 30 ISDS cases brought against States arose out of destruction or harm caused to investments in the context of war, armed conflict, military operations and civil unrest. This includes the first known ISDS case based on an IIA brought in 1987: *AAPL v. Sri Lanka*, which arose out of the alleged destruction of the claimant's investment during a military operation conducted by Sri Lankan security forces.

International courts and tribunals (e.g. the International Court of Justice and the International Criminal Court) may weigh in on specific elements of armed conflicts. Disputes may also occur in the trade context and at the WTO through the State–State dispute mechanism.

The stock of IIAs in force commonly protects covered investments in cases of direct and indirect expropriation, impairment and losses owing to war or armed conflict. They also include other substantive protection standards such as full protection and security, and FET. While most of these treaties grant foreign investors direct access to international arbitration in case of treaty violations and the possibility of treaty shopping, some of them include exceptions that could allow countries to avoid facing ISDS claims in emergency situations. Generally, ISDS tribunals have not pronounced on the legality of the use of force; instead, they have limited their assessments to the question of State responsibility for breaches of IIAs. The underlying events giving rise to ISDS claims related to armed conflicts are multifaceted and multi-layered.

Out of the 30 ISDS cases identified in this context, the Russian Federation and Libya were the most frequent respondents, with 10 cases each. The cases against the Russian Federation related to the events in Crimea in 2014, including nationalizations in different economic sectors. Ukrainian companies and businesspeople invoked the Russian Federation–Ukraine BIT (1998), alleging expropriation of assets by the Russian Federation (e.g. *Ukrenergo v. Russia*; *Oschadbank v. Russia*; *Naftogaz and others v. Russia*). The cases against Libya mostly related to the alleged failure to protect foreign investments during times of war and civil unrest in the country (e.g. *Trasta v. Libya*; *Cengiz v. Libya*). In addition, several ISDS cases have related to economic sanctions and the suspension of diplomatic relations (e.g. *Qatar Pharma and Al Sulaiti v. Saudi Arabia*; *belN v. Saudi Arabia*).

Source: UNCTAD.

Note: The ISDS cases related to war and armed conflict were identified on the basis of UNCTAD's ISDS Navigator and information from other public sources, including notices of arbitration, arbitral decisions and specialized reporting services.

(i) Respondent States

The new ISDS cases in 2021 were initiated against 42 countries. Peru was the most frequent respondent, with six known cases, followed by Egypt and Ukraine with four known cases each. Five countries – Cambodia, the Republic of Congo, Finland, Malta and the Netherlands – faced their first known ISDS claims. As in previous years, the majority of new cases (about 65 per cent) were brought against developing countries.

(ii) Claimant home States

Developed-country claimants brought most – about 75 per cent – of the 68 known cases in 2021. The highest numbers of cases were brought by claimants from the United States (10 cases), France (5 cases), the Netherlands (5 cases) and the United Kingdom (5 cases).

(iii) Applicable investment treaties

About 75 per cent of investment arbitrations in 2021 were brought under BITs and TIPs signed in the 1990s or earlier. The ECT (1994) was the IIA invoked most frequently in 2021, with seven cases, followed by the North American Free Trade Agreement (NAFTA) (1992) in combination with the USMCA (2018), with four cases.¹² Overall (1987–2021), about 20 per cent of the 1,190 known ISDS cases have invoked the ECT (145 cases), NAFTA (76 cases) or the OIC Investment Agreement (16 cases).

b. ISDS outcomes

(i) Decisions and outcomes in 2021

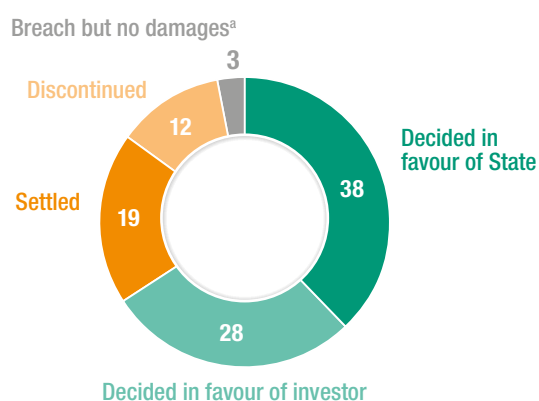
In 2021, ISDS tribunals rendered at least 54 substantive decisions in investor–State disputes, 31 of which were in the public domain at the time of writing: 11 of the public decisions principally addressed jurisdictional issues (including preliminary objections), with 4 upholding the tribunal’s jurisdiction and 7 declining jurisdiction. The remaining 20 public decisions were rendered on the merits, with 12 holding the State liable for IIA breaches and 8 dismissing all investor claims.

In addition, six publicly known decisions were rendered in annulment proceedings at the ICSID. Ad hoc committees of the ICSID rejected the applications for annulment in five cases; in one case, the award at issue was partially annulled.

(ii) Overall outcomes

By the end of 2021, at least 807 ISDS proceedings had been concluded. The relative share of case outcomes changed only slightly from previous years (figure II.7).

Figure II.7. Results of concluded cases, 1987–2021 (Per cent)



Source: UNCTAD, ISDS Navigator.

^a Decided in favour of neither party (liability found but no damages awarded).

C. KEY TRENDS IN TAXATION OF INVESTMENTS

Foreign investors base their decision to enter a country on many factors, including political stability, economic potential, natural resources, transparency and efficiency of regulatory regimes and the level of infrastructure and skills. The tax regime is also a factor in investment decisions, and although tax incentives are frequently far from being the most important one,¹³ they have traditionally been one of the most widespread policy tools to attract and retain foreign investment. The pandemic has accentuated the importance of incentives and tax relief efforts as part of the economic recovery and resilience packages adopted worldwide.¹⁴

This section highlights key trends in the taxation of investment by analysing the evolution of corporate income taxes (CITs) across the world (section C.1), as well as country efforts to attract investments through tax incentives (section C.2). It highlights how, beyond engaging in tax competition for investment by lowering the statutory CITs, countries rely on a wide array of investment incentives to attract investors to priority sectors or regions. Section C.3 highlights how IIAs impose obligations on States that can create friction with taxation measures and sheds light on the interplay between the international tax system, double-taxation treaties (DTTs) and investment policymaking.

The analysis of the tax incentives for investment is based on review of tax-related investment policy measures adopted worldwide in the last decade. The chapter also examines the treatment of tax incentives in investment laws, which often constitute the legal basis for their adoption, and in industrial policies, which generally provide their broader policy background or motivation.

For the purpose of this analysis, tax incentives are categorized into CIT-based and other incentives. CIT-based incentives include two kinds:

- (i) Profit-based incentives, i.e., those determined as a percentage of profit, including tax holidays, reduced CIT or loss carry-forward or carry-back to be written off against profits earned later
- (ii) Expenditure-based (or capital investment-based), i.e., those that reduce the after-tax cost of capital investment expenditure, including investment allowance, accelerated depreciation, tax credits and the like¹⁵

Profit-based incentives provide tax relief based on earnings and not on new investment. In this regard, they are particularly attractive to mobile FDI. Expenditure-based incentives, by contrast, tend to promote reinvestment and therefore further integration into the local economy. In addition, expenditure-based incentives typically target specific types of capital investment or activities that can be associated with countries' sustainable development objectives, such as skills development and low-carbon transition. Other tax incentives include reduced rates on indirect taxes (e.g. value added tax (VAT), duties and tariffs), taxes on labour and land, social security contributions and other payments.

The analysis confirms that countries rely intensively on tax incentives for investment and that profit-based incentives are among the most widespread and frequently adopted ones (see chapter IV).

1. Evolution of corporate income tax rates

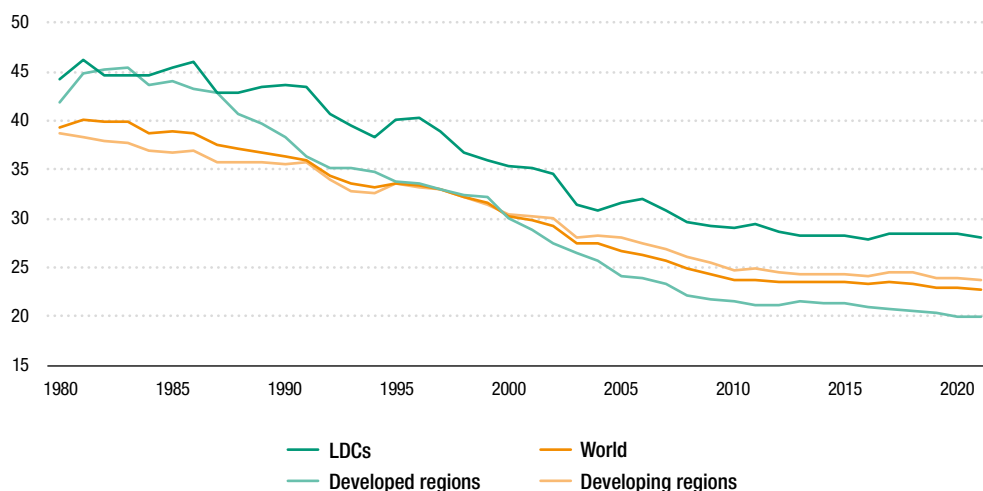
CIT rates have gradually declined throughout the world since the 1980s, as countries have increasingly engaged in tax competition to promote investment. Declines have been seen in all geographical regions and in an overwhelming majority of economies, regardless of their size or level of development.

