POLICY BRIEF, JANUARY 2024

Sovereign Wealth Fund ("SWF") and Investment in Pakistan

MUHAMMAD SHAHZEB USMAN

IPRI Islamabad Policy Research Institute
Research | Innovation | Dialogue | Policy

NETT National Economic Think Tank

Chair, International Law

About the Author

Muhammad Shahzeb Usman completed his Bachelor of Laws (BA-LL.B.) from the Lahore University of Management Sciences (LUMS) in 2021. He graduated with the degree of Master of Laws (LL.M.) in 2022 from the University of Nottingham, United Kingdom where he studied as the Developing Solutions Scholar. In 2019, he completed the International Course on Global Refugee Crisis on Merit Scholarship at *Koc* University, Istanbul, Turkey. In 2018, he also completed an International Course on Politics in South – East Asia at UNMC, Kuala Lumpur, Malaysia. He is currently working as a Legal Researcher in the Department of International Law at the Islamabad Policy Research Institute (IPRI). His areas of interest include analysing the impact of International Financial Institutions (IFIs) from TWAIL perspective, International Human Rights Laws, Economic Rights, Labour Laws, Tax Laws, Competition Laws, and Refugee Laws.

About IPRI

The Islamabad Policy Research Institute (IPRI) is one of the oldest non-partisan think tanks on all facets of National Security, including international relations and international law, strategic studies, governance, public policy, and economic security in Pakistan. IPRI exemplifies two decades of rigorous and timely analysis of crucial strategic agendas and inter-governmental processes that influence national and regional policy community. Recognized for its objectivity and policy relevance, IPRI's publications offer current, up-to-date, and high-quality research in the form of authoritative journals, books, monographs, and policy briefs. The Institute's events vary from seminars on current international and national affairs to large-scale international conferences that attract renowned leaders, academics, and policymakers from all over the world. The Institute also house two specialized Chairs for International Law and Economic Security.

Table of Contents

Executive Summary

Issue

Investment from Sovereign Wealth Funds are controversial as there is a foreign state which supports the investment. It is presumed that there is an inherent political element attached to the investment. Moreover, definition of investor is also controversial for international arbitrations involving Sovereign Wealth Funds since International Center of Settlement of Investment Disputes only handles investor – state disputes rather than state – state disputes. Therefore, it is essential to peruse the legal intricacies of the investments via Sovereign Wealth Funds to formulate recommendations.

Recommendations

Pakistan need to adopt the following options:

- Clearly defining Sovereign Wealth Funds in the BITs.
- Clearly mentioning to either include or exclude Sovereign Wealth Funds within the ambit of BITs.
- Rules of Attribution and Santiago Principles to be followed by Sovereign Wealth Funds
- Clearly providing within domestic laws on how to treat the investment of SWFs especially in relation to taxation laws and investment laws.

Introduction

Before making decisions of investing, Sovereign Wealth Funds ('SWF') considers the presence of a Bilateral Investment Treaty ('BIT') between Pakistan and that particular country of which SWF is investing. Moreover, SWFs consider the legal intricacies of a BIT between that particular country and Pakistan. This is especially important because BITs generally provide a cushion from domestic court proceedings and safeguards from national expropriation.[1] Under BITs, the recipient country must provide a 'fair and equitable treatment' to the entity of the investing country. However, the involvement of government in SWFs make it a controversial legal issue as BITs allow a private party to file a case in International Center of Settlement of Investment Disputes ('ICSID') in case the host country fails to follow BITs.

