



DAILY EDITORIAL ANALYSIS

TOPIC

**BALANCING FOREIGN INVESTMENT
WITH TAX SOVEREIGNTY**

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BALANCING FOREIGN INVESTMENT WITH TAX SOVEREIGNTY

Context

- As India renegotiates and formalises its Bilateral Investment Treaties (BITs), it faces the challenge of protecting foreign investors while preserving its sovereign authority to frame tax policy.

What is a Bilateral Investment Treaty (BIT)?

- BITs are **agreements between two countries** that set rules for protecting investments made by investors from one country in the territory of the other.
- They **seek to provide a predictable and stable investment environment** by protecting investors against arbitrary government action, discriminatory treatment and unlawful expropriation.
- BITs may provide **access to Investor-State Dispute Settlement (ISDS)**, which allows eligible foreign investors to bring claims against host states before international arbitration tribunals.

Features of Bilateral Investment Treaties

- National Treatment:** Foreign investors receive treatment no less favourable than domestic investors.
- Fair and Equitable Treatment (FET):** Investors are protected from arbitrary or discriminatory actions by the host state.
- Free Transfer of Funds:** Investors can transfer profits, dividends, and capital across borders subject to applicable regulations.
- Dispute Settlement Mechanism:** Provides procedures for resolving disputes between investors and host states or between states.

India's Progress on BITs

- Evolution of India's BIT Framework:** India signed its first **Model BIT in 1993**, which was amended in **2003**.
 - Following several international arbitration disputes, India adopted a **new Model BIT in December 2015**, which became operational in **2016**.
- Recent Developments:** India has signed BITs or investment agreements with countries such as; Belarus, Kyrgyz Republic, United Arab Emirates, Uzbekistan and Brazil (through an Investment Cooperation and Facilitation Treaty).
- In Budget 2025-26**, the Government announced a review of the BIT framework to make it more investor-friendly while safeguarding national interests.

Why Is the Issue of Tax Sovereignty Important?

- Tax sovereignty** refers to the authority of a state to determine its tax policies, impose taxes and enforce tax laws in accordance with its domestic legal framework and international obligations.
- Governments require this authority to **mobilise revenue, finance public expenditure, prevent tax avoidance** and ensure that businesses contribute fairly to the economy.
- However, **foreign investors may challenge certain tax measures** under investment treaties if they believe that such measures **violate treaty protections** creating a potential conflict between investor protection and the state's regulatory powers.

Concerns Associated with BITs

- Unequal treatment:** Foreign investors may access international arbitration, while domestic investors generally have to seek remedies through domestic courts.
- Risk to tax sovereignty:** Investors may challenge government tax decisions through international arbitration, limiting the state's freedom to frame and implement tax policies.
- Inconsistency with India's tax dispute policy:** Allowing tax disputes under BITs may conflict with India's preference for resolving them through domestic laws and tax treaty mechanisms.

- **Forum shopping:** Investors may use BITs to bypass tax-specific dispute resolution mechanisms, even when alternative remedies are available.

Tax Dispute Cases Under BITs

- **Cairn Energy dispute:** Cairn Energy has launched international arbitration against India over retrospective tax measures. An arbitral tribunal found in favour of Cairn in 2020.
- **Vodafone dispute:** Vodafone disputed the Indian government's retrospective tax claim in relation to the acquisition of an indirect stake in an Indian company.
 - ♦ The controversy brought to the fore issues of tax certainty and the impact of retrospective taxing on foreign investment.

International Approaches to Investment Dispute Resolution

- **United Nations model:** International discussions on investment treaty reform increasingly examine whether tax measures should be excluded from investment dispute settlement while preserving safeguards against abusive or discriminatory government action.
- **Brazil's Cooperation and Facilitation Investment Agreements** generally emphasise investment facilitation, joint committees and state-to-state dispute resolution rather than conventional investor-state arbitration.
- **Mutual Agreement Procedure (MAP):** Tax treaties usually provide MAP, through which the competent authorities of the countries concerned attempt to resolve disputes relating to the interpretation or application of tax treaty provisions.

Way Ahead

- **Clarify tax exception:** India should define which tax measures fall outside investment treaty arbitration while retaining protection against discriminatory actions that violate applicable legal obligations.
- **Strengthen domestic dispute Resolution:** Tax tribunals and appellate authorities should be adequately equipped to deliver timely decisions for investors.
- **Improve tax certainty:** Clearer tax laws, predictable implementation and safeguards against arbitrary retrospective changes can reduce disputes without unduly restricting the government's regulatory authority.
- **Evaluate BITs empirically:** India should periodically assess whether treaty protections actually improve investment inflows and investor confidence, while accounting for their fiscal and regulatory costs.

Concluding remarks

- India has to evolve an investment framework that gives legal clarity and effective remedies without sacrificing its tax sovereignty or creating unequal access to justice.
- Such a legitimate investment structure should not only safeguard investors against arbitrary state action but also preserve the government's power to regulate in the public interest and ensure justice for all taxpayers.

Daily Mains Practice Question

- [Q] Bilateral Investment Treaties (BITs) seek to promote foreign investment but may also raise concerns regarding tax sovereignty and equal access to justice. Discuss the challenges involved and suggest measures to balance investor protection with India's regulatory autonomy.

Source: IE