In 1980, the worldwide CIT rate averaged 39.3 per cent, and 80 per cent of the jurisdictions for which data on CIT rates are available imposed rates of 30 per cent or higher. A steady decline was observed globally until 2010, when the number of economies charging CIT at or above 30 per cent decreased to 67 and the worldwide average CIT rate fell to 23.7 per cent. Since then, the average rate has practically stabilized at the current level of 22.7 per cent (figure II.8). In 2021, fewer than one third of all countries applied CIT at 30 per cent or above.¹⁶

The largest downswing has occurred in developed regions, where the average CIT rate more than halved between 1980 and 2021 (from 41.8 per cent to 19.9 per cent) (see figure II.8). The average rate for developing regions, which contain 75 per cent of the world's economies, has been very close to the worldwide average. Nevertheless, 105 developing economies (some 65 per cent) still have CIT rates above the world average. The average CIT rate for the least developed countries (LDCs) has followed the common downtrend but has been characterized by more volatility and the highest values among the three groups. Although the average rate in LDCs has dropped from 44.3 to 28 per cent over the last four decades, in half of these countries it remains at the level of 30 per cent or above. Whereas in many developing economies reducing the corporate tax became possible because of a shift from direct to indirect taxes in the structure of fiscal income, this was not the case for several LDCs, which rely much less on other sources of fiscal revenue than on CIT.¹⁷

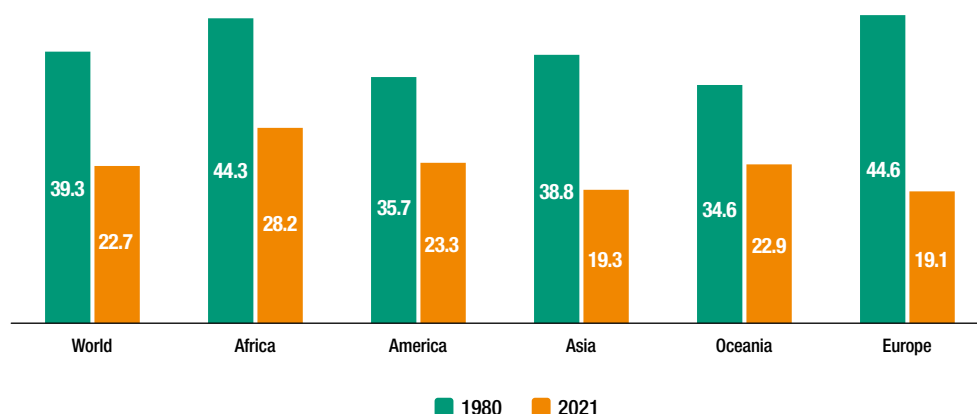
In 2021, Europe, which has seen the largest reduction in CIT rates of all regions, had the lowest regional average rate, at 19.1 per cent, followed by Asia at 19.3 per cent. In contrast, Africa had the highest regional average statutory rate, at 28.2 per cent. Countries in Latin America and the Caribbean also tend to have higher corporate tax rates than do Asian and European economies, and in Oceania and North America corporate tax rates align closely to the world average at 22.9 and 23.3 per cent, respectively (figure II.9).

Figure II.8. Statutory CIT rates, regional and world averages, 1980–2021
(Per cent)



Source: UNCTAD, based on Tax Foundation.

Figure II.9. Average statutory CIT rate by region, 1980 and 2021 (Per cent)



Source: UNCTAD, based on Tax Foundation.

2. Tax incentives for investment

a. Recent trends in investment policy measures related to taxation

National investment policy measures adopted in the past decade reveal widespread use of investment tax incentives across all regions. Profit-based incentives, including tax holidays and reduced CIT, are the most frequently used, with lower emphasis on expenditure-based and other tax and non-tax incentives for investment. Most tax incentives target specific sectors or policy objectives. In Africa and Asia, the majority are not time-bound.

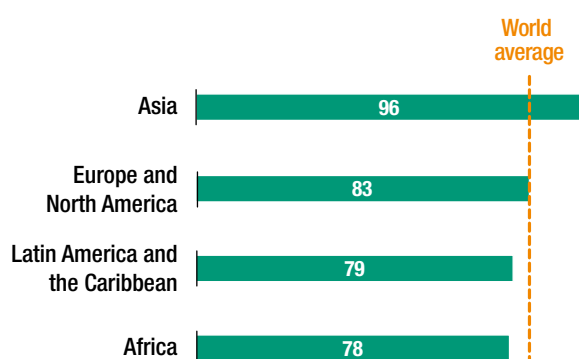
This section highlights key trends in the taxation of investment, on the basis of a review of headline investment policy measures related to taxation adopted worldwide from January 2011 to December 2021, as recorded by UNCTAD in its Investment Policy Monitor.¹⁸ It reveals the continued and extensive use of tax incentive schemes by countries around

the world as a tool for promoting and attracting FDI. In that period, of 100 countries adopting measures related to taxation, 90 lowered taxes, introduced new tax incentives or made existing incentives more generous. Of all tax measures adopted, only 17 per cent were specifically directed at foreign investors, while 83 per cent targeted both domestic and foreign investors.

Investment-related tax measures adopted globally during the last decade were overwhelmingly more favourable to investment – 83 per cent introduced new incentives or made existing incentives more generous across the economy or in selected sectors. This trend held for all levels of development (84 per cent in developing countries, 82 per cent in LDCs and 81 per cent in developed countries) and all regions, though it is particularly strong in Asia (figure II.10).

Figure II.10.

Tax-related investment policy measures more favourable to investment by region (Per cent)



Source: UNCTAD, Investment Policy Monitor.

Among tax measures less favourable to investment, three out of four consisted of an increase in tax rates (e.g. CIT or VAT) or the establishment of new taxes (e.g. mining royalties or other sector-specific taxes). The remainder involved the outright elimination of an incentive scheme. Almost half of all tax measures less favourable to investment were adopted in Africa (19 measures), one third in Latin America and the Caribbean (12 measures), with the balance split between Europe and North America (7 measures in all) and Asia (2 measures).

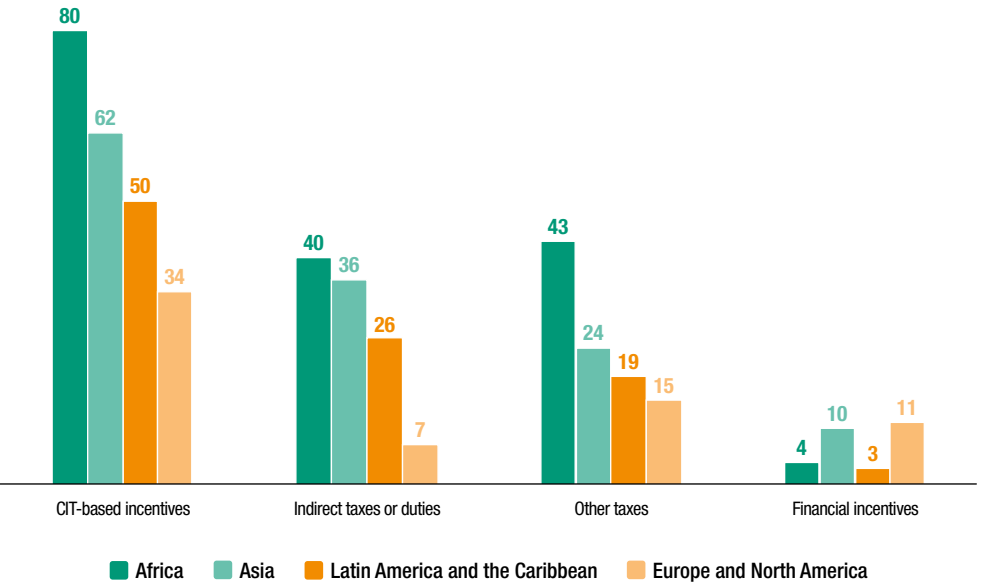
(i) A strong reliance on profit-based tax incentives for investment

Jointly considered, CIT-based instruments are the most prevalent form of investment incentive introduced over the last decade across the globe (49 per cent of all new incentives) (figure II.11). Their share in all investment incentives is evenly distributed between all regions (51 per cent in Europe and North America and Latin America and the Caribbean, 48 per cent in Africa, 47 per cent in Asia).

