UNFCITC draft protocol on dispute prevention and resolution

Notes for the Fifth Session negotiations

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TAX JUSTICE NETWORK

Prevention of Tax Disputes

Article II(1)-(2) Multilateral Arrangements

Any protocol under the UNFCITC has the same legal authority as a self-standing international treaty. This explains why its signature is optional by convention signatory countries and to enter into force, a protocol will have to go through its own ratification or accession process.

The dispute prevention mechanisms in Article II(1) to II(3) contain language and a level of detail that do not belong in an inter-national instrument, but rather in an *executive* inter-governmental instrument. Article II(1)-(2) should be reduce to a single article that provides the legal ground on which Bilateral and Multilateral Advance Rulings can be achieved.

The clause setting out the legal ground should provide that the details of implementation are left to a multilateral competent authority agreement, developed under the Conference of Parties (COP). Setting and finetuning the rules on implementation of the mechanism needs flexibility, and flexibility is not achieved by locking any future change to these rules into the protocol text.

Furthermore, it is highly unusual, and borderline improper, to use the term 'transfer pricing' in a formal international agreement. The term is not used in existing tax instruments of 'primary law' nature. Transfer pricing is an executive level term, used solely by competent authorities. The Convention and its protocols are an inter-national instrument. The proper term that should be used is the "rulings on the cross-border allocation of profits of multinational enterprises".

Given transfer pricing's controversial nature, the protocol should be forward-looking. It should draft mechanisms that could apply to future mechanisms of cross-border MNE profit allocation, like more unitary/formulary-based approaches. In fact, protocol 1 is considering practices of profit allocation that might go beyond transfer pricing, including fractionary apportionment, and it is inadequate that a protocol which is being negotiated at the same time might not cover it in its mechanism. If the general mechanism needs specific application rules for specific cases, this should be articulated in a competent authority agreement under the COP.

Article II(3) Coordinated Unilateral Arrangements

It would also be strange to restrict a coordinated unilateral pre-filing mechanism (Article II(3)) to transfer pricing cases. Again, the protocol should use general terms on unilateral rulings on cross-border MNE profit allocation. A competent authority agreement under the COP can apply the mechanism to specific matters. It could also extend its scope to other MNE group matters, like rulings on the global minimum tax (GloBE) under Pillar Two.

Without a proper multilateral instrument underpinning GloBE and GloBE's implementation left to 'coordinated unilateralism', the OECD has struggled to find a multilateral legal ground to support tax certainty initiatives. Countries not implementing any of the GloBE rules are also expected to be confronted with GloBE disputes where the alleged ‘undertaxation’ in their jurisdictions leads to top-up tax liability elsewhere.

Delegates should seize the opportunity of the UN Forum as the only universal and inclusive forum that can achieve tax certainty. For this reason, article II(3) should be redrafted.

In short:

- Reduce the level of detail in Article II and keep only what is needed to create the legal ground and the fundamental aspects, in two articles, one on ‘multilateral arrangements’ and one on ‘unilateral arrangements’;

- Remove implementation details that need more flexibility and move these details to an ‘executive’ multilateral competent authority agreement or likewise instrument to be created under the auspices of the COP’.

- Remove references to ‘transfer pricing’ in the Protocol to make the mechanism less context specific and more forward looking;

- Redraft the coordinated unilateral mechanism to be more versatile than just transfer pricing cases and to also be of use in relation to the Global Minimum Tax, which is the pinnacle of ‘coordinated unilateralism’.

Article II(5) and II(6) Simultaneous Tax Audits & Joint Audits

Article II(5) and article II(6) develop a new dispute resolution mechanism in the form of simultaneous tax audits and joint audits, as was consistently pleaded for in previous sessions by a handful of OECD countries. Country delegates/competent authorities are obviously best positioned to determine what are the most efficient ways to provide this type of cross-border assistance in dispute prevention matters The inclusive state-led negotiations under the protocol are the best way to achieve results, as is shown in the draft mechanisms, even if just optional mechanisms.

Interestingly, the MAAC also has provisions on 'simultaneous tax examinations' (article 8 of the MAAC) and 'tax examinations abroad' (article 9 of the MAAC). These articles are not optional under the MAAC and they currently provide the legal basis for such administrative exchanges in all of the 150 countries participating in the MAAC.

The Protocol mechanisms go much further than the MAAC provisions. They refine and expand the rules on both simultaneous tax audits and on joint audits, known as 'examinations abroad' under the MAAC.Two things are worth pointing out in this regard.

First, that in creating these optional mechanisms, countries have effectively agreed to update and improve the rules regarding an existing administrative? that is already enshrined in an existing international instrument (the MAAC). The protocol gives its own modern spin to these established rules considering the objectives and principles of the Framework Convention. The workstream should be commended for this. This approach should serve as a reminder that any 'duplication' arguments regarding the Framework Convention and its commitments are essentially moot. There cannot be any 'duplication' where the focus is on the development of previous rules that have not been developed in light of the same objectives and principles as the ones in the Framework Convention. Existing rules have not been developed in the light of the principle of inclusiveness or with consideration of the different capacities of countries.

