المجلة الدولية للقانون
INTERNATIONAL REVIEW OF LAW

Research article

Sovereign Wealth Funds: Problems of international law between possessing and recipient States

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ABSTRACT
As the influence of Sovereign Wealth Funds (SWFs) is increasing in the world economy, the legal problems between the possessing States and recipient States become very important. The famous Santiago Principles are self-pledges of the governance and activities of SWFs by the possessing States and do not regulate the legal problems between the possessing States and the recipient States. This article considers the following relevant problems from the point of international law: (A) restrictions on foreign investment, (B) sovereign immunity, (C) taxation and (D) responsible investment.

As to (A), although restrictions on foreign investment for national security reasons is generally permitted under international law, they should be guided by the principles of non-discrimination, transparency of policies and predictability of outcomes, proportionality of measures and accountability of implementing authorities.

As to (B), when SWFs are involved in a civil action concerning holding shares in a company, they cannot enjoy jurisdictional immunity. This is because holding shares come under participation on companies in the United Nations Convention on Jurisdictional Immunities of States and Their Property.

As to (C), there is no established rule of customary international law whether SWFs are granted exemption from taxation in recipient States. State practice is mixed. Some States including Japan do not categorically grant exemption from taxation to SWFs, but grant it to specific SWFs based on bilateral tax treaties.

As to (D), Norway's Government Pension Fund Global and New Zealand Superannuation Fund are faithful to the method of responsible investment. The heart of its responsible investment lies in the disinvetement and negative screening in particular. The disinvestment does not constitute unlawful intervention under international law.

Finally, the balance of interests between the possessing States and the recipient States has to be kept in order to attain an equitable result. The concept of equity, although somewhat ambiguous, can play an important role in this field.

Keywords: sovereign wealth funds, international law, restrictions on foreign investment, sovereign immunity, taxation, responsible investment

http://dx.doi.org/10.5339/irl.2015.swf.7

Submitted: 20 January 2014
Accepted: 17 March 2014

Cite this article as: Nakatani K. Sovereign Wealth Funds: Problems of international law between possessing and recipient States, *International Review of Law* 2015:swf.7
http://dx.doi.org/10.5339/irl.2015.swf.7

صناديق الثروة السيادية: مشاكل القانون الدولي بين الدول المالكة للصناديق والدول المُستثمر بها

ملخص

مع زيادة تأثير صناديق الثروة السيادية في الاقتصاد العالمي، أصبحت المشاكل القانونية بين الدول المالكة للصناديق والدول المُستثمر بها بالغة الأهمية. وتُمثل مبادئ سانتياغو الشهيرة تعهدات ذاتية للحوكمة وأنشطة صناديق الثروة السيادية من قبل الدول المالكة للصناديق ولا تنظم المشاكل القانونية بين الدول المالكة للصناديق والدول المُستثمر بها.

تتناول هذه المقالة المشاكل التالية ذات الصلة من وجهة نظر القانون الدولي: (أ) القيود المفروضة على الاستثمار الأجنبي. (ب) والحصانة السيادية. (ج) والضرائب. (د) والاستثمار المسؤول.

وبالنسبة للمشكلة (أ)، فإنه على الرغم من أن القيود المفروضة على الاستثمار الأجنبي لأسباب تتعلق بالأمن القومي يسمح بها عمومًا بموجب القانون الدولي، فينبغي أن تسترشد بمبادئ عدم التمييز والشفافية في السياسات، والتنبؤ بالنتائج، وتناسب التدابير، ومساءلة السلطات المُنفذة.

وفيما يتعلق بالمشكلة (ب)، فعندما تشارك صناديق الثروة السيادية في دعوى مدنية تتعلق بحيازة أسهم في شركة ما، فإنها لا تستطيع التمتع بالحصانة من الولاية القضائية. ويرجع ذلك إلى أن حيازة الأسهم تخضع لمشاركتها في شركات اتفاقية الأمم المتحدة لحصانات الدول وممتلكاتها من الولاية القضائية.

أما بالنسبة للمشكلة (ج)، فلا توجد قاعدة ثابتة في القانون الدولي العرفي بشأن ما إذا كانت صناديق الثروة السيادية تُمنح إعفاءً من الضرائب في الدول المُستثمر بها، وممارسات الدول في هذا المجال مختلطة؛ فبعض الدول، بما في ذلك اليابان، تمنح إعفاءً من الضرائب لصناديق الثروة السيادية بصورة قاطعة، ولكنها تمنحها لبعض صناديق الثروة السيادية المحددة على أساس المعاهدات الضريبية الثنائية.

أما فيما يتعلق بالمشكلة (د)، فإن كلًا من صندوق المعاشات التقاعدية الحكومية في النرويج، وصندوق التقاعد النيوزيلندي، مطابقان لمبدأ الاستثمار المسؤول. ويكمن جوهر استثمارهما المسؤول في نقل الأصول بالبيع بقرارات من المحكمة والفرز السلبي على وجه الخصوص. ولا يشكل هذا الاستثمار تدخلًا غير مشروع بموجب القانون الدولي.

وأخيرًا، يجب الحفاظ على توازن المصالح بين الدول المالكة للصناديق والدول المُستثمر بها، من أجل تحقيق نتيجة منصفة. إن مفهوم الإنصاف، وإن كان غامضًا إلى حد ما، يمكن أن يلعب دورًا مُهمًا في هذا المجال.