Focusing specifically on fiscal incentives, 39 per cent of those adopted globally since 2011 were profit-based. Tax holidays were used by the largest number of countries (55). By themselves, they represent about 20 per cent of all fiscal incentives introduced worldwide (22, 19 and 17 per cent of all incentives adopted respectively by LDCs, developing and developed countries). Tax holidays are also the main profit-based incentive used by African and Asian countries (accounting for 21 and 23 per cent of all tax incentives respectively), while reduced CIT is the most frequent profit-based incentive in Latin American and Caribbean countries (18 per cent) and European and North American countries (20 per cent) (figure II.12).¹⁹

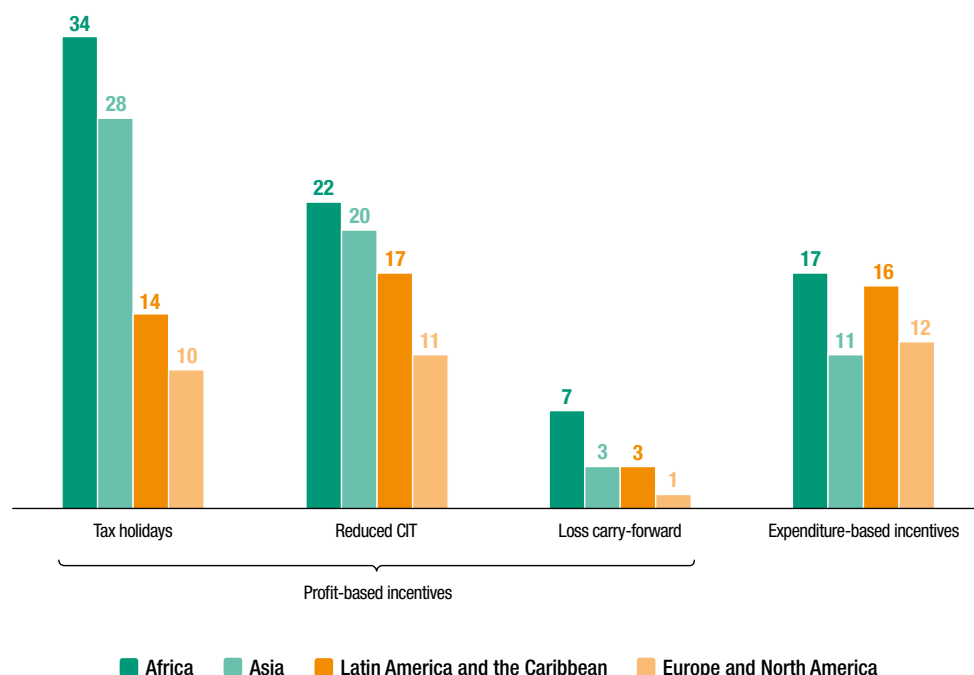
Tax holidays of up to five years are the incentive most utilized worldwide (figure II.13). This overall trend is largely influenced by African countries, which overwhelmingly favour the use of short-term tax holidays (75 per cent). By contrast, longer tax holidays of up to 10 years are the most common among countries of Latin America and the Caribbean (62 per cent). Tax holidays of over 10 years are much less common in developing countries (20 per cent) and LDCs (11 per cent), than in developed countries (40 per cent).

Figure II.11. New investment incentives by main type and region, 2011–2021
(Number of incentives)



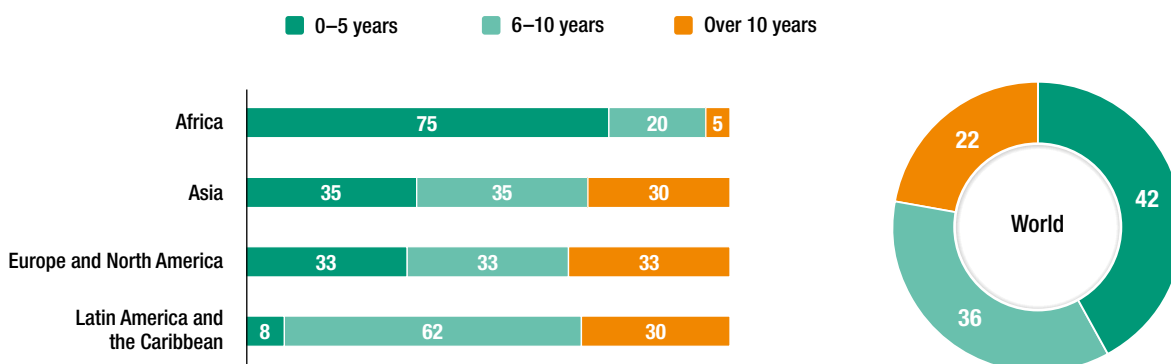
Source: UNCTAD, Investment Policy Monitor.

Figure II.12. New CIT-based investment incentives by type and region, 2011–2021
(Number of incentives)



Source: UNCTAD, Investment Policy Monitor.

Figure II.13. Investment-related tax holidays by duration, by region and world
(Per cent)



Source: UNCTAD, Investment Policy Monitor.

Reductions of the CIT rate (across all sectors or in selected sectors) accounted for 16 per cent of all tax incentives introduced worldwide since 2011 (42 countries). Their weight in the overall incentives landscape is higher in developed countries (21 per cent) than in developing ones (16 per cent) and in LDCs (14 per cent).

In contrast, the use of loss carry-forward provisions was much less widespread (accounting for 3 per cent of all new tax incentives). Almost 30 per cent of loss carry-forward provisions are included in incentive packages for SEZs.

(ii) With lower emphasis on expenditure-based incentives

Expenditure-based incentives represent 13 per cent of all tax incentives for investment introduced over the last decade. They mainly consist of schemes to provide accelerated depreciation for fixed assets, investment allowances and/or tax credit mechanisms. This type of fiscal incentive was adopted by 39 countries worldwide (14 in Africa, 10 in Latin America and the Caribbean, 8 in Asia and 7 in Europe and North America). Over 55 per cent of expenditure-based instruments were adopted in conjunction with a tax holiday or a CIT reduction.

(iii) And frequently in combination with other tax and non-tax incentives for investment

Both expenditure-based and profit-based incentives for investment are often combined with additional fiscal benefits in the form of tax breaks for indirect taxes and duties, such as VAT or import tariffs. These accounted for about 30 per cent of all tax incentives introduced in Asia and in Latin America and the Caribbean. They were also frequently utilized in Africa (24 per cent of all tax incentives), but far less common in Europe and North America (13 per cent). They can be found in virtually every tax scheme for the establishment of an SEZ across all regions.

Deductions and exemptions for taxes on labour and land and other payments are also used extensively as tax incentives for investment. They accounted for over a quarter of all tax incentives in Africa and in Europe and North America (adopted by 25 and 11 countries respectively). They are also relatively frequently used in Asia and in Latin America and the Caribbean, where they represented 20 per cent of all new tax incentives in the past decade.

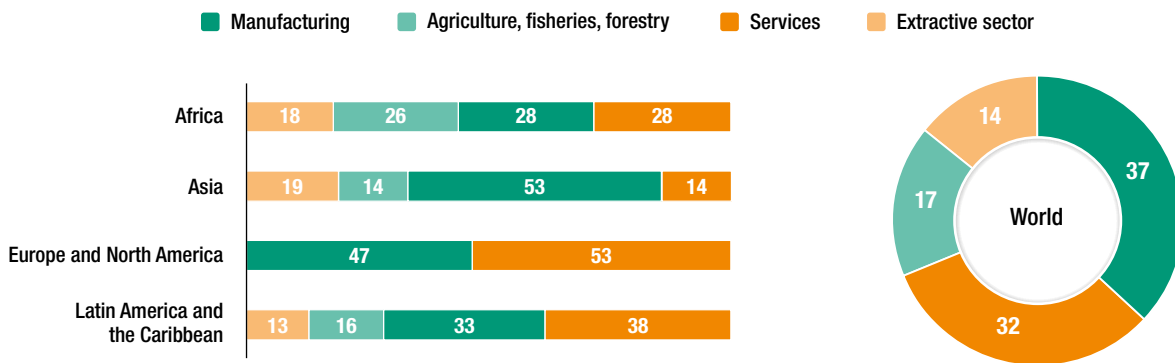
In addition, several non-tax instruments to promote investment were introduced jointly with the tax reform initiatives over the last 10 years. They include financial incentives (e.g. grants, loans or State subsidies supporting salaries or production output), relaxed restrictions on foreign ownership and business facilitation measures (such as simplified import and export procedures, single-window mechanisms for permits and licences, and streamlined procedures for employment visas). Business facilitation measures are particularly noteworthy and represent the most significant non-tax promotion instrument adopted in every region of the globe (62 per cent of all non-tax promotion instruments in Africa, 57 per cent in Europe and North America, 56 per cent in Latin America and the Caribbean, 46 per cent in Asia).

(iv) Target sectors change by region and level of development

Globally, 57 per cent of all tax-related investment policy measures more favourable to investment are sector-specific. In particular, developing countries (70 per cent) and LDCs (55 per cent) often implement reduced-CIT incentives that are based exclusively on sectoral requirements. In contrast, almost two thirds of reduced-CIT incentives adopted by countries in Europe and North America are granted fully or partially on the basis of minimum investment thresholds.

Most sector-specific tax incentives for investment introduced in the last decade target manufacturing and services (figure II.14). Tax incentives for the services sector are particularly relevant in Europe and North America (53 per cent of all incentives), and Latin America and the Caribbean (38 per cent) and fairly relevant in Africa (28 per cent). In contrast, Asian countries adopted more tax incentives for investment in the manufacturing industry than for all other sectors combined (52 per cent). Notably, all tax incentives specifically targeting the agricultural and extractive sectors are concentrated in developing countries and LDCs.

Figure II.14. Sectoral distribution of new tax incentives for investment, by region and world, 2011–2021
(Per cent)



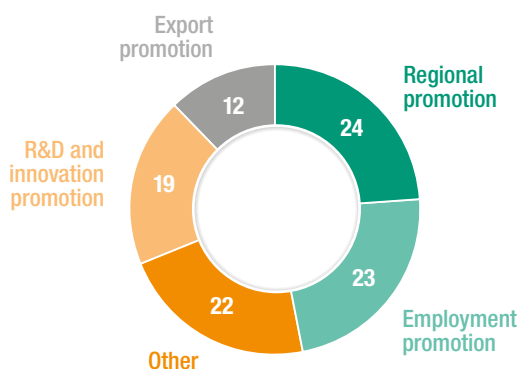
Source: UNCTAD, Investment Policy Monitor.