Meaning of the term 'Investor' in ICSID Convention

In strict legal terms, ICSID handles only disputes which are between private parties and states. The nature of SWFs is controversial as the investment has some presumed sovereign strategic interest. Article 25(1) of the ICSID Convention considers the ambit of ICSID as disputes between contracting states and nationals of another contracting state. Subsequent to the ratification of ICSID Convention, if two contracting states have a BIT which agrees to take the matter to ICSID, the nationals of investing state can take the matter against the State which provides unfair matter to the exclusive jurisdiction of ICSID.[2] In CSOB v. Slovak Republic[3], ICSID clarified that it is true that SWFs conduct the bidding of the state when they make an investment in a foreign country. However, these acts are commercial in nature and the purpose of these activities shall be irrelevant. ICSID expanded jurisdiction based on the elongation of the concept of 'national' in Article 25 (1) of the ICSID Convention. The tribunal referenced the statement of Aron Broches who was one of the architects of ICSID Convention. These statement favoured that a government owned corporation should not be disqualified from the ambit of ICSID. If the BIT also provides that SWF

[1] UNCTAD, *Investment Policy* -International Investment Navigator – Pakistan <*https://investmentpolicy.unctad.org/international-investment-agreements/countries/160/pakistan*>
[2] Muhammad Ussama, 'Sovereign Wealth Funds and Investor – State Dispute Settlement; Examining Questions of ICSID's Jurisdiction and Impact of Investment – Treaty Arbitration' 7:1 WCL College of Journals and Reviews (2021) 11, 26
[3] *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Jurisdiction, ¶ 1 (24 May 1999)

shall be considered within the ambit of 'national', this shall reinforce the jurisdiction of ICSID. However, BIT still cannot make a dispute clearly between States as within the ambit of ICSID. [4] However, it is essential that rules of attribution to the State are clearly chalked out in the BITs such as the ones in International Law Commission's Articles on Responsibility of State for Internationally Wrongful Acts ('ARSIWA').[5] Moreover, there needs to be a provision within BITs that Investing SWF shall comply with Santiago Principles which de – politicize the investment of SWFs and make the SWFs invest only on the basis of economic and financial risks with full compliance of local regulatory regimes.[6]

Meaning of the term 'Investor' in BITs of Pakistan

For a snapshot, the definition of the term 'investor' in BIT between Pakistan and Kuwait; BIT between Pakistan and Australia and BIT between Pakistan and Germany shall be considered. In relation to the BIT between Pakistan and Kuwait, Article 2(a) of the BIT defines the term investor to include the Government of the contracting states. Thus, SWFs investment shall come within the ambit of the investment and will be protected by the BIT. Moreover, Article 8(5) of the BIT also provides this provision that the contracting states shall not resort to a sovereign immunity in case of dispute. Both parties shall have to comply with BIT without any specific privileges. The BIT between Pakistan and Germany does not include explicitly the word 'government' in Article 2 of the BIT but uses the term 'juridical' person. Since juridical person generally means an entity which has a distinct identity in relation to the law, therefore, it could be assumed that government is included within the framework of this particular BIT. The BIT between Australia and Pakistan is quite different from the one that is observed for 'Pakistan – Kuwait' and 'Pakistan – Germany'. Article 1(c) of this BIT does not explicitly include the word 'government' and only includes the natural person or a company. Since, the items are listed, it is considered that the list is exhaustive. Therefore, an Australian SWFs might not benefit from such a BIT. A pattern could also be observed that Pakistani government is vary of the political and domestic considerations of the other country before signing these BITs. Since, the Arab Gulf

[4] Ibid (n.2), 41-43
[5] Sejko, Dini, Sovereign Investors as ICSID Claimants: Lessons from the Drafting Documents and the Case Law, 56:3 Vanderbilt Journal of Transnational Law (2023) 853, 902
[6] Meg Lippincott, 'Depoliticizing Sovereign Wealth Funds though International Arbitration 13:2 Chicago Journal of International Law 649, 658

states have generally SWFs, therefore, the Pakistani government is also keen on explicitly including the word 'government' while such consideration is not present with Western or developed nations which are most likely to invest through private entities.