INTRODUCTION

As the influence of Sovereign Wealth Funds (SWFs) in the world economy has been increasing, legal regulation of SWFs has become a matter of interest among the recipient States.[1]
The Santiago Principles (Generally Accepted Principles and Practices, GAPP)[2] adopted by the International Working Group of Sovereign Wealth Funds in 2008 can be positioned as self-pledges or self-restraints of the governance and activities of SWFs by the possessing States. However, the Santiago Principles regulate neither the legal relationship between the possessing States and the recipient States nor the legal responses of the latter. The legal problems include such important subjects as (A) restrictions on foreign investment, (B) sovereign immunity, (C) taxation and (D)

[1]For a recent comprehensive analysis of SWFs including regulatory concerns, *see* Sovereign Investment: Concerns and Policy Reactions (Karl P. Sauvant et al. eds., 2012).
[2]Int'l Working Grp. of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles" *available at* http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf.

responsible investment. (A) The recipient States pay particular attention to the restrictions on foreign investment if a SWF's investment is based on political motivations. (B) Sovereign immunity hereby means whether the court of a recipient State has jurisdiction in a civil case against a foreign SWF and it is a important matter in the investment by, or transaction with SWFs. (C) Whether SWFs are granted exemption from taxation in recipient States is a great concern not only for both the possessing States but also for recipient States particularly when the amount of investment is large. (D) Responsible investment by some SWFs and exclusion from the investment universe of the listed company might lead to a diplomatic problem between the recipient State (the State of the listed company) and the possessing State. This short article tries to clarify these four legal problems from the viewpoint of international law.

(A) Restrictions on foreign investment

One of the main reservations recipient States have over SWFs is that SWFs might act based on non-economic or political motivation. They are afraid that SWFs might dominate or disrupt their strategic industries. Surely, most of the investments by SWFs are driven by economic consideration only. But the apprehensions that some SWFs might act politically cannot disappear among the recipient States.

On this particular point, it is important to note that the Santiago Principles do not prohibit that SWFs act based on non-economic motivation. GAPP 19.1 Subprinciple provides: "If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed." Its explanation and commentary states as follows:

> Some SWFs may exclude certain investments for various reasons, including legally binding international sanctions and social, ethical, or religious reasons (e.g., Kuwait, New Zealand, and Norway). More broadly, some SWFs may address social, environmental, or other factors in their investment policy. If so, these reasons and factors should be publicly disclosed.

The "publicly disclosed" requirement should be carefully considered. In the case of the responsible investment by Norway's Global and New Zealand's Superannuation Fund, these funds disclose the reasons of negative screening in detail, as detailed in (D). However, even if a SWF intends to control a strategically important company of the recipient State based on political reason, it does not disclose its true intention. Therefore, this subprinciple is ineffective in the most crucial situation.

Restrictions on foreign investment for national security reasons is generally permitted under international law. Article 3 of the Organisation for Economic Cooperation and Development (OECD) Code of Liberalization of Capital Movement provides that a State can restrict foreign investment when it considers necessary for the maintenance of public order or for the protection of its essential security interests.[3] It provides:

> The provisions of this Code shall not prevent a Member from taking action which it considers necessary for: (1) the maintenance of public order or the protection of public health, morals and safety; (2) the protection of its essential security interests; (3) the fulfillment of its obligations relating to international peace and security.

The third provision corresponds to the non-military enforcement measures under Chapter 7 of the Charter of the United Nations in accordance with a Security Council Resolution. In OECD, it has been considered that each Member has the capacity to interpret (1) and (2) of this section. Japan interprets that the restriction on foreign investment in the drag manufacturing and biological products manufacturing sectors comes under (1) and the restriction on foreign investment in the aircraft manufacturing, weapon, nuclear energy and space development sectors comes under (2).[4] Also, Article 2(b) provides that a Member may lodge reservations, which means that a Member can restrict foreign investment of a particular industry if it makes a reservation. Japan, as well as other Members, has lodged reservations relating to investment by non-residents in (1) primary

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[3]As for the OECD Code, *see* Kazuhiro Nakatani, *Restrictions on Foreign Investment in the Energy Sector for National Security Reasons: the Case of Japan*, *in* Property and the Law in Energy and National Resources 311–25 (Aileen MacHarg et al. eds., 2010).

[4]Nakatani, *supra* note 3, at 313.

industry related to agriculture, forestry and fishing, (2) mining, (3) oil, (4) leather and leather products manufacturing, (5) air transport, and (6) maritime transport.[5]

As foreign investment by private funds can be restricted for national security reasons, there is no reason why restriction of investments by SWFs for the same reason cannot be justified. In June 2008, the OECD Ministerial Council adopted OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies.[6] Ministers endorsed the following policy principles for countries receiving SWF investments:

> Recipient countries should not erect protectionist barriers to foreign investment. Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns. Where such national security concerns do arise, investment safeguards by recipient countries should be: transparent and predictable; proportional to clearly-identified national security risks; and subject to accountability in their application.

In May 2009, the OECD Council adopted a recommendation called "Guidelines for Recipient Country Investment Policies relating to National Security."[7] The Council recommends that, if governments consider or introduce investment policies (including measures) designed to safeguard national security, they should be guided by the principles of non-discrimination, transparency of policies and predictability of outcomes, proportionality of measures and accountability of implementing authorities. The annex attached to this recommendation elaborates these principles as follows:

> 1. *Non-discrimination:* Governments should be guided by the principle of non-discrimination. In general, governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security.
> 2. *Transparency/predictability:* while it is in investors and governments interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes. 'Codification and publication,' 'prior notification,' 'consultation,' 'procedural fairness and predictability' and 'disclosure of investment policy actions' constitute the elements.
> 3. *Regulatory proportionality:* restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern. 'Essential security concerns are self-judging,' 'narrow focus,' 'appropriate expertise,' 'tailored responses' and 'last resort' constitute the elements.
> 4. *Accountability:* procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions (including decisions to block an investment) should be taken at high government levels should be considered to ensure accountability of the implementing authorities. 'Accountability to citizens,' 'international accountability mechanisms,' 'recourse for foreign investors,' 'the ultimate authority for important decisions (e.g. to block foreign investments) should reside at a high political level' and 'effective public sector management' constitute the elements.