Tax incentives that specifically target manufacturing industries for the most part have been designed to apply horizontally across all manufacturing activities (79 per cent). The balance reveals a substantial share of incentives aimed at the manufacturing of transport equipment (44 per cent), the production of computer and electronic equipment (33 per cent) and the production of pharmaceuticals (22 per cent). Zooming in on tax incentives that specifically target services, 73 per cent apply to the whole sector. The rest reflect a policy focus on information technology (32 per cent), tourism (27 per cent) and transport (22 per cent).

(v) Specific policy objectives are often associated with new incentives

Over 60 per cent of tax-related measures more favourable to investment introduced over the last decade are associated with the pursuit of one or more policy objectives, such as the development of specific regions within a country (e.g. priority development areas or rural areas), the promotion of exports, the reduction of unemployment or the upgrading of skills, the promotion of research and development and the transfer of innovative technologies (figure II.15). Individually considered, tax incentives that aim at regional promotion are the most recurrent globally (24 per cent), in Africa (33 per cent) and in Asia (27 per cent). Among these incentives, 70 per cent aimed at promoting the development of an SEZ and 30 per cent targeted the development of a specific location within the country. Employment promotion is the most recurrent policy objective associated with incentives in Europe and North America (35 per cent), and in Latin America and the Caribbean (33 per cent).

Figure II.15. Policy objectives associated with new tax incentives for investment, 2011–2021
(Per cent)



Source: UNCTAD, Investment Policy Monitor.

Note: "Other" includes various policy objectives including the expansion of health-care and education markets, the internationalization of national enterprises and support for the generation of domestic added value.

(vi) Only about half of new incentives worldwide and one third in Africa are time-bound

About half of all tax incentives for investment introduced worldwide over the last decade were time-bound (48 per cent), but the share is lower in

Africa (35 per cent) and in Asia (40 per cent), with important implications in terms of forgone revenue, impact assessment and distortions in the market. Conversely, time-bound incentives are more frequently used in Latin American and Caribbean countries (60 per cent) and particularly significant in European and North American countries (79 per cent).

(vii) Investment laws are among the main instruments to introduce tax incentives for investment

Investment laws and the associated secondary legislation were the primary legal basis for the introduction of tax incentives in LDCs (55 per cent), followed by tax codes or budget laws (16 per cent), ad hoc decrees (10 per cent) and other policy instruments (19 per cent). African countries also enacted tax-related investment incentives mostly through introducing or revising national investment laws (39 per cent) or through enacting budgetary or taxation legislation (33 per cent). The use of ad hoc decrees for adoption of tax-related incentive schemes is minimal in Africa, whereas it is very significant in Latin America and the Caribbean (84 per cent of all measures) and in Europe and North America (71 per cent) and remains substantial in Asia (45 per cent).

b. Tax incentives in investment laws

Over half of the investment laws worldwide contain tax incentives for investment, including three quarters of investment laws in LDCs. In only 30 per cent of the laws, incentives are granted on the basis of measurable criteria, and allocation decisions can involve several stakeholders, including investment promotion agencies.

Of 126 investment laws in UNCTAD's Investment Law Navigator,²⁰ 68 laws (54 per cent) dedicate a section to the treatment of tax incentives for investment. LDCs lead the trend, with three quarters of their investment laws including provisions on tax incentives, followed by developing and developed countries (46 and 36 per cent of all investment laws, respectively).

On a regional basis, almost two thirds of investment laws in Africa and Asia include a section on tax incentives. In other regions, the treatment of tax incentives in investment laws is less prominent (44 per cent in Latin America and the Caribbean, 42 per cent in Europe and 10 per cent in Oceania).

One third of the investment laws dealing with taxation selectively reproduce or illustrate incentives that are regulated by separate legislation (e.g. tax, customs or sectoral). This is the case, notably, for all developed countries that deal with incentives in their investment law (Bulgaria, Lithuania, Russian Federation, Serbia), but also of some developing countries (the Plurinational State of Bolivia, Guyana, the Republic of Moldova, Qatar, Tajikistan, the United Republic of Tanzania and Turkmenistan). However, the remaining two thirds of investment laws (43 laws) are themselves the legal basis for the introduction of special tax regimes for investment. This includes almost 50 per cent of investment laws in Africa, 38 per cent in Asia, 22 per cent in Latin America and the Caribbean and 10 per cent in Oceania. These are the laws considered in the following analysis.

(i) Profit-based incentives are prevalent also in investment laws

Although there are significant differences in the range of incentives offered, over 80 per cent of all investment laws dealing with tax incentives utilize profit-based incentives to promote investment. In particular, tax holidays are offered in the investment laws of 31 countries (16 countries in Africa, 12 in Asia, 3 in Latin America and the Caribbean), and reduced CIT in those of 15 countries (9 countries in Africa, 4 in Asia, 2 in Latin America and the Caribbean).

Expenditure-based incentives can be found in more than 60 per cent of investment laws dealing with tax incentives (27 investment laws), including those of 17 countries in Africa, 6 in Asia, 3 in Latin America and the Caribbean, and 1 in Oceania, with an almost equal distribution among developing economies and LDCs (12 and 15 countries respectively).

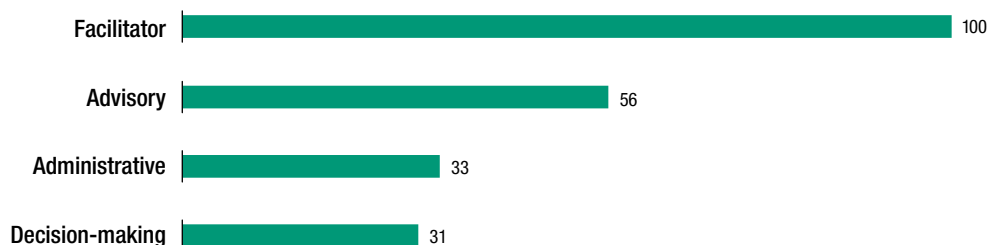
Among incentives not based on CIT, the ones most frequently used are exemption from customs duties on goods imported and directly involved in realizing the investment (86 per cent), exemption from VAT (37 per cent), exemption from land taxes (26 per cent) and exemption from stamp duty (16 per cent).

(ii) The governance of incentives varies greatly across countries

In only about 30 per cent of investment laws, investors are automatically eligible for incentives based on measurable criteria, such as the invested amount, the volume of employment generated or the location of the investment. In all other cases, the provision of tax incentives and their scope and duration depend on the discretion of the authorities. These are often the ministries of finance, industry or both. The process of approval can also require an expert opinion of several governmental institutions (box II.2). These findings were confirmed by the investment promotion agencies (IPAs) that responded to UNCTAD's Annual Survey of Investment Promotion Agencies for 2022. Of 126 respondents to the survey, only 29 per cent indicated that incentives in their country are granted automatically on the basis of objective criteria, whereas the large majority (63 per cent) indicated that incentives are allocated on the basis of an assessment process that involves criteria that may or not all be public. In all other cases, incentives are granted on an ad hoc basis through negotiation with investors (8 per cent).

IPAs are also actively involved in the provision of tax incentives. Their role varies from facilitating investment to actively participating in the allocation of incentives (figure II.16). All respondents to the UNCTAD survey stated that their agency provides information to investors on available incentives and the application processes. Most IPAs also act as advisory agents by issuing recommendations to decision-making entities. Another core function of IPAs is to support their clients in administrative tasks, such as collecting and processing applications for incentives. Finally, almost one third of the IPAs actively participate in decisions regarding the allocation of tax incentives. This can create conflicts of interest, particularly when the IPA's performance is assessed on the basis of the investment volumes it helps to generate.

Figure II.16. | Role of IPAs in the provision of tax incentives (Per cent of respondents)



Source: UNCTAD.

Incentives granted on the basis of automatic criteria

In *Algeria*, investments registered with the National Agency of Investment Development automatically benefit from the tax incentives described in the investment law, including exemption from custom duties, exemption from VAT and exemption from CIT for up to three years during the operational phase.

In *Mali*, depending on the amount invested, investment projects can automatically benefit from a set of tax incentives that include exemption from import duties and VAT, and reduction of CIT.

In *Rwanda*, a package of tax incentives is available to registered investors that meet the requirements set forth in the Annex to the Law on Investment Promotion and Facilitation. Such investors are entitled to preferential CIT rates or tax holidays of up to seven years.

Incentives subject to approval by the IPA

In *Kuwait*, investors apply to the Direct Investment Promotion Authority for all or part of the incentives described in the investment law. The Authority, in line with the approved general policy of the State and economic development plans, defines the value, type and duration of incentives and exemptions granted.

In *Libya*, the IPA may offer additional advantages beyond those applicable under the standard tax incentive regime, for those investment projects that contribute to the achievement of food security, regional development, environmental protection or the development of energy and water infrastructure.

In *Myanmar*, the Myanmar Investment Commission, in charge of investment promotion activities, is responsible for granting and defining the scope of available tax exemptions or relief for investors that apply for preferential treatment.

Under the investment laws of *Senegal and Togo*, the IPA defines the scope of the tax incentives and advantages granted. In case of refusal, the IPA is required to provide justification.

Subject to approval by other authorities

In *Burkina Faso and Niger*, the preferential tax regimes are granted by joint decree of the ministers in charge of industry and finance.

In *Benin*, approval for preferential treatment for investments is given by the Government on the proposal of the Minister of National Planning and following the opinion of the Technical Commission on Investments.