Pakistani Arbitration Laws

Pakistan has ratified the New York Convention 1958 through a legislation called as Recognition and Enforcement (Arbitration Agreement and Foreign Arbitral) Act, 2011 (the "2011 Act"). Previously, the area was governed exclusively by the Arbitration Act 1940 (the "1940 Act"). The former relates to the international arbitrations while the latter governs the domestic arbitrations. Similarly, the Arbitration (International Investment Disputes) Act 2011 (the "ICSID Act") was promulgated to implement the International Convention on the Settlement of Investment Disputes between States and Nationals of other States.[7] Thus, if a SWF has invested in Pakistan and there is a BIT (allowing the government to be an investor) between that particular country and Pakistan, the ICSID Act will allow an exclusive jurisdiction to the ICSID in relation to any dispute between the SWF and Pakistani government. Section 3 of the ICSID Act provides for the registration of the award in the High Court if any registration or enforcement of the award rendered by ICSID is sought. If such a registration is executed, section 4 of the ICSID Act allows the award to have the same effect as the judgment of the High Court. In case, there is no unfair treatment between the Pakistani government and the SWFs, but a dispute arises between SWFs and a private party and an international arbitration clause is present within the contract, the 2011 Act will also allow High Court to enforce and recognize the arbitral awards rendered by the international arbitration center.[8]

However, despite these legislations, Pakistani courts and government have not been very consistent with their attitudes involving foreign parties. In cases of foreign investments in infrastructure, public procurement regulatory authority exists which improves the governance and transparency of such investments. No such authority exists for investments in natural resources.[9] Similarly, Pakistani courts have also not

[7] Saifullah Khan, Pakistan: International Arbitration Comparative Guide, *Mondaq* 18th November 2018 < https://www.mondaq.com/litigation-mediation-arbitration/979724/international-arbitration-comparative-guide

[8] Section 6, Recognition and Enforcement (Arbitration Agreement and Foreign Arbitral) Act, 2011

[9] Ahmed Ghouri, 'Pakistan`s woes with Foreign Investors – Ways to Prevent the Tethyan Saga', *Kluwer Arbitration* November 18, 2019 < http://arbitrationblog.kluwerarbitration.com/2019/11/18/pakistans-woes-with-foreign-investors-ways-to-prevent-the-tethyan-saga/>

always been very careful in recognizing foreign arbitration jurisdiction and awards. The general position of Pakistani courts seems to be of intervention and assuming of jurisdiction themselves if any criminality and antagonism to public policy is found within contracts although the contracts give jurisdiction to arbitration centers.[10]

Domestic Laws

Pakistani Domestic Laws are uncertain and unclear about the question of Sovereign Wealth Funds. Board of Investment Ordinance 2001 ('2001 Ordinance') does not attempt to define the word 'Investment' and whether it includes the investment by SWFs. Similarly, no such provision is present in the Investment Policy of 2013 to elucidate any investment present by a SWFs.

Special Economic Zones (the 'SEZ') are formed to attract foreign investment and provide certain privileges in relation to the establishment located in that particular zone. The relevant legislation in regard to the SEZ are Special Economic Zones Act 2012 (the '2012 Act') and Special Economic Zones Rules 2013 (the '2013 Rules'). Although, these legislation does include the word 'foreign investor' and 'foreign investment' in relation to the provision of investment in SEZ, but it fails to provide any specific explanation about this word. For instance: the section 3 (k) of the 2012 Act which defines Provincial Investment Promotion Authority consider the purpose of the authority to promote domestic and 'foreign investment' in a particular province. Similarly, Section 8(1) (e) and Section 8(1) (f) of the 2012 Act also considers the purpose of Board of Investment to promote 'international investment' in SEZs and facilitate the interaction with international investors. It must be noted that specific concessions to encourage foreign investment are provided like in section 38 of the 2012 Act. Jurisdiction of the High Court is directly accorded to the disputes arising from SEZ if no alternate dispute resolution mechanism is provided. Thus, we can consider that within the 2012 Act, although there is no specific provision for SWFs, but if they come within the ambit of foreign investors or foreign investment, then considerable privileges are provided to them.