Second, the protocol's draft mechanisms contradict in certain aspects the rules of similar mechanisms in the MAAC. For example, article II(5)(2) of the MAAC provides that each competent authority must respond and give reasons for decisions not to accept, whereas article 8(1) of the MAAC does not oblige to give any reasons for refusal.

The protocol contains a conflict clause/compatibility clause in article V(2)(B) which provides that countries that have opted-in to the mechanisms can opt-out of the mechanism where they prevail over existing instruments with substantially similar mechanisms. The most relevant instrument with substantially similar mechanisms is the MAAC. It seems strange, therefore, to give countries the option to opt-in to apply the mechanism and then opt-out in relation to all MAAC partners who do not apply the protocol. The opt-out should be reformed so it applies only if both countries involved in the simultaneous or joint audits.

In short:

- Article II(5) and II(6) are exemplary cases against duplication claims in the field of administrative assistance/dispute resolution. The new mechanisms show that there is no duplication in effort if such actions to redesign rules are in light of the principles and objectives of the Framework Convention.

- Article II(5) and II(6) comes with a conflict clause/compatibility clause which should only allow opt-out of the mechanism in favour of mechanisms in existing agreements (i.e. MAAC) if both countries involve have opted out, and not just if one country has opted out.

Resolution of Tax Disputes

Mutual Agreement Procedure (article III.1)

The Mutual Agreement Procedure in article III(1) of the draft protocol is hybrid in origin. It brings together elements of the MAP procedure in both the UN Model and the OECD Model, but also adds elements that are not included in the models but are reminiscent to the rules of EU Directive 2017/1852.

For example:

- Article III(1)(1) provides that the taxpayer's request to initiate a MAP can only be introduced to the competent authorities in their state of residence. The UN Model Article 25(1) provides a similar rule, yet the OECD Model provides that the request can be introduced in either state involved in the dispute.

- Article III(1)(2) provides for the grounds on which MAC access can be denied. Neither the OECD nor the UN Model article provides grounds for access refusal. III(1)(2) instead is reminiscent to the approach adopted in article 5 of EU Directive 2017/1852 which includes similar grounds for refusal MAP access, including the ground of 'no genuine dispute', which is included in III(1)(3).

- Article III(1)(4) introduces constitutional limitations. Similar limitations are not included in the model articles on MAP. The EU Directive also does not include provisos for national constitutional limitations, which implies, one assumes, that EU countries have no constitutional limitations to MAP. To the extent that the mechanism is designed to be optional under article V(1), it seems that there is no need to include constitutional limitations. A country with constitutional limitations can simply opt-out of signing up to the mechanism.

The workstream has clearly tried to bring together the best practices on MAP in a single coherent instrument. Reliance on the MAP procedure as established by the EU Directive needs however careful consideration. On the one hand, it is clear that EU countries operate between themselves at a high standard of cross-border administrative cooperation, and elements of the EU practice may be useful to replicate similar high standards of cooperation between 'third countries'. On the other hand, EU countries are similarly situated in terms of economic development and administrative capacity. Any 'transplantation' of EU norms (or OECD Model norms, for that matter) should be assessed through the lens of the principles and objectives of the Framework Convention, and not just from the EU/OECD perspective of effective dispute resolution between high-income countries.

In short:

- Revaluation needed of those procedural elements transplanted from the OECD or EU mutual agreement procedure regulations is necessary to ensure they are 'fit for purpose' in the context of the Framework Convention.

Arbitration (article III.3)

Similar considerations apply to the MAP Arbitration mechanism in article III(3) as the ones to the MAP clause in article III(2). The MAP Arbitration clause is of a hybrid nature: it absorbs most of the elements of the UN Model's arbitration clause in Article 25B(5) on access to arbitration (on request by either of the competent authorities, but not by the taxpayer like under the OECD Model); period to resolve the case (3 years from presentation and not 2 years from completion of info like in the OECD Model); and competent authority departure from arbitration decision (not permitted in the OECD Model).

The protocol also takes elements from EU Directive 2017/1852, like arbitration decision based on 'independent opinion' instead of 'last best offer' or 'final offer' under the Models and BEPS MLI.

In general, it remains doubtful whether the mechanism will find many supporters among countries that have not already signed up to MAP arbitration through the BEPS MLI or in bilateral tax treaties. As was made clear in previous sessions, the opposition against MAP arbitration is not just procedural. Rather, the issue is its mandatory nature which leads to a loss of control and thereby sovereignty: once a country signs up to the mechanism, it has no handbrake to avoid certain highly disputed case that remain unresolved under MAP to end up in arbitration. As in the UN Model, the mechanism allows a single competent authority to trigger MAP arbitration, even if the other competent authority would prefer the case not to go to MAP arbitration.