Cameroon may provide investors with tax incentives upon approval by the Minister in charge of private investment, with the assent of the Minister of Finance.

Source: UNCTAD, Investment Laws Navigator.

c. Tax incentives in industrial policies

Most recent industrial policies call for the introduction of new tax incentives for investment (61 per cent), while only few call for their review or streamlining (15 per cent). The most recurrent motivations for introducing tax incentives in industrial policies are reducing the cost of doing business, supporting innovation, stimulating local production and developing SMEs.

Introduced under various names, such as strategic development plan, vision, industrial strategy, five-year plan or economic development policy, industrial policies remain widely employed around the world to impel long-term structural transformation and promote sustainable development objectives. Tax incentives are often a key element in the policy toolkit put forward by these documents.

Of 103 industrial policies implemented across the globe between 2011 and 2022 and reviewed by UNCTAD, 61 per cent mention tax incentives, 10 per cent mention only non-tax incentives (such as preferential loans, grants, export subsidies and credit guarantees), and 29 per cent do not refer to incentives at all. LDCs are more prone to utilize tax incentives in industrial policies (they appear in 68 per cent of them), followed by developing countries (61 per cent) and developed ones (56 per cent).

Unlike many investment laws, industrial policy documents are typically not the legal basis for the adoption of incentives, but they often provide a motivation for their introduction. As such, they are generally less detailed about the proposed nature of the tax incentives they contain, particularly in developing countries, where less than one fifth of industrial policies spell out the nature of the planned incentives, compared with one third of the industrial policies in developed countries.

One third of the tax incentives in industrial policies worldwide have no other policy objective than promoting investment by reducing the cost of doing business. The rest target one or more development goals. Chief among them are promoting R&D and innovation (24 per cent), promoting local production (19 per cent) and promoting SMEs and start-ups – also often considered an avenue for encouraging innovation (13 per cent), exports (13 per cent) and employment (9 per cent).

Other objectives pursued through tax incentives in industrial policies include goals as diverse as avoiding capital flight, promoting digitalization, developing e-commerce, increasing domestic savings or improving productivity, creating value, renewing equipment, taking countercyclical actions, promoting migration from the informal to the formal sector, and combating climate change.

Yet not all industrial policies call for the introduction of new incentives. About 15 per cent of them seek to review, streamline or ensure that the existing fiscal rebates produce the desired effects (box II.3).

Box II.3.

Industrial policies calling for streamlining and rationalizing incentives (illustrative list)

Several countries have stressed the need to streamline, rationalize and review the tax incentives for investment in their industrial policy documents. Some examples:

Belize – Growth and Sustainable Development Strategy 2016–2019: “Action 4: The [Ministry of Investment, Trade and Commerce], in collaboration with the [Ministry of Economic Development], will lead efforts to review the incentive regime (tax and non-tax incentives) aimed at attracting investments, to take account of the need to minimize the provision of incentives to those who are not taking commensurate risks, balanced against the need to provide appropriate incentives on a timely basis in areas where they could be most effective” (p. 22).

Cameroon – National Development Strategy 2020–2030: “It will also have to do with strengthening the policy of mobilizing budgetary revenues by: (i) auditing tax exemptions in order to maintain only those with a proven positive impact on the economy” (p. 130).

Jordan – Economic Growth Plan 2018–2022: “Implementation of this policy requires: Adopting the principle of linking the increase in tax revenues to economic growth, addressing tax distortions, raising the efficiency of collections, and rationalizing unwarranted tax exclusions and exemptions” (p. 29).

Liberia – Industry for Liberia’s Future (2011): “Policy 8: The Government will use incentives to promote investment in industrial activities and capabilities, and it will track and measure the impact incentives granted have to ensure the use of incentives is done in a transparent manner and serves the Government’s strategic goals of generating investment, promoting sustainable economic growth, diversifying economic activities and expanding the private sector” (p. 26).

Malawi – National Industrial Policy (2016): “3.2.3 Taxation. The Government will: Monitor implementation of the Industrial Rebate Scheme to avoid misuse of the facility” (pp. 6-7).

Sri Lanka – Vision 2025: “We will rationalize the tax system by minimizing exemptions, holidays and special rates, towards a fair and effective tax administration” (p. 17.) “We will clarify and reform investment incentive policies to improve investment policy predictability. We propose to phase out tax holidays, which have been the main traditional incentive offered to investors, and switch to other forms of efficiency improving incentives” (p. 20).

/...

Box II.3.**Industrial policies calling for streamlining and rationalizing incentives** (illustrative list) (Concluded)

Turkey – The Medium-Term Programme 2022–2024: “8. Efforts to review tax incentives, exceptions and exemptions by considering the efficiency principle will continue.”

United Republic of Tanzania – National Five-Year Development Plan 2016/17–2020/21: “The Government needs to close loopholes leading to revenue leakages (...). This will involve measures geared to: (...) (viii) Reviewing tax holidays, tax exemptions and tax relief systems as incentives to investors in order to minimize their abuse and thus increase tax collection. (...) efforts will further be directed at minimizing the application of tax exemptions, building on existing reforms” (p. 91).

Source: UNCTAD, based on the documents listed in this box.

3. Taxation measures and international investment policies

a. IIA provisions and taxation measures

IAs impose obligations on States that can create friction with taxation measures undertaken at national level. The actions of tax authorities, as organs of the State, and tax policymaking more generally can potentially engage the international responsibility of a State under an IIA when they adversely affect foreign investors and investments.

Some 2,500 old-generation IIAs are in force today. They typically feature broad provisions and include few exceptions or safeguards. Tax provisions do not usually form a principal part of IIAs, in part owing to the existence of DTTs. Most IIAs do not exclude taxation from their scope, which means that they cover a wide range of tax-related measures, whether of general or specific application. They can expose States to tax-related claims brought under the ISDS mechanism. Overall, investors have brought close to 1,200 ISDS cases based on IIAs against 130 countries. UNCTAD data suggest that in some 160 of these cases, investors have challenged tax-related measures undertaken by developed and developing countries (box II.4).

Box II.4.**Tax-related ISDS cases based on IIAs: facts and numbers**

Investors have challenged tax-related measures in 165 ISDS cases based on IIAs. Tax-related claims accounted for about 15 per cent of the 1,190 publicly known ISDS cases filed overall as of the end of 2021.

Sixty per cent (99 cases) of the tax-related cases were brought against developed countries; the remaining 40 per cent (66 cases) were directed at developing countries. Spain was the most frequent respondent with 42 cases (about 25 per cent of all tax-related ISDS cases), followed by Ecuador and Italy with 10 cases each. Overall, 47 respondent States have faced at least one known tax-related ISDS claim.

Developed-country investors brought over 90 per cent of tax-related IIA claims. The highest numbers of such cases were initiated by investors from the Netherlands (30 cases), the United States (26) and Germany (24).

About 40 per cent of all such cases were intra-EU disputes between EU investors and EU member States (63 cases).

The ECT (1994) was the IIA invoked most frequently in tax-related ISDS cases, with 68 cases, followed by NAFTA (1992) with 12 cases and the Ecuador–United States BIT (1993) with 6 cases.

/...

Box II.4.**Tax-related ISDS cases based on IIAs: facts and numbers**
(Concluded)

Several tax-related ISDS cases and awards have attracted public attention. High-profile examples include cases challenging the following types of State conduct:

- Imposition of capital gains taxes (*Vodafone v. India (I) and (II)*, *Cairn v. India*)
- Initiation of tax investigations and large tax assessments (*Hulley Enterprises v. Russia*, *Veteran Petroleum v. Russia*, *Yukos Universal v. Russia*)
- Increases in windfall profit taxes and royalties (*Burlington v. Ecuador*, *ConocoPhillips v. Venezuela*)
- Legislative reforms in the renewable energy sector related to feed-in tariffs and incentives for solar energy (*The PV Investors v. Spain*, *Charanne and Construction Investments v. Spain*)
- Withdrawal of subsidies or tax exemptions (*Micula v. Romania (I)*)

Source: UNCTAD.

Note: These 165 cases were identified on the basis of UNCTAD's ISDS Navigator and information from other public sources, including notices of arbitration, arbitral decisions and specialized reporting services.

IIA provisions – particularly the unreformed clauses prevalent in old-generation IIAs – can have a variety of implications for tax policymaking and tax-related measures (table II.3).

Definitions of investment and investor. Old-generation IIAs frequently rely on broad definitions, covering an open-ended list of assets held by foreign investors. A major challenge for host governments is to know whether an investment is foreign investment and by which (if any) IIA relationships it could be covered. The ownership chains behind a local investment may be complex and designed to access IIA benefits through indirect ownership stakes. This means that tax administrations and policymakers may not be able to determine whether certain actions or measures affect a foreign investor covered by an IIA.

Substantive scope of IIAs. Most old-generation IIAs do not contain exclusions from their substantive scope for taxation, which means that tax-related measures, whether of general or specific application, are covered by such IIAs. This includes tax measures that fall within the scope of a DTT between the two countries. Even where exclusions exist, ISDS tribunals adopt their own interpretation or definition of “taxes” and do not necessarily rely on domestic law guidance or international best practices.

Temporal scope of IIAs. Old-generation IIAs frequently extend treaty protection to investments made before the agreement's entry into force. A taxation measure that was taken prior to the entry into force of the IIA but with “lasting effects” on such investments could, under certain circumstances, give rise to ISDS proceedings, creating uncertainties for tax policymakers.