However, this does not mean that the restriction is completely discretionary. Recent declarations of the G8 Summit set an international standard when the restriction for national security reasons is applied. For example, paragraph 11 of the Heiligendamm Summit Declaration on Growth and Responsibility in the World Economy in Germany in 2007 provides: "[W]e remain committed to minimizing any national restrictions on foreign investment. Such restrictions should apply to very limited cases which primarily concern national security. The general principles to be followed in such cases are non-discrimination, transparency and predictability...."[8] Similarly, paragraph 6 of the

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[5] OECD, Code of Liberalization of Capital Movements 84 (2009).

[6] *Meeting of the Council at Ministerial Level, 4-5 June 2008*, OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies, http://www.mofa.go.jp/policy/economy/oecd/dec0806.pdf (last visited Aug. 29, 2014).

[7] *Guidelines for Recipient Country Investment Policies Relating to National Security: Recommendation adopted by the OECD Council on 25 May 2009*, OECD Investment Division, http://www.oecd.org/daf/inv/investment-policy/43384486.pdf (last visited Aug. 29, 2014).

[8] *Growth and Responsibility in the World Economy: Summit Declaration 7 June 2007*, G8 Summit 2007 Heiligendamm, http://www.mofa.go.jp/policy/economy/summit/2007/worldeconomy.pdf (last visited Aug. 29, 2014).

Hokkaido Toyako Summit Leaders Declaration on World Economy in Japan in 2008 provides: “Any foreign investment restrictions should be very limited, focusing primarily on national security concerns, and should adhere to the principles of transparency, predictability, proportionality, and accountability.”[9] Although the Summit declarations are non-binding, they have strong political influence for setting global standard. Now, it can be said that restrictions on foreign investment by SWFs for national security reasons have to be transparent, predictable, proportionate and accountable.

In March 2008, the United States, Abu Dhabi (possessing Abu Dhabi Investment Authority, ADIA) and Singapore (possessing Government of Singapore Investment Corporation, GIC) agreed upon policy principles for sovereign wealth funds and policy principles for countries receiving SWF investment.[10] The policy principles for sovereign wealth funds provide:

> 1. SWF investment decisions should be based solely on commercial grounds, rather than advance, directly or indirectly, the geopolitical goals of the controlling government. SWFs should make this statement formally as part of their basic investment management policies.
> 2. Greater information disclosure by SWFs, in areas such as purpose, investment objectives, institutional arrangements, and financial information… can help reduce uncertainty in financial markets and build trust in recipient countries.
> 3. SWFs should respect host-country rules by complying with all applicable and disclosure requirements of the countries in which they invest.
> The Policy Principles for Countries Receiving SWF Investment provide:
> 1. Countries receiving SWFs investment should not erect protectionist barriers to portfolio or foreign direct investment.
> 2. Recipient countries should ensure predictable investment frameworks. Inward investment rules should be publicly available, clearly articulated, predictable, and supported by strong and consistent rule of law.
> 3. Recipient countries should not discriminate among investors. Inward investment policies should treat like-situated investors equally.
> 4. Recipient countries should respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment. Any restrictions imposed on investments for national security reasons should be proportional to genuine national security risks raised by the transaction.

These principles, although not binding, are considered to constitute an important code of conduct not only for the two SWFs and the US Government but also for the SWFs and the recipient governments in general. The former principles request the SWFs to refrain from acting for geopolitical goals, while the latter principles permit the recipient States to restrict investments by SWFs for national security reasons only when the restrictions are proportional to genuine national security risks raised by the transaction.

(B) Sovereign immunity

One of the important problems within international law concerning the legal status of SWFs in recipient States is whether the SWFs can enjoy jurisdictional immunity before domestic courts of the recipient States in civil actions. The following study shows that the answer is negative. Firstly, SWFs can be classified into the following three categories: the first category is established as a separate legal identity with full capacity to act and be governed by a specific constitutive law (e.g., Kuwait, Korea, Qatar and ADIA). The second category takes the form of a state-owned corporation (e.g., Singapore’s Temasek, GIC, China Investment Corporation (CIC)). The third category is constituted by a pool of assets without a separate legal identity and the pool of assets is owned by the state or the central bank (e.g., Botswana, Canada Alberta, Chile and Norway).[11]

SWFs can *prima facie* be considered as “State” under Article 2 of the United Nations Convention on Jurisdictional Immunities of States and Their Property.[12] The third category can come under the

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[9] *G8 Hokkaido Toyako Summit Leaders Declaration: Hokkaido Toyako, 8 July 2008*, G8 Hokkaido Toyako Summit, http://www.mofa.go.jp/policy/economy/summit/2008/doc/doc080714__en.html (last visited Aug. 29, 2014).

[10] *Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi*, U.S. Department of the Treasury, http://www.treasury.gov/press-center/press-releases/Pages/hp881.aspx (last visited Aug. 29, 2014).

[11] *See* Explanation and Commentary of the GAPP 1.

[12] *Convention on Jurisdictional Immunities of States and Their Property*, United Nations, http://treaties.un.org/doc/source/RecentTexts/English_3_13.pdf.

State and its various organs of government (paragraph 1(b)(i)). The first and second categories can come under "agencies or instrumentalities of the State or other entities" (paragraph 1 (b)(iii)), but they do not satisfy the following requirement of the same provision "to the extent that they are entitled to perform and are actually performing acts in the exercise of sovereign authority of the State." Therefore, SWFs which belong to the first or second category cannot be "States" under the Convention and they do not enjoy jurisdictional immunity.

Secondly, concerning participation in companies or other collective bodies, Article 15 paragraph 1 provides as follows:

> A State cannot invoke immunity from jurisdiction before a court of another State which is otherwise competent in a proceeding which relates to its participation in a company or other collective body, whether incorporated or unincorporated, being a proceeding concerning the relationship between the State and the body or the other participants therein, provided that the body: (*a*) has participants other than States or international organizations; and (*b*) is incorporated or constituted under the law of the State of the forum or has its seat or principal place of business in that State.

