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Item 4
Framework Convention, Protocol I on taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy and Protocol II

Note by the Chair

The Chair transmits three notes prepared by the Co-Leads of each of the workstreams.

Issues note by the Co-Lead of Workstream I

I. Introduction

1. Workstream I of INC/Tax is charged with developing the draft text of the UN Framework Convention on International Tax Cooperation. It will be submitted, along with the draft text of the first early protocol on the "taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy"[1] and the draft text of the second protocol on the "prevention and resolution of tax disputes"[2] to the UN General Assembly for its consideration in the first quarter of its 82nd session in the second half of 2027.

II. Scope of Initial Work

2. The Terms of Reference (ToR)[3] provide significant detail regarding the expected content of the Framework Convention. The work plan prioritizes drafting of the commitments by the end of 2025, as many of the other provisions will flow naturally from them. A second category of provisions is those that depend on what is covered in the commitments (such as capacity building and technical assistance). A third category consists of those that can be drafted at any time (primarily procedural provisions commonly found in multilateral conventions).

3. The individual subparagraphs in paragraph 10 of the ToR generally set out the subjects to be addressed in the commitments but were not drafted using the language of commitments. There may be some differences in purpose among the commitments, with some intended to provide support for the early or future protocols and others possibly including stand-alone actions. These differences may result in some commitments being more detailed than others.

4. The workstream had productive discussions regarding possible elements of commitments relating to every subject described in paragraph 10 of the ToR, but, as described below, those not addressed in Section III require further development before discussion in the INC Plenary. The workstream may also consider including commitments on additional subjects, subject to the Committee completing its tasks on schedule.

III. Commitments that might be presented at the August 2025 Sessions

5. This section sets out a summary of the views expressed thus far in the workstream's discussions with respect to three commitments that could be presented to the INC Plenary for discussion at the August 2025 Sessions. Two of them have been prioritized because they relate to the subjects to be addressed in the early protocols.

a. Effective prevention and resolution of tax disputes

6. The ToR mention settlement of disputes in three contexts. Paragraph 10 includes "effective prevention and resolution of tax disputes" as one of the subjects for a commitment. Paragraph 16 lists prevention and resolution of tax disputes as a priority area

[1] See A/AC.298/2.
[2] See A/AC.298/CRP.5.
[3] See A/AC.298/2.

for a potential early protocol and this topic was chosen for the second protocol[4] at the INC organizational session in February 2025. In addition, the ToR includes dispute settlement in the paragraph 13 list of "Other Elements" provisions that should be included in the Framework Convention. Discussion of the topic of effective prevention and resolution of tax disputes therefore took place in both Workstream I and Workstream III because of the need to coordinate the various provisions of the Framework Convention and protocol. A full issues overview with respect to effective prevention and resolution of tax disputes can be found in the issues note relating to Workstream III regarding Protocol II; this section provides background for the commitment that would be included in the Framework Convention. The issue of resolution of disputes arising under the Framework Convention itself will be addressed in connection with the third category of provisions mentioned in paragraph 2.

7. Litigation of tax disputes frequently is time-consuming and resource-intensive for both taxpayers and tax authorities. For these reasons, tax authorities over time have developed various mechanisms aimed at either preventing tax disputes from arising in the first place or resolving them without resorting to court proceedings. Successful use of such mechanisms can be in the best interests of both taxpayers and tax authorities by conserving resources. However, this is the case only if the processes are fair, independent, accessible, and effective in resolving disputes in a timely manner for both taxpayers and the tax authorities involved. A system that satisfies those criteria can provide legal certainty to taxpayers and lessen compliance burdens, reducing barriers to cross- border trade and investment, making tax administration more efficient and, indirectly, increasing domestic resource mobilization.

8. Moreover, final resolution of a cross-border tax dispute through domestic courts may take years, and there is no guarantee that a court decision will be accepted by any other countries whose tax revenues are at stake, meaning that the risk of double taxation may persist. The urgency to address these problems has increased as individual taxpayers are more mobile, business structures and supply chains touch more jurisdictions, and underlying transactions become more complex. The primary mechanism for resolving disputes regarding the allocation of taxing rights between jurisdictions are the substantive rules contained in bilateral tax treaties and their "mutual agreement procedure", a government-to-government mechanism. However, many developing countries have small treaty networks but host a significant amount of cross-border trade and investment; for them, bilateral or multilateral resolution of tax disputes can be difficult. This puts greater pressure on prevention of tax disputes in those jurisdictions.