National treatment. The NT provisions of IIAs cover de facto and de jure discriminatory treatment. Distinctions based on residence are not specifically safeguarded under NT in IIAs. Preferential treatment exclusively granted to national investors, such as tax exemptions, may be challenged under IIAs even where this treatment is in accordance with the host State's legislation.

Most-favoured-nation treatment. Investors have rarely invoked the MFN standard to challenge the actual level of material treatment of foreign investors from third States. More frequently, investors have invoked the MFN clause to import more investor-friendly provisions from the host State's IIAs with third States, thereby “cherry-picking” advantageous IIA standards. For example, investors can attempt to circumvent tax exceptions in the IIA under which the ISDS case is brought, on the basis that another IIA signed by the host country does not contain them.

Table II.3.

IIAs and their implications for tax policymakers

Selected IIA issue or provision	Description	Implications for tax measures
Definitions of investment and investor	<ul style="list-style-type: none"> Old-generation IIAs frequently rely on broad definitions, covering an open-ended list of assets. Ownership chains behind a local investment may be complex and designed to access IIA benefits through indirect ownership stakes. 	<ul style="list-style-type: none"> Tax administrations and policymakers may not be able to determine whether certain actions or measures affect a foreign investor covered by an IIA.
Substantive scope	<ul style="list-style-type: none"> Most old-generation IIAs do not contain exclusions from their substantive scope for taxation. 	<ul style="list-style-type: none"> Tax-related measures are covered by most old-generation IIAs.
Fair and equitable treatment	<ul style="list-style-type: none"> ISDS tribunals' interpretations of fair and equitable treatment have expanded and covered expectations of regulatory stability and compliance with the investor's legitimate expectations, expectations of transparency and participation in governmental decision-making, and proportionality tests for State measures. 	<ul style="list-style-type: none"> For tax administrations and policymakers working in an environment of evolving tax regulations, FET concepts can create important challenges and potentially involve ISDS claims.
Indirect expropriation	<ul style="list-style-type: none"> Most old-generation IIAs include protection in case of indirect expropriation, without explicit safeguards for non-discriminatory regulatory actions in the public interest. Tax measures with the effect of (substantially) depriving the investor of the value of their investment are vulnerable to challenge. 	<ul style="list-style-type: none"> There is no bright line separating permissible tax measures from tax measures that amount to confiscation or expropriation of investment and require compensation.
Investor–State dispute settlement	<ul style="list-style-type: none"> Most IIAs provide for States' advance consent to international arbitration proceedings between an investor and the host State. Recourse to domestic courts or exhaustion of local remedies is not required under most IIAs. Tax matters are generally not excluded from ISDS. 	<ul style="list-style-type: none"> The types of tax-related claims that have arisen under IIAs have been diverse and often intertwined with non-tax measures.

Source: UNCTAD.

Fair and equitable treatment. FET is the clause most frequently invoked by investors in ISDS cases. Old-generation IIAs typically include an FET provision drafted in a minimalist, open-ended way. ISDS tribunals' interpretations of FET have expanded over time and have covered expectations of regulatory stability and compliance with the investor's legitimate expectations, expectations of transparency and participation in governmental decision-making and proportionality tests for State measures. For tax administrations and policymakers working in an environment of evolving tax regulations, these FET concepts can create important challenges and potentially involve ISDS claims.

Full protection and security. Many old-generation IIAs contain a full protection and security clause that does not include clarifications. ISDS tribunals have, in some cases, extended the scope of full protection and security to legal, economic or commercial, or other security aspects. Notions and concepts such as stability of the tax framework, stability of the commercial environment and protection against economic impairment of an investment can be relevant under this provision.

Expropriation. The expropriation provision protects foreign investors in case of dispossession of their investments by the host country. Most old-generation IIAs equally include protection in case of indirect expropriation, without explicit safeguards for non-discriminatory regulatory actions in the public interest. Tax measures with the effect of (substantially) depriving the investor of the value of their investment are vulnerable to challenge.

Expropriation clauses constitute a source of uncertainty for States and tax authorities. There is no bright line separating permissible tax measures from tax measures that amount to confiscation or expropriation of investment and require compensation.

Transfer-of-funds obligation. The transfer-of-funds provision grants the right to free movement of investment-related financial flows into and out of the host country. Many old-generation IIAs contain a transfer-of-funds provision without exceptions. In most IIAs, no explicit guidance is provided on the types of restrictive measures that may be permitted or conditions for their application. While the good faith application of tax measures is unlikely to violate this standard, including clear guidance in IIA texts can provide certainty to tax policymakers and investors and limit arbitral tribunals' discretion in ISDS cases.

“Umbrella” clause. An umbrella clause establishes a commitment on the part of the host State to respect its obligations regarding specific investments, for example, those arising from contractual arrangements. Revising or withdrawing bilateral (and potentially unilateral) commitments the host State entered into with respect to a foreign investor, such as tax stabilization clauses in investment contracts or tax rulings, can come within the ambit of the IIA. Through the umbrella clause, contractual obligations or unilateral commitments could thus be elevated to IIA obligations and lead to ISDS proceedings.

Public policy exceptions. Largely absent from old-generation IIAs, public policy exceptions permit measures otherwise inconsistent with the IIA to be undertaken under specified circumstances. They can provide a higher degree of flexibility in implementing tax measures when these are justified with respect to specific policy objectives (e.g. protecting the environment or public health) and can have implications for the outcomes of tax-related ISDS cases.

Investor–State disputes. About 95 per cent of IIAs provide for States' advance consent to international arbitration proceedings between an investor claimant and the respondent State. Investors can directly challenge State measures before an ISDS tribunal. Recourse to domestic courts or the exhaustion of local remedies is not required under most IIAs. Tax matters are generally not excluded from ISDS. The types of tax-related claims that have arisen under IIAs were diverse (e.g. withdrawal of incentives, increases in windfall profit taxes). They were often intertwined with non-tax measures (e.g. forced liquidation, interference with or termination of contracts). Such claims can but do not necessarily overlap with the subject matter covered by DTTs and mutual agreement procedures.

b. IIA reform and taxation measures

The broad clauses of unreformed IIAs can expose States to legal challenges when raising tax revenue or preventing tax avoidance or evasion. During the last decade, investment policymakers worldwide have reassessed the role of IIAs in national development plans and weighed the pros and cons of signing them. Many countries have embarked on reform of the IIA regime to address challenges for public policymaking that arise from broad and vague substantive protection standards coupled with wide access to investor–State arbitration in IIAs. IIA reform efforts aimed at refining and limiting the scope of the key standards have a direct bearing on taxation measures. These efforts can ensure that countries can implement legitimate, non-discriminatory taxation measures while minimizing the risk of ISDS claims. Since 2012, more than 80 countries and regional economic integration organization have benefited from UNCTAD support in developing reform-oriented model BITs and IIA reviews (*WIR19*). More than 1,000 government officials have been trained on key issues in IIAs and ISDS.

The strongest safeguard for tax policymaking would perhaps be a complete and unambiguous tax carve-out from the scope of an IIA (e.g. accompanied by a mechanism that gives the host State discretion to determine whether the carve-out applies in a specific dispute or that gives the competent authorities the power to decide). If the State parties negotiating or renegotiating an IIA do not desire or cannot agree on a complete tax carve-out, other options are available to limit a State's exposure to ISDS claims and safeguard the right to regulate in the public interest. Reform options can clarify and limit the scope of IIA provisions, narrow the interpretive discretion of ISDS tribunals and give respondent States a stronger legal basis in the IIA to defend themselves more effectively. In 2021, UNCTAD released a guide for tax policymakers on IIAs and their implications for tax measures (UNCTAD, 2021b). The guide was produced in cooperation with the WU Global Tax Policy Centre of the Vienna University of Economics and Business, Institute for Austrian and International Tax Law. It seeks to stimulate interaction between tax policymakers and IIA negotiators and provides policy recommendations on minimizing the risks of taxation-based ISDS claims.

c. Developments in the international tax system, DTTs and investment policymaking

The Base Erosion and Profit Shifting (BEPS) Project was launched in 2013 by the OECD and G20 to address tax planning strategies used by multinational enterprises (MNEs) to avoid paying taxes. Tax-planning strategies exploit loopholes and mismatches between national tax rules. Despite having done significant work to reduce opportunities for tax arbitrage, countries – particularly developing countries – have continued to raise concerns that increasing tax competition to attract FDI has frustrated revenue mobilization efforts. Furthermore, the rise of the digital economy has also challenged traditional tax rules, which generally attribute profits on the basis of physical presence in a jurisdiction. Combined, these developments have reignited reform in the international tax system not only to address the tax challenges arising from digitalization of the economy, but also to restore stability to the international tax framework and prevent uncoordinated unilateral tax measures (OECD, 2020b). A consensus-based response has been the primary focus of the two-pillar solution developed by the OECD Inclusive Framework on BEPS. The BEPS Project and other developments in this area shed light on the interplay between the international tax system, DTTs and investment policymaking (table II.4).

Among the key reform proposals, the members of the Inclusive Framework are negotiating the adoption of a minimum tax for the largest MNEs (commonly referred to as Pillar II). This reform is expected to dissuade MNEs from shifting profits and tax revenues to low-tax jurisdictions and minimize the race to the bottom between countries, particularly developing ones. Pillar II includes a Subject to Tax Rule that would be introduced by way of a bilateral agreement between States and would allow them to tax certain intragroup outbound payments such as interest and royalties if the residence country of the investor does not tax the respective income up to a minimum predetermined rate. The minimum taxation idea incorporated in Pillar II can have a profound impact on certain domestic tax incentives; e.g. the benefit of tax holidays or SEZs to investors might be eliminated or reduced when their application leads to an effective tax rate below a certain threshold for large-scale MNEs. Other tax developments, related to Pillar I of the BEPS Project, provide newly created taxing rights for market jurisdictions. Although these reforms are forward-looking, a significant number of DTTs between countries have already had a demonstrated impact on investment decisions.