On this provision, the International Law Commission's commentary on Article 15 paragraph 1 states as follows:

> When a State participates in a collective body, such as by acquiring or holding shares in a company or becoming a member of a body corporate which is organized and operated in another State, it voluntarily enters into the legal system of that other State and into a relationship recognized as binding under that legal system. Consequently, the State is of its own accord bound and obliged to abide by the applicable rules and internal law of the State of incorporation, of registration or of the principal place of business. The State also has rights and obligations under the relevant provisions of the charter of incorporations, articles of association or other similar instruments establishing limited or registered partnerships. The relationship between shareholders *inter se* or between shareholders and the company or the body of any form in matters relating to the formation, management, direction, operation, dissolution or distribution of assets of the entity in question is governed by the law of the State of incorporation, of registration or of the seat or principal place of business. The courts of such States are best qualified to apply this specialized branch of their own law.[13]

Therefore, when SWFs are involved in civil action concerning holding shares in a company, they cannot enjoy jurisdictional immunity. Although this article cannot cover perspectives of major States on immunity enjoyed by SWFs,[14] a Japanese court case and a new Japanese Act are worth mentioning as state practices of a major recipient State.

In Japan, there exists a court case concerning this problem. The Tokyo District Court delivered a Judgment on November 30, 2000.[15] The Nauru Finance Corporation issued bonds under the guarantee of the Republic of Nauru. The Corporation could not redeem the bonds on the due date.

The plaintiff sought the payment of the principal and interest. The court concluded that neither the corporation nor the government was entitled to sovereign immunity and ordered the corporation and the government to pay the principal and interest to the plaintiff. The court stated as follows:

> The cause of action in this case is an interest of bonds under the guarantee of a foreign government. The issuance of bonds is an example of an economic activity being carried out largely and usually as an international financial transaction in international society at the present time. In addition, the defendant agreed by a written clause on the bonds that the court of another State of which the defendants are not nationals has jurisdiction and they waived their immunity explicitly from that jurisdiction. Under such circumstances, it cannot be considered that a foreign State or the agency of a foreign State, which is acting as a subject in commercial transaction, is entitled to sovereign immunity.[16]

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[13] 2 Yearbook of the International Law Commission 1991 49, pt. 2.
[14] For the U.S. perspective on SWF immunity, *see* Joel Slawotsky, *Sovereign Wealth Funds and Jurisdiction Under the FSIA*, 11 U. Pennsylvania J. Bus. L. 967 (2009).
[15] Tokyo District Court, *Judgment, November 30, 2000*, 44 Japanese Annual of International Law 204 (2001).
[16] *Id.* at 206.

In 2009, Japan enacted the Act on Civil Jurisdiction of Japan with respect to a Foreign State.[17] It adopts the principle of relative immunity and Article 8, which corresponds to Article 10 of the UN Convention, and provides that a foreign State, (which includes entities that are granted the authority to exercise sovereign power), shall not be immune from jurisdiction with respect to judicial proceedings regarding commercial transactions, which includes contracts or transactions relating to the civil or commercial buying and selling of commodities, procurement of services and lending of money.[18] Article 14 of the Act, (which corresponds to Article 15 of the UN Convention), provides that in cases where a foreign state, etc., is a member of a juridical person, it shall not be immune from jurisdiction with respect to judicial proceedings.

(C) Taxation

Whether SWFs are granted exemption from taxation in recipient States is a great concern for them. In the United States, SWFs may benefit from a long-standing income tax that applies to certain passive income received by foreign governments,[19] but this exemption does not apply to income related to commercial activities.

There seems to be no established rule of customary international law on this particular point. The basic position of the United Kingdom is that foreign governments are not typically taxed in the UK, based upon the principle of sovereign immunity and that the UK Government has specifically noted that SWFs are excluded from taxation on the basis of this principle.[20] However, this statement overlooks an important point: The relationship between foreign governments and SWFs and the purpose and character of SWF's activities in recipient States have to be taken into consideration when considering whether SWFs can enjoy sovereign immunity and exemption from taxation. It cannot generally be said that customary international law requires recipient States to grant SWFs exemption from taxation in all cases.

The International Law Commission considered this problem in drafting the Articles on Jurisdictional Immunities of States and Their Property. In 1984, Article 17 (Fiscal Matters) was provisionally adopted.[21] It provides that "unless otherwise agreed between the States concerned, the immunity of a State cannot be invoked before a court of another State in a proceedings relating to the fiscal obligation for which it may be liable under the law of the State of the forum, such as duties, taxes or other similar charges."

However, on the second reading in 1991, this article was deleted mainly because it concerned only the relations between the two States (the forum State and the foreign State) and the article which dealt with inter-State relations alone was not considered to have its proper place in the draft articles which dealt with relations between a State and foreign natural or judicial persons.[22] The United Nations Convention on Jurisdictional Immunities of States and Their Property has no provision on fiscal matters. In its preamble it states that "a*ffirming* that the rules of customary international law continue to govern matters not regulated by the provisions of the present Convention," but there is no established rule of customary international law on the taxation.

This means that each recipient State can decide whether or not to impose tax on SWFs. The International Law Commission, in its commentary to Article 17 on the Draft Articles on Jurisdictional Immunities of States and Their Property, stated that exception to the immunity of States from jurisdiction with respect to proceedings regarding fiscal obligations, including taxes, is recognized in State practice and cited in domestic laws of UK, Singapore, Pakistan and South Africa.[23]

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[17] Act No. 24 of 2009. The provisional English translation of the Act is available at http://www.japaneselawtranslation.go.jp/law/detail/?id = 1948&vm = 04&re = 01.

[18] *See* art. 2.