9. The workstream discussed elements of a commitment that would address these concerns. The relevant article could begin with a statement recognizing the importance of legal certainty to cross-border trade and investment, with the ultimate goal of improving domestic resource mobilization. It could also include an undertaking to establish dispute prevention and resolution mechanisms that are fair, independent, accessible, and effective in resolving disputes in a timely manner for both taxpayers and the tax authorities involved.

10. The Committee is invited to discuss the issue of effective prevention and resolution of tax disputes and, in particular, whether:

a) the commitments described in paragraph 9 effectively would

[4] See A/AC.298/CRP.5.

address the concerns that have been expressed in the workstream with respect to effective prevention and resolution of tax disputes;

b) the commitments described in paragraph 9 would provide sufficient support for the early protocol being developed in Workstream III; and

c) there are additional concerns regarding effective prevention and resolution of tax disputes that should be addressed in that article of the Framework Convention.

b. Fair allocation of taxing rights, including equitable taxation of multinational enterprises

11. The issues note for Workstream II[5] on "taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy" describes the in-depth and nuanced discussions of the problem of fair allocation of taxing rights with respect to one type of income. These discussions also helped to shape the discussions in Workstream I.

12. Some participants emphasized that a fair allocation of taxing rights would support domestic resource mobilization. In this regard, some participants focused on restoring taxing rights that had been eroded as business models changed. Others took a broader view, regarding the goal as ensuring that every jurisdiction where business activity takes place should share in taxing rights over the income generated from such business activities. For them, this would include not only the countries of supply and demand but also where users are located while other participants are uncertain of the economic basis on which taxing rights should be allocated to third countries. Some referred to basing taxing rights on economic substance and value creation while questioning whether demand, by itself, creates value. Participants also argued for taking into account possible negative effects with respect to cross-border trade and investment, economic efficiency and tax neutrality, and simplicity and administrability. The rules should also be "future-proof" by satisfying these criteria even as business models change in ways that are impossible to now foretell.

13. It was clear that what is perceived as "fair" is subjective and differs from country to country. Even if "fairness" is not explicitly defined in the Framework Convention, it is likely that elements of such a concept will emerge as the Framework Convention and its protocols address aspects of the current system that many view as unfair.

14. The commitment should urge parties to agree on an approach to the allocation of taxing rights that recognizes that every jurisdiction where business activity takes place should share in taxing rights over the income generated from such business activities, while recognizing the value of economic efficiency and tax neutrality, simplicity and administrability and the importance of effects on cross-border trade and investment. There might also need to be some explanation of how to determine where business activity takes place in light of digitalization and other new business models.

15. ***The Committee is invited to discuss the issue of fair allocation of taxing rights and, in particular, whether:***

[5] [Reference to WSII issues note.]

a) the elements included in paragraph 14 provide a useful outline of a commitment on this topic; and

b) there are additional concerns regarding the fair allocation of taxing rights that should be addressed in that article of the Framework Convention.

c. *Sustainable development*

16. The ToR refers to a commitment to pursuing international tax cooperation approaches that will contribute to the achievement of sustainable development in its three dimensions, economic, social and environmental, in a balanced and integrated manner. This language was adopted in the ToR because it was felt that the concept, which is referenced in a number of documents, is well understood in the UN system.

17. Therefore, a commitment on this subject could consist largely of language from subparagraph (c) of Paragraph 10 of the ToR:

> Taking into account their different capacities, the States Parties agree to pursue international tax cooperation approaches that will contribute to the achievement of sustainable development in its three dimensions, economic, social and environ- mental, in a balanced and integrated manner.

18. ***The Committee is invited to discuss the issue of international tax cooperation approaches that contribute to sustainable development and, in particular, whether there are additional aspects of international tax cooperation approaches that contribute to sustainable development that should be addressed in additional paragraphs of that article of the Framework Convention.***

IV. Commitments requiring further work before presentation to the INC Plenary

19. The workstream will continue to work on the other subjects covered in paragraph 10 of the ToR: tax evasion and avoidance by high-net worth individuals, tax-related illicit financial flows, tax avoidance, tax evasion and harmful tax practices and effective mutual administrative assistance, including with respect to transparency and exchange of information for tax purposes. Developing countries noted that, in one way or another, lack of information regarding income or assets held outside their country is one of the primary barriers they face in connection with all those subjects. It is therefore anticipated that these subjects will be presented as a comprehensive package at the November 2025 Session of the INC Plenary to ensure common or complementary approaches to the subjects.

Issues note by the Co-Lead of Workstream II

I. Introduction

1. Workstream II of INC/Tax is charged with developing the first early protocol, on the "taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy".[6] The draft text of the protocol will be submitted, along with the draft text of the UN Framework Convention on International Tax Cooperation and the draft text of the second protocol on the "prevention and resolution of tax disputes"[7] to the UN General Assembly for its consideration in the first quarter of its 82nd session in the second half of 2027.

