Kluwer International Tax Blog

The Override of International Investment Agreements by Double Taxation Conventions in the Latest UN Model Tax Convention: Critical comments

Robert Danon (Head of Tax Policy Center, University of Lausanne and Chairman of the Permanent Scientific Committee (PSC) of the International Fiscal Association (IFA)) and Prof. Dr. Adolfo Martín Jiménez (Prof. Dr. Adolfo Martín Jiménez, University of Cádiz) · Tuesday, April 15th, 2025

Prof. Dr. Robert J. Danon, University of Lausanne /DANON /Prof. Dr. Adolfo Martín Jiménez, University of Cádiz/AMJ ITC

On 24-27 March 2025, the United Nations Committee of Experts on International Cooperation in Tax Matters ("UN Tax Committee"), in its 30th session, approved the latest changes to a new clause to be introduced into art. 25 of the United Nations Model Tax Convention ("UN MC") designed to switch off the possibility for investors to have recourse to investor-state dispute settlement ("ISDS") in tax-related disputes ("the ISDS model clause")[1]. The new clause is meant to be included in double taxation conventions ("DTCs") and to apply alongside International Investment Agreements ("IIAs")

This "*override*" of IIAs by DTCs, which has no counterpart in the OECD Model Tax Convention, is significant. It occurs at a time when international tax law continues to struggle to provide a comprehensive and effective dispute resolution system. First, under international tax law, dispute settlement – the mutual agreement procedure ("MAP") – is mainly confined to disputes arising from the application of DTCs. Therefore, no international tax remedy is available for disputes concerning, for instance, the misapplication or arbitrary application of domestic tax law, expropriation through taxation, or breaches of investment contracts. Second, despite the introduction of a global minimum standard promoting access to a MAP in good faith and in a fair and objective manner, the procedure is not necessarily effective in practice. This is because the MAP – as a state-to-state procedure – remains rooted in diplomatic protection, with competent authorities (CAs) merely required to' *endeavor"* to resolve the dispute. Although some DTCs include *arbitration clauses* to incentivize competent tax authorities to reach an agreement, many DTCs do not contain such clauses. In this context, it is easy to understand that the introduction of a clause into tax treaty practice aimed at suppressing ISDS in tax-related disputes (without any international tax law counterpart) could negatively impact foreign investors (and, consequently, foreign investment), especially as global tax controversies are on the rise.

The UN Model Tax Convention ISDS clause

The text of the new UN MC ISDS clause has two separate but inter-connected sentences. After the latest changes of March 2025, the clause reads as follows:

First sentence	"*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 by reference to the provisions of the Convention and without recourse to dispute resolution arrangements under any other treaty of which the Contracting States are parties*"
Second sentence	"*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 recourse to any dispute resolution arrangements under [such treaties as are agreed to be covered]*"

The main features of the clause are the following:

- The first sentence affirms the primacy of DTCs over IIAs if a taxation measure (i) falls within the scope and (ii) is in accordance with a DTC concluded between states parties to an IIA. The first sentence will override both the standards of protection of IIAs and their dispute settlement procedure. Specifically, by referring to a settlement without recourse to "*dispute resolution arrangements under any other treaty*", the first sentence excludes ISDS. This means that disputes concerning taxation measures covered by this first sentence may only be settled through a MAP or by the courts of the contracting states.

- The second sentence concerns disputes over a taxation measure that would not be covered by a DTC. This would, for example, concern alleged expropriation through taxation cases, arbitrary state conduct in taxation matters, or a dispute concerning an indirect tax to which a DTC would not apply. In all of these instances, the object and purpose of the second sentence is simply to disapply ISDS without providing any alternative international dispute resolution procedure different from domestic courts (which could, as the case may be, apply the substantive standards of protection of IIAs).

- The clause is meant to be self-judging. That is, it would be completely up to the relevant CAs (or domestic courts) to decide whether a taxation measure falls in the first or the second sentence. Only the latter permits the CAs, if they both agree, to again "*switch on*" the ISDS procedure.

- The clause does not provide any time frame for the CAs to settle a dispute under its first or second sentence.