[19] Joint Committee on Taxation, Economic and U.S. Income Issues Raised by Sovereign Wealth Fund Investment in the United States 1 (2008). The Section 892(a)(1) of the Internal Revenue Code provides that the income of foreign governments received from (1) investments in the United States in stocks, bonds, or other securities owned by such foreign governments, (2) investments in the United States in financial instruments held in the execution of governmental financial or monetary policy, or (3) interest on deposits in banks in the United States of moneys belonging to such foreign Governments, is exempt from U.S. tax. *Id.* at 46-47.

[20] *Id.* at A-49.

[21] 2 Yearbook of the International Law Commission 1984 69, pt. 2. In 1986 after the first reading, this Article was adopted as Article 16.

[22] 2 Yearbook of the International Law Commission 1991, *supra* note 15, at 35–36.

[23] 2 Yearbook of the International Law Commission 1984, *supra* note 23, at 69.

State practice is more complicated and mixed; States which grant SWFs tax exemption are few, if any. According to Price Waterhouse Cooper's research, among the Asian jurisdictions, those which grant foreign SWFs tax exemption are Australia and the Philippines, while China, Hong Kong, India, Indonesia and Japan, Malaysia, South Korea, New Zealand, Pakistan, Singapore, Sri Lanka, Taiwan, Thailand and Vietnam do not grant it to SWFs, although they often grant it to SWFs based on bilateral tax treaties.[24] In the case of Japan, the bilateral tax treaties with Singapore,[25] UAE,[26] Kuwait[27] and Oman,[28] have special provisions on the relevant SWFs and grant exemption from taxes on them.

Article 11 paragraph 3 of the Agreement with Singapore provides:

> [I]nterest arising in a Contracting State and derived by the Government of the other Contracting State, a local authority thereof, the central bank of that other contracting State or any institution wholly owned by that Government, or by any resident of that other Contracting State with respect to debt-claims guaranteed, insured or indirectly financed by the Government of that other Contracting State, a local authority thereof, the central bank of that other Contracting State or any institution wholly owned by that Government shall be exempt from tax in the first-mentioned Contracting State.

Paragraph 4 provides:

> For the purpose of paragraph 3 of this Article, the terms "the central banks" and "institution wholly owned by the Government" mean ... in the case of Singapore: (i) the Board of Commissioners of Currency; (ii) the Monetary Authority of Singapore; (iii) the Government of Singapore Investment Corporation; and (iv) such other institution the capital of which is wholly owned by the Government of Singapore as may be agreed upon from time to time between the Governments of the two Contracting States.

Article 11 paragraph 1 of the Convention with UAE provides: "Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other Contracting State." Paragraph 2 provides "However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that Contracting State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest."

Paragraph 3 provides:

> Notwithstanding the provisions of paragraph 2, interest arising in a Contracting State shall be taxable only in the other Contracting State if: (a) the interest is beneficially owned by the Government of that other Contracting State including a political subdivision and local authority thereof, or the central bank of that other Contracting State or any institution wholly owned by that Government; or (b) the interest is beneficially owned by a resident of that other Contracting State with respect to debt-claims guaranteed, insured or indirectly financed by the Government of that other Contracting State including a political subdivision and local authority thereof, or the central bank of that other Contracting State or any institution wholly owned by that Government.

Paragraph 4 provides:

> For the purposes of paragraph 3, the terms "the central bank" and "institution wholly owned by that Government"mean ... in the case of the United Arab Emirates: (i) Central Bank of the United Arab Emirates; (ii) Abu Dhabi Investment Authority; (iii) International Petroleum Investment Company; (iv) Abu Dhabi Investment Council; (v) Investment Corporation of Dubai; and (vi) such other similar institution the capital of which is wholly owned by the Government of the United Arab Emirates including a political subdivision and local authority thereof as may be agreed upon from time to time between the Governments of the Contracting States through an exchange of diplomatic notes.

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[24] *Sovereign Wealth Funds: Investment Trends and Global Tax Risks-Asia*, Price Waterhouse Coopers, https://www.pwc.com/jp/en/tax-publications-financial-services/assets/sovereign-wealth-funds-asia.pdf 3-11 (last visited Apr. 19, 2014).

[25] Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Japan-Singapore, Apr. 9, 1994 (entered into force Apr. 28, 1995).

[26] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Japan-United Arab Emirates, May 2, 2013.

[27] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Japan-Kuwait, Feb. 17, 2010 (entered into force June 14, 2013).

[28] Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Japan-Sultanate of Oman, Jan. 9, 2014 (entered into force Sept. 1, 2014).

Paragraph 2 of the Protocol attached to the Convention provides on the resident of a Contracting State as follows:

> With respect to paragraph 1 of Article 4 of the Convention, it is understood that the term "resident of a Contracting State" includes a pension fund established under the laws of that Contracting State, and an organisation established under the laws of that Contracting State and operated exclusively for a religious, charitable, educational, scientific, artistic, cultural or public purpose (or for more than one of those purposes), only if all or part of its income or gains may be exempt from tax under the domestic law of that Contracting State. It is further understood that, in the case of the United Arab Emirates, the term"resident of a Contracting State" includes, but is not limited to: (a) Central Bank of the United Arab Emirates; (b) Abu Dhabi Investment Authority; (c) International Petroleum Investment Company; (d) Abu Dhabi Investment Council; (e) Investment Corporation of Dubai; and (f) Mubadala Development Company.

The substantive content of Article 11 paragraphs 1 to 3 of the Convention with Kuwait and of the Agreement with Oman are the same as that of the Convention with UAE mentioned above. Article 11 paragraph 4 of the Convention with Kuwait provides:

> For the purposes of paragraph 3, the terms "the central bank" and "institution wholly owned by that Government"mean ... in the case of Kuwait: (1) the Central Bank of Kuwait; (2) Kuwait Investment Authority; (3) Kuwait Petroleum Corporation; (4) the Public Institution for Social Security; and (5) Kuwait Fund for Arab Economic Development; and ... such other similar institution the capital of which is wholly owned by the Government of a Contracting State as based upon the exchange of diplomatic notes between the Governments of the Contracting States.