II. Possible Scope of Work

2. At its organizational session, INC/Tax considered a note by the Secretariat, A/AC.298/CRP.4, on the four possible subjects for the second early protocol. In a footnote, this note stated:

> The INC-Tax will have to further clarify, over the course of its work, how to interpret the subject of this first protocol, which might focus on traditional services provided through digital means of communication and/or genuine digital services. Depending on the interpretation of this subject, the INC-Tax might also need to delineate the subject from the "taxation of the digitalized economy."

This description is to be understood as an orientation, and not as a limitation of the possible scope of the protocol.

3. The first task with respect to Workstream II is to agree on the scope of the protocol. The work plan for Workstream II anticipates that the INC Plenary will have an initial discussion of the scope and approach of Protocol 1 at its August 2025 Sessions, provide guidance to the workstream at its November 2025 Session, and begin discussing drafting options in late 2025.

4. Workstream II has had 7 weekly meetings, starting on 13 May 2025. At those meetings, participants first discussed the issues that they encounter in trying to tax non-residents on income from services provided to residents of their countries. At subsequent meetings, participants discussed common structures involving cross-border services with a view to developing principles of taxation that might be reflected in Protocol 1.

III. Issues Discussed in the Workstream

5. This section first summarizes the issues discussed in the workstream and the various views that were expressed in order to provide background for the August 2025 Sessions of the INC Plenary. It begins in subsection (a) by describing current rules for the taxation of cross-border services income, both under countries' domestic laws and as modified by tax treaties and explaining why some countries are calling for changes to those

[6] See A/AC.298/2.
[7] See A/AC.298/CRP.5.

rules, with the primary focus on source State taxation.[8] Subsection (b) then describes the workstream's discussions regarding possible new rules for the taxation of income from cross-border services. Subsection (c) mentions some preliminary questions regarding the scope of the protocol. Subsection (d) provides a short summary of the current state of discussions in the workstream.

a. Current rules for taxation of income from cross-border services and reasons for change

6. There are significant differences between the ways that income from cross-border services is taxed under the domestic laws of Member States. These differences affect not only the substantive rules but, as demonstrated during discussions in the workstream, views regarding the relative administrability and fairness of different rules.

7. In many countries, primarily but not limited to developing countries, gross-basis withholding taxes are imposed on all or most payments made from the country to a non-resident. This general rule goes beyond withholding on passive income, such as dividends and interest, that is common even in countries described in paragraph 8. As applied to services, however, application of the general rule means that income from services is taxed no matter where the services are performed. Countries with this system find it easy to administer as they do not have to determine whether the service provider is within their country or, generally, where the services were performed (except in cases where the non-resident's activities within the jurisdiction rise to the level of a permanent establishment or similar threshold under the country's domestic law). Some countries noted that the problem of detecting economic activities within their borders is not limited to multinational enterprises but arises with respect to small enterprises as well. Others explained that taxing the gross amount of the payment means that they do not have to deal with the allocation of income or expenses. In addition, when a payment for services gives rise to a business deduction, tax authorities find it relatively easy to then determine whether the payer has withheld the payment giving rise to the deduction. In at least some countries, non-residents are allowed to file a tax return to pay tax on a net basis; whether taxpayers choose to do so or not may depend on the compliance costs connected with filing such a return compared to the possible reduction of tax.

8. Other countries, including most developed countries, tax income from services primarily based on where the services are performed. Therefore, if a non-resident is physically present in the country while performing the services, the income generally will be subject to tax. Such taxation is usually on a net basis, with deductions allowed for relevant expenses (even if such expenses were paid by another part of the entity (such as the head office) but incurred for purposes of the activities in the other Contracting State). Conversely, under this approach, when services are performed remotely, the resulting income will not be taxed in the country from which payment is made. During the workstream discussions, some countries with this system noted that they believe that taxation based on physical presence on a net basis is more economically correct, efficient, and fairer. Moreover, the resident State is in the best position to determine the net profits.

[8] Most Member States will tax their residents on their worldwide income on a net basis, relieving double taxation either through the exemption method (in which certain income earned abroad is not included in the tax base in the residence State), the credit method (in which the tax that would have been imposed in the residence State is reduced by the amount of taxes paid to the other State), or a mix of both. If the exemption method applies with respect to certain income, the residence State will simply not tax that income and so will have no residual taxing rights. If the credit method applies, the residence State will in principle have residual taxing rights but, whether it actually will collect any tax will depend on a complex interaction between taxation in the source State and limitations in the residence State (including the application of any relevant expense allocation rules).