[10] Christopher Finnigan, 'The Reko Diq 'Fiasco' in Perspective: Pakistan`s Experience of International Investment Arbitration', *LSE Blogs*, August 14th, 2019 < https://blogs.lse.ac.uk/southasia/2019/08/14/long-read-the-reko-diq-fiasco-in-perspective-pakistans-experience-of-international-investment-arbitration>

Similarly, the Competition Laws of Pakistan also prohibit mergers which substantially lessen competition in Pakistan, but there is no provision which creates any specific distinction either in favor or detriment of transnational mergers in which a SWP might be the holder of the merging entity.[11] It is a statutory rule of interpretation that if there is no specific definition provided within an Act, definition in the closely related Act can be perused. Thus, the public sector company has been defined in section 2(54) of the Companies Act 2017 ("2017 Act") as an entity which is directly or indirectly controlled by the government or any agency. However, the term 'government' under section 2(36) of the 2017 Act means only the Federal Government of Pakistan or the Provincial Governments of Pakistan and not any foreign government. Similarly, the Foreign Private Investment (Promotion and Protection) Investment Act 1976 defines the term 'foreign private investment' as investment made by a company or a person outside Pakistan but does not include a foreign government or agency.[12] Hence, the trends 'seems' to be not including SWFs within the general term of foreign investors. .

Taxation Laws

In Pakistan, there is no specific exemption in relation to taxation for foreign SWF and there is no specific exemption accorded to them unless specific concessions have been granted under an applicable income tax treaty. For instance: Pakistan has tax treaties with Singapore, Germany and Oman which allows SWFs from such countries to claim tax exemptions on interests earned on investment in Pakistan.

Domestic tax law treats the non-residents including SWFs with respect to their Pakistan source income in relation to the specific nature of incomes differently. For instance: dividends are generally subject to 10% of the total gross amount as Withholding Tax (the "WHT"). However, at the same time, the interest payment is subject to 0% tax if the scheme generating interest is approved by the Federal Government. Similarly, tax exemptions are granted to SWFs if there are given interest on investment on government securities.

The normal corporate tax rate is 35% and if the assets are disposed of after 1 year, tax is imposed only on 75% of the capital gains. Similarly, if there is any gain from the

[11] Competition Act 2017, Section 11(1); Merger Control Regulations, Regulation 28

[12] Foreign Private Investment (Promotion and Protection) Investment Act 1976, Section 2; Sarjeel Mowahid and Ahmed Raza Mirza, 'Snapshot: Foreign Investment Law and Policy in Pakistan' *Lexology,* January 28, 2021

alienation of the shares which relate to a company holding exploration licenses and immovable property, then those gains are generally taxable. However, if a foreign investor invests in public company shares, there are given exemptions on any capital gains from that particular shares` alienation. Similarly, capital gains from the holding of securities for more than 1 year are generally exempt from taxation, but if the securities are held for than 6 months than they are subjected to 10% of the taxation. Lastly, it must be reiterated again that the capital gains may be exempt from Pakistan taxation under certain bilateral tax treaties like with the Netherlands, Malaysia, and the UAE. [13]

Recommendations

- Negotiation with relevant countries for revision of BITs especially with gulf countries to clearly consider the jurisdiction of ICSID.
- A thorough review of all the BITs to decide according to a particular country whether SWFs should be included within ICSID jurisdiction and that rules of Arbitration and Santiago principles need to be framed within BITs.
- Training capacity of judges to understand the significance of arbitration and to provide consistent jurisprudence.
- Pakistan to provide a clear international arbitration policy to serve as soft law for judges and a benchmark of the intention of the government.
- Removal of confusion about the nature of the term ‘investor’. Tax laws does provide leeway to foreign investment if there is a specific treaty. However, clarity of tax treatment of SWFs need to be provided especially in case there is no such treaty.

[13] Sovereign Wealth Funds – Investment Trends and Global Tax Risks in Asia – *PWC* – Page 9, 10.