Article 11 paragraph 4 of the Agreement with Oman provides:

> For the purposes of paragraph 3, the terms "the central bank" and "institution wholly owned by that Government"mean ... in the case of the Sultanate of Oman: (1) the Central Bank of Oman; (2) the State General Reserve Fund; (3) The Omani Investment Fund; (4) any retirement or pension fund organized under Omani laws; and (5) such other similar statutory body or institution wholly owned by the Government of the Sultanate of Oman as may be agreed upon from time to time between the Governments of the Contracting States through an exchange of diplomatic notes.

Also, the Convention with Norway has a similar provision on Article 11.[29] However, the name of Norway's SWF Global (or its predecessor the Petroleum Fund of Norway) is not mentioned in the Convention. Paragraph 4 provides:

> For the purposes of paragraph 3, the terms"the central bank" and "financial institution wholly owned by the Government" mean ... In the case of Norway, (i) the Central Bank of Norway; (ii) the Norwegian Guarantee Institute for Export Credits; and (iii) other such financial institutions, the capital of which is wholly owned by the Government of Norway as may be agreed upon from time to time between the Governments of the two Contracting States.

Thus, Norway's SWF Global can be covered by subsection (iii).

In its public comments to the OECD Model Tax Convention, on January 19, 2010, the ADIA stated as follows:

> A large number of States do not uniformly recognize the customary international law principle of sovereign immunity and its application to taxation. As the OECD discussion correctly points out, where States do apply sovereign immunity to tax, there is still great variation in its application. However, we suggest that the tax status of "Sovereign Wealth Funds" is also a matter that goes to the heart of the "comity of nations."[30]

In the Santiago Principles, the International Working Group of Sovereign Wealth Funds (IWG) agreed that a generally accepted principle and practice of its members was that "SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate."[31] In mutual respect for the laws and institutions of other States, the IWG had an expectation that host countries would not subject SWFs "to any requirement, obligation, restriction or regulatory action exceeding that to

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[29]Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Japan-Norway, No. 8, Mar. 2, 1992 (entered into force Dec. 16, 1992).

[30]*Available at* http://www.oecd.org/ctp/treaties/44581129.pdf.

[31]GAPP 15.

which other investors in similar circumstances may be subject."[32] We believe that this expectation should apply to the taxation of SWFs.

There are two aspects to this expectation: Firstly, States should not adversely discriminate between SWFs and other foreign investors or between SWFs from different foreign States. Secondly, and perhaps more critically, States should not discriminate between SWFs and domestic investors, particularly domestic government investment institutions. Thus, if a State does not tax its own government investment institutions it would be consistent with the "comity of nations" for the State to also not tax foreign government investment institutions. Of course, the "comity of nations" also embraces reciprocity between States. As a growing number of States establish their own SWFs, it increasingly makes sense for States with SWFs to agree not to tax each other's SWFs.

It is important to note that reciprocity and comity have been the basis of international economic relations when there is no established rule of international law on the subject. For example, the trade in service was regulated mostly by reciprocity and comity until the adoption of the General Agreement in Trade in Service (GATS) in 1995. As an international rule on taxation to SWFs has not been established, reciprocity and comity can still play an important role between the possessing States and the recipient States.

(D) Responsible investment

Some SWFs, particularly Norway's Government Pension Fund Global (Global) and New Zealand Superannuation Fund (Fund) are faithful to the method of responsible investment. They adopt the concept of SRI (Socially Responsible Investment) or ESG (Environmental, Social and Corporate Governance) as their basic investment strategy. The heart of its responsible investment lies in the negative screening.[33] Negative screening by a SWF means that it does not make investments to the companies which it considers are involved in "undesirable" activities. If it holds stocks of the "undesirable" companies, it sells them out. Global has been the most active SWF as concerns the negative screening.

In the case of Global, ethical guidelines for its management have been in place since 2004, and in 2010 new guidelines for observation and exclusion from Global's investment universe were introduced.[34] Section 2 (Exclusion of Companies from the Fund's Investment Universe) of the New Guideline provides:

> (1) The assets in the Fund shall not be invested in companies which themselves or through entities they control: a) produce weapons that violate fundamental humanitarian principles through their normal use; b) produce tobacco; c) sell weapons or military material to states that are affected by investment restrictions on government bonds as described in the management mandate for the Government Pension Fund Global Section 3-1(2)c.
>
> (2) The Ministry makes decisions on the exclusion of companies from the investment universe of the Fund as mentioned in paragraph 1 on the advice of the Council on Ethics.
>
> (3) The Ministry of Finance may, on the advice of the Council of Ethics, exclude companies from the investment universe of the Fund if there is an unacceptable risk that the company contributes to or is responsible for: a) serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation; b) serious violations of the rights of individuals in situations of war or conflict; c) severe environmental damage; d) gross corruption; e) other particularly serious violations of fundamental ethical norms.
>
> (4) In assessing whether a company shall be excluded in accordance with paragraph 3, the Ministry may among other things consider the probability of future norm violations; the severity and extent of the violations; the connection between the norm violations and the company in which the Fund is invested; whether the company is doing what can reasonably be expected to reduce the risk of future norm violations within a reasonable time frame; the company's guidelines for, and work on, safeguarding good corporate

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[32]Commentary to GAPP 15.

[33]On the problems of disinvestment in general, *see* Simon Chesterman, *The Turn to Ethics: Divestment from Multinational Corporations for Human Rights Violations – The Case of Norway's Sovereign Wealth Fund*, 23 Am. U. Int'l L. Rev. 577 (2008); Human Rights, Corporate Complicity and Disinvestment (Gro Nystuen et al. eds., 2011).

[34]Norway Ministry of Finance (Apr. 9, 2014), http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/guidelines-for-observation-and-exclusion.html?id=594254.