Table II.4.

Developments in the international tax system and their implications for investment policymakers

Selected international tax development	Implications for investment policymaking
Base Erosion and Profit Shifting (BEPS) Tax planning and tax avoidance	<ul style="list-style-type: none"> • Reduces regulatory scope for tax avoidance • Aims to decrease for tax competition • Addresses situations in which no tax is paid, especially in the context of applying DTTs
BEPS Inclusive Framework Minimum tax for largest MNEs (Pillar II)	<ul style="list-style-type: none"> • Expected to dissuade large MNEs from shifting profits and tax revenues to low-tax jurisdictions and minimize the race to the bottom • Affects tax incentive schemes for foreign investment • Creates a minimum tax on foreign profits generated by large MNEs
Double-taxation treaties (DTTs) Functions, effects and challenges	<ul style="list-style-type: none"> • Focus on the interaction between and overlap of tax rules in two (or more) jurisdictions – i.e. the cumulative tax result – and aim to avoid double taxation and double non-taxation arising from the tax jurisdiction overlap • Affects FDI depending on how favourable a country's DTT network is • Attribute taxing rights based either on country of source or country of residence, definitions that are challenged by digital economy activities • Provide a set of tools to avoid tax abusive conduct (e.g. denial of benefits, beneficial ownership test) • Cover taxes on income and capital, leaving other charges, such as VAT or social security contributions, outside their scope • Face particular challenges in taxing income from intellectual property • Generally contain mutual agreement procedures, which provides for a best-efforts obligation to find a solution to a DTT tax dispute

Source: UNCTAD.

DTTs are aimed at improving the conditions for cross-border trade and investment. Whereas IIAs may come into play when actions of a given State or State agency (e.g. through domestic tax policy measures) adversely affect an international investment and give rise to international responsibility, DTTs tackle different barriers to cross-border activities. DTTs are not primarily focused on the unilateral tax rules in a given jurisdiction but rather on the *interaction and overlap* of these rules between two (or more) jurisdictions, each set of rules producing equitable and non-discriminatory results if taken in isolation. DTTs address the cumulative tax result of the overlapping domestic frameworks of the contracting parties. They aim to prevent this overlap leading to international double taxation as well as double non-taxation.

The underlying premise of DTTs is that double taxation is an impediment to cross-border activities, including investment, since it puts such activities at a double burden as compared to purely domestic situations. DTTs aim to prevent this double burden by attributing the taxing rights between jurisdictions for activities with a cross-border element. They determine which of the jurisdictions involved will have the right to tax the given income, thereby limiting the taxing rights of the other jurisdiction. The following section highlights key provisions in DTTs aimed at achieving this objective. Where one jurisdiction either cedes the right to tax or agrees to tax at a reduced rate, there is a possibility that, because of BEPS structures, the transaction is not taxed or is taxed at below a minimum rate in the other jurisdiction. The BEPS Project aims to prevent no taxation from occurring in case of tax avoidance. The goal of the most recent reforms revolving around Pillar II is to make sure that all profits generated by MNEs are taxed at a minimum rate, no matter how DTTs attribute the taxing rights or whether an arrangement can be classified as tax avoidance legally.

Personal scope. Just as IIAs determine their scope by defining which investors are covered, DTTs do the same by defining which taxpayers are within their scope. Tax residence under DTTs is mainly determined on the basis of *factual* ties, such as place of effective management for companies and domicile for individuals. Although the factual ties requirement makes treaty shopping relatively less straightforward, as it requires developing an objective link with a jurisdiction, the phenomenon still exists and is at the centre of a number of provisions and principles underpinning DTTs and broader international tax reforms. Research confirms that the effect of a DTT on FDI depends on whether a newly agreed DTT introduces any further benefits to the DTT network that a country already has (Petkova et al., 2018). Due to treaty-shopping structures, FDI would generally flow through the jurisdiction that offers the most favourable bilateral DTT with the targeted jurisdiction. Empirical observation demonstrates that one particularly advantageous DTT has the potential to substantially distort the FDI picture. A prominent example in this regard is the DTT between India and Mauritius, signed in 1982 and later amended by way of a protocol in 2016, which caused about one third of all FDI flows into India between 2000 and 2016 to come from the small island country (Kotha, 2017).

Denial of DTT benefits. DTTs provide a set of tools that domestic authorities may rely upon when a treaty has been invoked by a private party for abusive ends, including in case of treaty-shopping structures. These tools might be of a different nature: some address entitlement to the provisions of the DTT in general by allowing denial of benefits when the principal purpose of an arrangement is a tax benefit rather than a valid business rationale. Others, such as the beneficial ownership test, look at specific streams of income (e.g. dividend, interest, or royalties) and ask whether the recipient entity is the ultimate beneficiary of the payment. Moreover, DTTs generally allow contracting States to rely on their domestic anti-tax avoidance provisions for the purposes of denying DTT benefits.

Finding the right balance between allowing investors to take advantage of the most beneficial legal framework available to them and determining when their behaviour can be classified as abusive has been a challenge. Different jurisdictions have adopted different approaches to finding this balance, leading to diametrically different legal qualifications of the same underlying facts. For example, while some jurisdictions apply an economic substance test to determine the beneficial owner of a transaction, others focus on the existence of a legal obligation to pass on the income. Having vague and broad anti-avoidance rules such as the principal purpose test introduced in DTTs is beneficial to the tax authorities that are applying them as such rules require relatively limited administrative capacity. While favoured by developing countries for this reason, broad anti-avoidance rules undermine legal certainty and potentially open possibilities for arbitrary administrative practices. More specific anti-avoidance rules, by contrast, not only require substantial resources of the tax administrations but are also somewhat easier to circumvent as private parties can be well advised about the specific requirements of such rules. Thus, more recently the international tax landscape has seen a move away from introducing an ever-increasing number of anti-avoidance provisions and towards more general measures, such as a minimum tax for certain MNEs. These measures focus on creating a level playing field that may minimize the incentive to engage in tax avoidance practices rather than on filling the loopholes in a distortive international tax system.

Substantive scope of DTTs. DTTs generally include in their substantive scope only taxes on income and capital. This leaves some taxes, such as VAT, and other public liabilities, such as social security contributions, clearly outside their scope. However, there is no uniform view on whether other taxes such as direct turnover taxes or digital levies fall within the scope of DTTs. As some jurisdictions consider such taxes to fall outside the

scope of DTTs, they apply unilateral tax measures in their tax framework that might result in double taxation for MNEs and potentially reduce FDI flows to the jurisdiction that levies them.

Attribution of taxing rights and active business income. Traditionally, DTTs attribute taxing rights to source countries only as long as the foreign tax resident has a “permanent establishment” on the territory of the source country. When a permanent establishment is missing, the income is taxed only in the country of residence. A permanent establishment, under its current definition, presupposes some form of a physical presence in the source country either through a fixed place of business or through a representative such as a dependent agent. This substantially restricts the possibility of the source country taxing income realized by digital business activity that requires no physical presence. International tax reform in the past several years has centred on changing this imbalance between the attribution of taxing rights between the source and residence countries for activities that are directed at the market of the source country, where the foreign resident has a significant digital presence in that market but does not meet the permanent establishment definition. The UN Model Convention introduced the concept of a services permanent establishment to enable source jurisdictions to establish a taxable presence.

The arm’s length principle. Many MNEs operate a number of subdivisions in a global value chain, with the jurisdiction of each subdivision having taxing rights over a portion of the total income realized. The attribution of this income cannot be left to the sole discretion of the MNE, as it could opt to shift all profits to the country where the effective tax rate is lowest, by engaging in intragroup transactions. Here, the arm’s length principle comes into play, introducing a transfer-pricing rule. When the subdivisions of an MNE transact with one another, they must value these transactions for tax purposes at market prices. As with anti-avoidance rules, application of this provision has proven difficult, especially for transactions that do not have meaningful free market comparators such as unique intellectual property rights. Thus, MNEs can engage in profit-shifting activities, sometimes with the active endorsement of the tax authorities of some jurisdictions that aim to provide favourable transfer-pricing administrative practices for the purposes of attracting investment. The result is to shift taxable base from both developed and developing countries into low-tax jurisdictions or in some instances, where specific legal forms are utilized, to a loophole referred to as “nowhere”.

Attribution of taxing rights and passive business income. The principle under DTTs is that passive business income – dividends, interest and royalties – can be taxed also by the source country without a permanent establishment of the foreign resident on its territory. However, usually DTTs limit the taxing rights of the source country to a certain maximum percentage (e.g. not more than 10 per cent on the gross amount of the interest). Different DTTs contain different maximum percentages (or in some circumstances eliminate the taxing powers of the source country altogether), often triggering treaty-shopping structures where an investor chooses the cheapest tax route for repatriating the profits realized (looking at the dividend tax rates under different DTTs) or for financing activities (looking at the interest tax rates under different DTTs).

