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The Potential Impact of the UN Model Tax Convention on ISDS

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Recent amendments to the United Nations ("UN") Model Tax Convention aim at banning the use of investor-State dispute settlement ("ISDS") provisions for disputing tax measures, thereby attempting to deal a further blow to international investment agreements (IIAs). The UN Model Tax Convention is regularly updated and was drafted with the aim to cater for the needs of countries which are not members of the Organisation for Economic Co-operation and Development ("OECD") and therefore whose interests are not represented in the OECD Model Tax Convention.

Background

During the twenty-ninth session of the UN Committee of Experts on International Cooperation in Tax Matters held in October 2024, the body approved the Co-Coordinators' Report *Relationship of Tax, Trade and Investment Agreements*. The Report is divided into two parts: Workstream A, which addresses the relationship between tax and investment agreements (presented for approval), and Workstream B, which examines the options to improve guidance on the interaction between tax treaties, GATS and non-tax agreements ("Free Trade Agreements").

This short contribution focuses on Workstream A, which concerns the relationship between the UN Model Tax Convention and IIAs, in particular the apparent intention to curtail the substantive and procedural standards of protection of IIAs.

The Proposed Amendment

Attachment B.2 of the Co-Coordinators' Report contains the text of the proposed amendment to Model Article 25 of the UN Tax Convention, which *inter alia* carves out the ISDS provisions contained in most IIAs by adding a new paragraph 5 (or 6):

> A *taxation measure*, taken by a Contracting State, that is in accordance with this Convention *shall be deemed not to breach any other treaty of which the Contracting States are parties*, and *any dispute* over whether a taxation measure taken by a Contracting State is in accordance with this Convention, or whether the measure falls

> within the scope of the Convention, *shall be settled only under the Convention*.
>
> As respects *any other dispute over a taxation measure*, or as to whether a measure is a taxation measure, the *settlement of such dispute* shall, unless the competent authorities of the Contracting States agree otherwise, be *undertaken without regard to any dispute resolution arrangements under* [Variant A: *any other treaty* of which the Contracting States are, or become, parties. Variant B: *[such treaties as are agreed to be covered through bilateral negotiations]*.] [emphasis added]

The text of this proposed paragraph is composed of two different sentences, with two different variants for the second sentence. The first part of the first sentence intends to replace any existing applicable ISDS provisions contained in IIAs which the respective Contracting Parties have concluded. The second part intends to prioritize the Mutual Agreement Procedures ("MAP") contained in most bilateral Double Taxation Agreements ("DTAs") over any other dispute resolution mechanism under applicable (present and/or future) IIAs.

The Mutual Agreement Procedure

As international investment, commercial and trade law do, bilateral tax treaties provide a level playing field to protect businesses' Return on Assets ("ROA"). Most DTAs contain a MAP provision, which is a State-to-State mechanism, allowing for the settlement of tax disputes. This method of dispute settlement is quite dissimilar to ISDS, which allows private parties to dispute a tax measure directly against a host State.

Put simply, MAPs only involve the tax authorities of the respective Contracting Parties involved in a tax dispute, i.e., two or more States with a competing claim on a given tax base (e.g., the proceedings of an investment). The whole procedure is very opaque in that the taxpayer has little or no information on the stage of the negotiations nor the specific matters that are being discussed. In particular, the taxpayer often has no idea of what the positions of the parties are during the discussions. Indeed, developing economies often insist on MAPs with no prescribed deadlines to close a case nor an obligation to reach an agreement—the only requirement is that of negotiating in good faith and trying to solve the dispute.

Article 26 of the Italy-Netherlands DTA is exemplary of the vague and non-binding nature of the MAP, which provides as follows:

> 1. Where a person considers that the actions of one or both of the States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the State of which he is a resident or, if his case comes under paragraph 1 of Article 25, to that of the State of which he is a national. The case must be presented within two years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

> 2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other State, with a view to the avoidance of taxation which is not in accordance with the Convention.

Unlike in the case of ISDS disputes, where there are complex regulations which address procedural matters and strongly guard the rights of the host State, the investor and even third parties, MAP proceedings (when they are contemplated) lack the most basic rules for a fair and efficient resolution of a tax dispute. The complaining taxpayer has often no procedural rights within the whole MAP. Only in the EU do some limited procedural rights apply on the basis of the 90/436/EEC Convention on the elimination of double taxation and Directive 2017/1852 but still more should be done.

The Potential Impact on ISDS

As is well-known, taxes are arguably one of the most sensitive policy areas and the "right to tax" is generally considered to be one of the core rights and functions of any State. Accordingly, high-stake ISDS disputes challenging taxation measures have been drawing high attention from the general public and media in host States as well as from policymakers. Reference can be made to *Cairn v. India* and *Vodafone v. India* which both involved the retroactive imposition of taxes totalling USD 3.3 billion. After Cairn and Vodafone succeeded in their claims, India withdrew the disputed tax measures. More recently, Anheuser-Busch InBev has initiated an ISDS dispute against Peru (the case is registered as *Unión de Cervecerías Peruanas Backus y Johnston S.A.A., Cervecería San Juan S.A. and AB InBev Southern Investment Ltd. v. Republic of Peru* (ICSID Case No. ARB/24/53)), challenging a taxation measure of more than USD 500 million, while AXA has initiated an ISDS dispute against Mexico (the case is registered as *AXA S.A. v. United Mexican States* (ICSID Case No. ARB/24/49)), disputing a taxation measure of USD 8.7 billion.

From this perspective, it is understandable that States' policymakers are looking for ways to limit or even completely ban the use of ISDS for disputing taxation measures and instead leave it to the respective tax authorities to find a solution within the MAP. If indeed the proposed addition to Article 25 UN Model Tax Convention is agreed upon, and, if it is subsequently widely implemented in DTAs, this *prima facie* could make it more difficult to use ISDS provisions for challenging taxation measures. However, it must be questioned whether a newly inserted provision in a DTA banning ISDS for taxation measures can simply override the ISDS provisions in existing IIAs. Arguably, foreign investors should be able to rely on their vested rights conferred to them by the existing ISDS provisions in IIAs against non-*bona fide* claims. Thus, only formal modifications of the IIAs themselves could limit the use of ISDS provisions for disputing taxation measures. Therefore, the immediate impact on ISDS seems to be limited—at least for now.

A Coordinated Approach is Needed

This UN initiative is likely going to cause more uncertainty and side effects than achieving the objectives it wants to attain. The way the amendment itself was drafted and passed is a violation of the same principle of mutual dialogue between branches of government that the Report propagates since investment specialists were not involved in the drafting process. MAP is not the ideal means to settle tax disputes—certainly not for foreign investors. Therefore, and until the MAP is developed into a fair, efficient, and mature dispute settlement system that can compete with international arbitration procedures, taxation measures should always be addressed through the relevant IIAs, whether limiting access to ISDS or enabling it.

In the meantime, it is clear that a coordinated approach between tax and investment treaty specialists is needed in order to ensure that the rules regarding the challenging of taxation measures in DTAs and IIAs remain available and effective to foreign investors. This is particularly true for another project on a new international tax framework currently underway at the UN level, which started with a decision of the UN General Assembly in November 2022 and which might further hit investment flows and the interests of many taxpayers.

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