> governance, the environment and social conditions; and whether the company is making a positive contribution for those affected, presently or in the past, by the company's behaviour.
>
> (5) The Ministry shall ensure that sufficient information about the case has been obtained before making any decision on exclusion. Before deciding on exclusion in accordance with paragraph 3, the Ministry shall consider whether other measures may be more suitable for reducing the risk of continued norm violations or may be more appropriate for other reasons. The Ministry may ask for an assessment by Norges Bank on the case, including whether active ownership might reduce the risk of future norm violations.

As of April 2013, sixty companies were excluded from the investment universe.[35] The contents of the companies which Global considered "undesirable" and excluded from the investment universe are as follows: (1) eighteen companies involved in the production of weapons that through their normal use may violate fundamental humanitarian principles (one company is involved in the anti-personnel land mines, five companies are involved in the production of cluster munitions and twelve companies are involved in the production of nuclear arms); (2) one company involved in the sale of weapons and military material to Burma; (3) twenty-one companies involved in the production of tobacco;[36] (4) three companies involved in the actions or omissions that constitute an unacceptable risk of the Fund contributing to the serious or systematic human rights violations; (5) fourteen companies involved in actions or omissions that constitute an unacceptable risk of the Fund contributing to the severe environmental damages; (6) two companies involved in other particular serious violations of fundamental ethical norms; and (7) one company involved in serious violation of the rights of individuals in situations of war or conflict.

Although Global and its responsible investment provides one of the best models for developed States which plans to establish a SWF in the future, it does not mean that it is a perfect existence. Whether its disinvestments based on the guidelines are fairly or selectively applied has to be considered in detail with regard to particular situations.[37]

Similar negative screening is also adopted by the New Zealand Superannuation Fund. When investing, the Guardians are required to avoid prejudicing New Zealand's reputation as a responsible member of the world community and to apply best-practice portfolio management principles. International conventions, New Zealand law, Crown actions, and companies' involvement and activities are key factors we consider within our responsible investment framework. The Fund excludes companies that are directly involved in one of the following: (1) the manufacture of cluster munitions; (2) the manufacture or testing of nuclear explosive devises; (3) the manufacture of anti-personnel mines; (4) the manufacture of tobacco; and (5) the processing of whale meat.[38] As of September 26, 2014, 165 companies were excluded from the investment (135 tobacco companies, nineteen companies involved in cluster munitions, nuclear explosive devices and anti-personnel mines, and eleven other companies).[39]

On the topic of disinvestment, the following three legal questions can be posed: The first question concerns the possibility of libel or defamation. The disinvestment consists of negative screening, selling off stakes and announcement of blacklisting. The target company's brand image would be damaged greatly due to the announcement of blacklisting. If the negative screening is based on erroneous fact-finding, would the announcement be wrongful? It must be pointed out

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[35] *Companies Excluded from the Investment Universe*, Norway Ministry of Finance (Apr. 9, 2014), http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/guidelines-for-observation-and-exclusion.html?id=594254.

[36] Japan Tobacco Inc. is the only Japanese company among the 60 excluded companies.

[37] In particular, the evaluation of disinvestments from companies involved in Israel or Burma can be controversial. On this point, *see* Larry Catá Backer, *The Norwegian Sovereign Wealth Fund: Between Private and Public*, 40 Geo. J. Int'l L. 1271 (2009). Earthrights International, in its report titled Broken Ethics in December 2010, alleged that Global stood in violation of its ethical guidelines through its holdings of 15 foreign oil and gas companies operating in Burma. The report is available at http://www.earthrights.org/publication/broken-ethics.

[38] *Exclusions*, NZ Super Fund, https://www.nzsuperfund.co.nz/how-we-invest-responsible-investment/exclusions (last visited Aug. 29, 2014).

[39] *Companies excluded from the New Zealand Superannuation Fund as at 26 September 2014*, NZ Super Fund, https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/Exclusions%20List.pdf (last visited Oct. 3, 2014). The list includes three Japanese companies: Tokyo Electric Power Company, Japan Tobacco Inc. and Kirin International Holding Inc..

that there is no clear rule of international law on this question. But it *can* be wrongful under the domestic civil and/or penal laws of the possessing State and the Fund might owe indemnification fees and/or penalties.

The second question concerns the possibility of unlawful intervention. In general, the acts of SWFs do not fall within the jurisdiction of the respective States in which they are located. The responsible investment and the negative screening of these two funds reflect the foreign policies of Norway and New Zealand, respectively. Article 5 (Conduct of persons or entities exercising elements of governmental authority) of the Articles on Responsibility of States for Internationally Wrongful Acts[40] provides:

> The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.

Since SWFs do not usually exercise elements of the governmental authority, their acts are considered formal acts of States. Even if a SWF exercises elements of governmental authority, which is very exceptional, the act shall be considered an act of the State in accordance with Article 5 of the Responsibility of States for Internationally Wrongful Acts[41] which was adopted by the International Law Commission in 2001. The disinvestment does not constitute unlawful intervention according to the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations, which was adopted as Resolution 2625 (XXV) of the United Nations General Assembly in 1970, the threshold of unlawful intervention is the following: “No State may use or encourage the use of economic political or any other type of measures to coerce another State in order to obtain from it the subordination of the exercise of its sovereign rights and to secure from it advantages of any kind.”As the target of the disinvestment is usually a company which is considered to be in complicity with a wrongdoing State and disinvestment is *per se* legal, it is hard to satisfy this threshold, which requires bad intention on the part of the intervening State.