A critique of the ISDS model clause from a policy, international and EU law point of view

From a policy perspective, the drafters of the ISDS model clause maintain it is consistent with a "whole-of-government approach". However, the clause clashes with modern investment treaty policy. Recent IIAs tend to include comprehensive tax carve-outs, but it is accepted by many States that some matters ought to remain within the ambit of ISDS (often subject to a "tax-filter" mechanism). These "claw-backs" concern expropriation through taxation, but also other matters (for example investment contracts, national treatment or most-favoured nation treatment of indirect taxes). Therefore, by completely overriding ISDS in tax-related disputes, the ISDS model clause achieves the opposite outcome of a "*whole-of-government approach*"*:* it treats tax-related investment disputes differently from any other ones.

The first sentence of the ISDS model clause gives priority to a DTC over an IIA where a taxation measure is "*in accordance*" and "*falls within the scope of the Convention*". In practice, however, it is difficult to see why such a priority clause is necessary. As the tribunal made it very clear in *Cairn v India*, DTCs and IIAs govern different subject matters (art. 30 Vienna Convention on the Law of Treaties ("VCLT")) and operate in different spheres. For example, the allocation of taxing jurisdiction under a DTC has nothing to do with the introduction of retroactive domestic tax legislation breaching the fair and equitable treatment standard. It might be argued that some overlap may exist between the limited non-discrimination of DTCs and the broader standards of protection of IIAs. However, arbitral tribunals have regularly found that the fact that two standards are unequal or apply to the same facts does not make them incompatible under art. 30 VCLT. It is therefore unlikely that an arbitral tribunal would accept the overriding effect of the first sentence of the clause in matters a DTC does not regulate (for example the arbitrary enactment or application of a taxation measure).

Of course, the second sentence of the ISDS model clause could come into play in matters not falling within the scope of a DTC. Although the sentence has a far-reaching scope, it is doubtful that an arbitral tribunal would be prepared to limit its jurisdiction based on an interpretation of this second sentence by CAs that is clearly "*ultra vires*". Accordingly, the clause should not, in our view, apply to switch off ISDS in instances involving a measure that is not a taxation measure under the relevant IIA applicable between the parties or is clearly a *mala fide* taxation measure.

Also, the question of whether a DTC that would incorporate the new ISDS model clause would qualify as a valid *inter se* agreement to modify a multilateral treaty under art. 41 VCLT (for example in connection with art. 16 of the Energy Charter Treaty) appears to have been neglected by the drafters of the clause. The latter seem indeed to wrongly assume that investment treaty protection is confined to bilateral investment treaties. Finally, the ISDS model clause cannot be used by EU members in connection with EU trade agreements to switch off the dispute resolution procedures they regulate.

For the foregoing reasons, as well as other interpretative problems it presents, it is not surprising that the latest commentaries to the ISDS model clause now incorporate a strong minority objection relating to its introduction in tax treaty practice.

Conclusions

The brand new ISDS model clause, rather than being in line with a "*whole-of-government approach*", leads to an undesirable fragmentation between international taxation and investment treaty protection. The clause also treats tax issues differently from other fields of law in an unjustified manner. Moreover, the new UN Commentaries on Article 25 have not thoroughly considered several interpretative problems and compatibility issues, notably the relation of the new clause with multilateral trade treaties (both from an international and EU law point of view). It thus remains uncertain whether the new clause will be capable of limiting the jurisdiction of arbitral tribunals as intended by its drafters. For all these reasons, before including the clause in their DTCs, countries should ponder whether it may have detrimental effects on the attraction of foreign investments and lead to new kinds of disputes.

[1] The October 2024 version of the UN Model clause commented here has been critically discussed in R. Danon / A. Martín Jiménez, The UN Model Tax Convention's Attempt to Override Investment Treaties : A Critical and Normative Assessment, Tax Notes International, vol. 177, February 10, 2025, pp. 825 ff. See also our previous coverage

---

This entry was posted on Tuesday, April 15th, 2025 at 11:04 am and is filed under Dispute resolution, International Investment Agreements, UN Tax Convention, United Nations
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.