A common issue under DTTs is the treatment of royalty income from intellectual property. On the one hand, although the OECD Model attributes the exclusive taxing rights of royalty income to the State of residence, many DTTs (especially with developing countries) follow the UN Model, which provides limited taxing rights also to the source country. However, if the limited taxing rights of the source country go hand in hand with a beneficial intellectual property box regime in the country of residence, whereby royalty income is taxed at a favourable rate, the overall level of taxation of intellectual property income might be especially low. At the same time, intellectual property income is often at the core of excess

profits generated by MNEs. The domestic minimum tax under Pillar II and the Subject to Tax Rule might contribute to ensuring at least a minimum level of taxation of intellectual property income.

Elimination of double taxation, capital import neutrality and capital export neutrality. Attributing taxing rights to a source country under a DTT does not automatically mean that the residence country is prevented from exercising taxing rights; it only means that the residence country is under an obligation to alleviate any double taxation. DTTs provide for two ways for residence countries to eliminate double taxation: the exemption method and the credit method. The exemption method is based on the idea of capital import neutrality, namely that all investment in a given jurisdiction must be subjected to the same level of taxation irrespective of where the investor is resident. Under the exemption method, therefore, the residence country exempts the foreign income from its tax base. Capital import neutrality would generally favour FDI outflows to lower tax countries. The credit method, by contrast, is based on the idea of capital export neutrality, namely that all domestic investors must be subjected to the same level of taxation no matter whether they have invested domestically or abroad. Under the credit method, therefore, the residence country recognizes (and gives credit for) all taxes paid in the source country but then also taxes the income up to its domestic corporate tax rate for the difference.

Tax disputes. DTTs contain a system for dispute settlement that differs from the ISDS mechanism used in IIAs. First, taxpayers are never direct participants in the international resolution of disputes and, therefore, the disputes are at the level of jurisdictions and never between an investor and a jurisdiction directly. Second, only a handful of DTTs contain an arbitration clause that can lead to a binding outcome in a State–State dispute. A number of countries have been opposing such binding arbitration. The vast majority of DTTs contain only the mutual agreement procedure, which provides for a best effort obligation rather than a requirement to find a solution for any taxation that has allegedly occurred not in accordance with the DTT in question. In principle, therefore, the first course of action for taxpayers is usually to seek recourse before the domestic courts of the jurisdiction involved. Tax-related disputes have also been brought to international arbitration under IIAs. IIAs cover a wide range of State conduct across economic sectors, including tax matters. The types of tax-related ISDS claims that have arisen under IIAs are diverse (e.g. withdrawal of incentives, increases in windfall profit taxes) and often intertwined with non-tax measures (e.g. forced liquidation, interference with or termination of contracts). They can, but do not necessarily, overlap with the subject matter covered by DTTs and the mutual agreement procedure.

Finally, it must be noted that DTTs form a rather consistent network with similar provisions. Therefore, international tax reform has seen instances where the whole system of DTTs has been amended simultaneously so that a recurring problem is addressed comprehensively. An example in this respect would be the multilateral instrument to prevent the use of DTTs for tax avoidance purposes, which covers DTTs between nearly 100 national jurisdictions around the globe.²¹ Moreover, DTTs operate alongside other international agreements in the tax area, such as tax information exchange agreements. Whereas countries would generally be reluctant to conclude DTTs with offshore jurisdictions, tax information exchange agreements offer the greatly needed transparency regarding tax-relevant information held by such jurisdictions without involving the restriction on taxing rights that DTTs entail.

* * *

It is important to enhance cooperation between investment and tax policymakers to avoid the formulation of investment and tax policymaking in vacuums. The joint expertise of these two policy communities can help improve the coherence between tax and investment policymaking. Equally important is the need to minimize the risk of friction between the IIA regime and the global tax treaty network, with more than 3,000 agreements each. IIA reform efforts require broad internal policy coordination, which can benefit from the involvement of tax policymakers. Tax policymakers can provide information on past or planned tax measures relevant to commitments under existing IIAs or IIAs under negotiation and contribute to assessing the interaction between IIAs and DTTs. For example, special agencies or interministerial task forces with a mandate to coordinate investment policy-related work can provide a formal setting in which tax policymakers can share their expertise (UNCTAD, 2018b).

Looking ahead, a key emerging issue that merits major efforts for policy research and policymaking is the ever-growing interaction between industrial policy and trade, investment and tax policy regimes. The worldwide proliferation of industrial policy has intensified such interactions. According to the *World Investment Report 2018*, more than 100 countries have put in place some sort of industrial policy package, 80 per cent of which were formulated only in recent years. This has triggered extensive realignments between trade, investment, and tax policies, as well as with the newly established industrial policies and strategies. Although industrial policy may contribute to the sustainable development and inclusive growth of individual countries, it may also pose challenges and opportunities for the effort towards a coherent international approach to trade, investment, and tax policies (Owens and Zhan, 2018). This will undoubtedly exert significant and far-reaching impacts on tax regimes and reforms, as well as IIA regimes and reforms in the years to come.

NOTES

- ¹ Less favourable measures include those introducing limitations on the establishment of foreign investment or new obligations for established investment, be it domestically controlled or foreign-controlled. More favourable measures include those that aimed at liberalizing, promoting or facilitating investment.
- ² For details on the nature of the measures adopted, see UNCTAD's Investment Policy Monitor, at <https://investmentpolicy.unctad.org/investment-policy-monitor>
- ³ The threshold for direct acquisition of control by foreign investors was reduced from \$1.075 billion to \$1.043 billion for investors from countries that are members of the WTO; from \$1.613 billion to \$1.565 billion for investors from countries that are members of a trade agreement with Canada.
- ⁴ For instance, in March 2021, the Federal Trade Commission in the United States joined with its EU, United Kingdom and Canadian counterparts to announce that they would rethink their approach to M&As by Big Pharma, noting the high volume of recent deals and fast-rising drug prices. See J. Smyth, "Pharma dealmaking hit by greater scrutiny of prices and competition", *Financial Times*, 28 February 2022, <https://www.ft.com/content/697f27b3-6b23-4326-95b5-02c25623eee2>.
- ⁵ The total number of IIAs is revised in an ongoing manner as a result of retroactive adjustments to UNCTAD's IIA Navigator.
- ⁶ The substantive IIAs for 2021 with texts available are: Australia–United Kingdom FTA, Colombia–Spain BIT, Georgia–Japan BIT and Israel–Republic of Korea FTA. The scope and depth of commitments in each provision varies across these IIAs.
- ⁷ For information on the status of Contracting Parties' ratification, acceptance or approval of the agreement, see <https://www.consilium.europa.eu/en/documents-publications/treaties-agreements/agreement/?id=2019049&DocLanguage=en>.
- ⁸ European Commission, "Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains", 23 February 2022, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145.
- ⁹ ICSID, "ICSID Administrative Council Approves Amendment of ICSID Rules", 21 March 2022, <https://icsid.worldbank.org/news-and-events/communiqués/icsid-administrative-council-approves-amendment-icsid-rules>.
- ¹⁰ World Trade Organization, "Joint Statement on Investment Facilitation for Development", 10 December 2021, <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/L/1130.pdf&Open=True>.
- ¹¹ For more information on the 10th UN Forum on Business and Human Rights, see <https://www.ohchr.org/en/events/forums/2021/10th-un-forum-business-and-human-rights>.
- ¹² Under Annex 14-C of the USMCA, the parties consent to the submission of so-called "legacy investment claims" under NAFTA until three years after its termination, i.e. on 1 July 2023.
- ¹³ Studies and investor surveys have consistently found that incentives are second-order considerations in determining decisions on investment location, behind factors such as political stability and security, a stable and transparent legal and regulatory environment, and the quality of infrastructure and skills. They appear mostly effective in determining the final choice between similar options. See World Bank (2018) or Freund and Moran (2017).
- ¹⁴ In a recent survey of 305 MNE affiliates operating in 34 developing countries, tax relief was cited among the most important areas of government support for businesses to address the challenges of the COVID-19 pandemic, and over half of the surveyed companies were receiving some form of tax relief (e.g. tax cuts, tax credits, deferred payments) as of the end of 2020. See Kronfol and Steenbergen (2020).
- ¹⁵ For details on this classification, see UNCTAD (2000).
- ¹⁶ The analysis carried out in this section is based on the data on the statutory CIT rate available at <https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/> for economies (sovereign States and other types of territorial units) included in the UNCTAD classifications of geographical groups and regional development status <https://unctadstat.unctad.org/EN/Classifications.html>. The list of economies included in the UNCTAD classifications may differ from the M49 standard of the Statistical Division of the United Nations Secretariat. The data set includes historic statutory CIT rates for 1980–2021.
- ¹⁷ An analysis of a large pool of LDCs shows that unlike in developed countries, corporate rather than personal tax is the greater source of public finance for LDCs. It also highlights that although the corporate tax rate has been decreasing in LDCs, corporate tax revenues have been increasing as a share of total tax revenues and gross domestic product (Baker, 2017).

- ¹⁸ For the purposes of this section, a measure is the enactment of an investment policy instrument (e.g. law, decree) that modifies either favourably or unfavourably the tax regime applicable to investment. Each measure may include the introduction of one or more new or revised incentives or their removal.
- ¹⁹ A recent study of tax incentives for investment across 36 developing countries confirmed that tax exemptions were the CIT instrument they used most often (Celani et al., 2022).
- ²⁰ Most investment laws were adopted by developing countries (59 per cent), followed by LDCs (32 per cent) and developed countries (9 per cent).
- ²¹ <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>