The third question concerns whether divested companies can raise prejudice claims or inconsistency in the manner the SWF’s policy is carried out. The Judgment of the Permanent Court of International Justice in the Chorzow Factory (Jurisdiction, 1927) says as follows:

> It is, moreover, a principle generally accepted in the jurisprudence of international arbitration, as well as by municipal court, that one Party cannot avail himself of the fact that the other has not fulfilled some obligation or has not had recourse to some means of redress, if the former Party has, by some illegal act, prevented the latter from fulfilling the obligation in question....[42]

United Nations Security Council Resolution 687 (1991) in its paragraph 29 provides:

> The Security Council decides that all States, including Iraq, shall take the necessary measures to ensure that no claim shall lie at the instance of the Government of Iraq, or of any person claiming through or for the benefit of any such person or body, in connection with any contract or other transaction where its performance was affected by reason of the measures taken by the Security Council in resolution 661 (1990) and related resolutions.

The Judgment and the Resolution are based on the principle of clean hands or the legal maxim *nullus commodum capare de sua injuria propria*. It would be extremely difficult for non-innocent divested companies to get something by raising inconsistency in the manner the SWF’s policy is carried out.

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[40]The Articles with Commentaries are available at *Responsibility of States for Internationally Wrongful Acts*, UN, http://legal.un.org/ilc/texts/instruments/english/draft%20articles/9_6_2001.pdf (last visited Oct. 3, 2014).

[41]Article 5 provides:

> The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.

Id.

[42]1927 P.C.I.J. 31 (ser. A) No. 9.

(E) Role of equity

We have considered four problems of international law between the SWF possessing States and the recipient States, namely restrictions on foreign investment, sovereign immunity, taxation and responsible investment. As the influence of SWFs in the world economy is increasing, more problems of international law which are not mentioned in this article will appear.

When we consider these problems including future ones, we should keep in mind the balance of interests between the possessing States and the recipient States in order to attain an equitable result. If the balance is lost, the problems will never be fully settled. The concept of equity, although somewhat ambiguous, can play an important role in this field.

Equity is a legal concept. The Chamber of the International Court of Justice, in its judgment on the Frontier Dispute between Burkina Faso and Mali, drew a distinction between equity and *ex aequo et bono*, which is a non-legal concept and equivalent to political compromise.[43] Every international lawyer knows that equity has played an important role in the case of delimitation of continental shelf.[44] Few international lawyers know the arbitral award of the case concerning the loan agreement between Italy and Costa Rica (1998), a case concerning the non-repayment of debt owed by Costa Rica to Italy that applied the concept of equity as follows when it decided the amount of the payment Costa Rica owed to Italy:

> Ce caractère équitable ne peut que conduire le Tribunal à prendre en considération, non pas les seules dispositions "techniques" de la Convention financière sur les échéances, les remboursements, les intérêts de retard, mais l'ensemble des circonstances de l'espèce, ce y compris les causes de retard, les malentendus et les doutes surgis du côté costaricien quant à l'efficacité ou la portée des divers accords passés avec la ou les Parties italiennes et d'une façon générale la situation concrète et le comportement des deux Parties, ainsi que l'ensemble de leurs relations d'amitié et de coopération.[45]

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[43]According to the Judgment:

> It is clear that the Chamber cannot decide *ex aequo et bono* in this case. Since the Parties have not entrusted it with the task of carrying out an adjustment of their respective interests, it must also dismiss any possibility of restoring to equity *contra legem*. Nor will the chamber apply equity *praeter legem*. On the other hand, it will have regard to equity *infra legem*, that is, that form of equity which constitutes a method of interpretation of the law in force, and is one of its attributes.

1986 I.C.J. 567, 567-68.

[44]Among many judgments which touch on equitable delimitation of continental shelf, the recent and the most comprehensive one is the Judgment on the maritime delimitation in the Black Sea between Romania and Ukraine. The following steps explain the method of delimitation of continental shelf:

> (1) The Court will thus begin by drawing a provisional equidistance line between the adjacent coast of Romania and Ukraine, which will then continue as a median line between their opposite coasts;
> (2) The Court will at the next, second stage consider whether there are factors calling for the adjustment or shifting of the provisional equidistance line in order to achieve an equitable result. The Court has also made clear that when the line to be drawn covers several zones of coincident jurisdictions, "the so-called equitable principles/relevant circumstances method may usefully be applied, as in these maritime zones this method is also suited to achieving an equitable result; (3) Finally, at a third stage, the Court will verify that the line (a provisional equidistance line which may or may not have been adjusted by taking into account the relevant circumstances) does not, as it stands, lead to an inequitable result by reason of any marked disproportion between the ratio of the relevant coastal lengths and the ration between the relevant maritime area of each State by reference to the delimitation line.

2009 I.C.J. 101, 101-03.

[45]25 Rep. Int'l Arb. Awards 73. The language of the award is French only. The tentative English translation by the present author is as follows:

> This character of equity can only lead the Tribunal to take into consideration not only the technical provisions of the Financing Agreement, repayment and interest on arrears but also all the circumstances of the case which include the cause of the arrears, the misunderstandings and the doubts arising from the Costa Rican side concerning the effectiveness or scope of the various agreements with the Italian Party (Parties) and generally the concrete situation and the behaviour of both Parties, and all their relations of friendship and cooperation.

It is interesting that the Tribunal considered these various elements within the framework of equity and not *ex aequo et bono*, because it had no mandate to decide the case based on *ex aequo et bono*. *See* Kazuhiro Nakatani, *Case concerning the Loan Agreement between Italy and Costa Rica*, 6 Univ. Tokyo L. Rev. 246 (2011) (Japanese).

By introducing the concept of equity, the Tribunal decided that Costa Rica would pay only fifteen million US dollars to Italy and not twenty-two million US dollars, (the total amount of the loan (including interest) which Costa Rica had owed to Italy). This award seems to be very important when we consider the role of equity in the field of economy including the international legal problems of SWFs between the possessing States and the recipient States.

CONCLUSION

The legal problems analysed in this article are rather neglected even among international lawyers. But solving these problems are very important for preventing misunderstandings between the possessing states and recipient states. International law can and should play a major role for better investments by SWFs.