A better solution, and one which would at least sufficiently differentiates the protocol's version of MAP arbitration from the UN Model and OECD Model/MLI (and therefore may make it more palpable for arbitration adverse countries) is to either require access conditional on a joint request by both competent authorities (which would make the arbitration 'non-mandatory') or to make more work about the specific type of cases that can give access to arbitration. Currently, the mechanism foresees mandatory MAP arbitration in all type of conflicts regarding substantive tax treaty. The scope of case that can go to arbitration could be restricted.

It is also important to note that the MAP arbitration mechanism in this protocol may also be relied on to ensure binding dispute resolution in relation to the Services Protocol (see article 11). Given that countries may be more confident to accept binding dispute resolution in case of rules that have been developed under the auspices of the Framework Convention (the service protocol rules, for example) thenn then for rules for which they have provided little input (like transfer pricing rules), it would be advisable to allow countries the option to only bind themselves to mandatory binding dispute resolution in relation to disputes regarding UNFCITC protocol rules.

In short:

- Modify the triggering conditions to that the MAP arbitration under the protocol is not mandatory, but only available if both countries in the dispute agree to use it;

- Alternatively, restrict the type of disputes that can give rise to MAP arbitration under the protocol
- More specifically, make the mechanism available for opt-in only in relation to UNFCITC protocol disputes.

Missing elements

Below, a few elements are discussed that have not been included in the draft protocol but of which the inclusion is strongly advisable.

Transparency

It should be noted that the African Union urged for the Framework Convention's commitment on dispute resolution in article 9 to provide for dispute resolutions to be implemented that are fair and independent and, crucially, transparent.

In previous sessions, some delegates repeatedly mentioned the relevance of transparency in dispute resolution mechanisms.

In Workstream III's Co-Leads' Concept Note on occasion of the Fourth Session, there is a section dedicated on 'access to information'. During the Fourth Session negotiations, it became clear that delegates were not supporting efforts to develop the envisioned idea of creating transfer pricing databases. There was, however, less opposition against the idea to create "*databases compiling high-level information on APAs or MAP cases*".

The draft protocol contains not a single rule that would implement Article 9's commitment to transparency in dispute resolution. There is no effort to create transparency in MAP decisions, nor MAP arbitration decisions (unlike in the EU Directive 2017/1852), nor is there an effort to create a high-level database of decisions.

There is a dire need for more transparency in the competent authority decision making process at large, as recognised both by certain national judiciaries and in academia. A certain degree of transparency is needed simply to ensure MAP and the MAP arbitration process is:

(1) Consistent among treaty partners. Similar rules have to be applied similarly across various partner countries, otherwise the rule of law is at peril. This is especially relevant in the case of the MAP being used to settle disputes regarding multilateral protocols under the UNFCITC

(2) As indicated by certain Global South delegates: without making MAP decisions accessible in one form or another, dispute resolution fails its purpose to be of service to future dispute prevention. Dispute resolution may be highly efficient and effective, but if countries cannot learn, identify and change rules that trigger disputes, rising MAP stocks are nothing more but a self-fulfilling prophecy. Disputes have become part of the design of international tax rules. This, in itself, is against the principles of the framework convention to provide rules that are easy to administer and the principle of ensuring legal certainty for taxpayers.

Transparency will ensure access to relevant MAP decision information (i.e. anonymized MAP summaries) by means of public access, or by means of government-access only information sharing.

Override of ISDS clauses in investment treaties

The draft protocol provides an excellent opportunity to implement the UN Tax Committee's work on the so-called 'extended clause', a new clause that was added to Article 25(7) of the UN Model (2025) by the previous Committee membership.

The clause provides that tax related disputes shall be decided by dispute resolution mechanisms in international tax instruments (which could be the Protocol), rather than having these disputes on compatibility of tax matters with investment treaties being decided by binding Investor State Dispute Settlement mechanisms. Instead, such disputes would be decided through MAP (or MAP arbitration) in the tax treaties, allowing competent authorities to decide on tax matters, and not external arbitrators.

In past negotiations, certain countries have been insisting on the relevance of preserving national tax sovereignty. An ISDS override clause is the ultimate remedy to preserve national tax sovereignty from the 'freezing' effect currently achieved by imbalanced investment treaties. The protocol can give countries the option to bilaterally agree to such an override clause. Certain countries have successfully inserted such a clause in their bilateral tax treaty and have successfully overridden investment treaties. A similar optional clause in the protocol would simply give interested countries the opportunity to expand this practice and swap ISDS with the MAP mechanism in the Protocol to settle tax-related investment disputes.