On the other hand, some countries that generally are described in this paragraph noted that they are exploring or have adopted broader nexus rules to take account of new ways of doing business.

9. Because of these basic differences in Member States' domestic laws, tax treaty limitations on taxation of income from cross-border services affect countries described in paragraph 7 more than those described in paragraph 8. Tax treaties (which are usually bilateral) use a system of "classification and assignment" to allocate taxing rights between the two parties (known as "Contracting States"). Under this system, different distributive rules that may restrict or eliminate taxing rights of both source and residence countries apply to different types of income. The OECD Model Tax Convention on Income and on Capital (the "OECD Model") provides that income from many services, including management, technical and consultancy services, is treated as business profits.[9] Because such income is treated as business profits, under Article 7 of the OECD Model it generally can be taxed only in the country of residence of the recipient of the income, unless that taxpayer has a "permanent establishment" in the other Contracting State. A permanent establishment is generally a fixed place through which the taxpayer's business activities are carried out, although a person providing goods or services may also have a permanent establishment by reason of the activities of certain employees or other dependent agents in the other Contracting State. Special rules apply with respect to certain types of services, including international transport (exclusive residence State taxation even if there is a permanent establishment in the other country), entertainment and sports (taxation where the services are performed without a threshold), and serving as a director of a company (taxation where the company is a resident, no matter where the services are performed). These rules tend to align fairly closely with the domestic laws of countries described in paragraph 8.

10. At the first meeting of the Ad Hoc Group of Experts that was charged with developing the UN Model Tax Convention in 1968, a delegate from a developing country argued that income from services should not be treated as business profits in order to allow countries to impose gross-basis withholding taxes. Ultimately, the 1980 UN Model did not adopt this approach; instead, it provided a separate threshold for services that does not require a fixed base but does require physical presence for at least 183 days in the relevant year. Over the years, the UN Model gradually has been changed to allow Contracting States to impose gross-basis taxes on a wide variety of services. In fact, with the adoption of Articles 12AA (all services except certain specialized services), 8 (Alternative A) (international transport) and 12C (insurance) in 2025 and 12B (income from auto- mated digital services) in 2021, it is fair to say that the general rule in the 2025 UN Model is that the state from which payment is made is permitted to impose gross-basis taxes on payments for services, with net-basis taxation as an exception that applies when services are physically provided in the source country, usually in connection with the creation of a permanent establishment.[10] This system is more consistent with the domestic laws of countries described in paragraph 7.

11. Although developing countries tend to have smaller treaty networks than developed countries, many of the treaties that they do have are older and/or based on older versions of the UN Model. As a result, they are prevented from imposing their preferred gross-basis withholding taxes on payments to non-residents. Many described these

[9] "Business profits" also, of course, includes income from the sale of goods.

[10] Article 17 (Artistes and Sportspersons) allows taxation of a non-resident who performs certain activities in a Contracting State even if the non-resident does not have a permanent establishment.

limitations in tax treaties as the most significant barriers they face in trying to tax cross-border services. They also noted that it is difficult for them to modify or terminate treaties once they are in force.

12. Developed countries often argue that the key to improving domestic resource mobilization in developing countries is capacity building and technical assistance so that they can apply transfer pricing rules to deny a deduction to the local payer to the extent that the relevant payment is not viewed as consistent with an arm's length arrangement. However, participants from developing countries noted difficulties with this approach. They often find that there is a lack of comparable transactions between unrelated parties. Participants also mentioned the expense or unavailability of commercial databases, or that the information in such databases is not appropriate for the circumstances of developing countries. Applying these rules results in significant economic burdens in terms of technology and human resources with no guarantee of success in increasing revenue. Some have questioned why they should incur those costs to apply transfer pricing rules that, in their view, put too much weight on activities that take place in the State of residence of the taxpayer or in third states and not enough weight on the contribution of the market where the services are consumed; they believe that there may be simpler and fairer rules that could be considered.

13. There was a general acknowledgement within the workstream that the rules that limit source State taxation to cases in which services are provided in that State do not fully reflect current ways of doing business. Such rules were originally developed in the 1930s or 1940s, when it was difficult to provide services without having a physical presence in the country where the consumer of the services was located, but this is no longer the case. For many who participated in the workstream, the examples discussed demonstrated that it is now possible to provide many services remotely, suggesting that physical presence may now not always be a sufficient or appropriate test for determining taxing rights. Some participants noted that this may be the case even in industries that involve a very close physical connection to the host State, such as the extractives industry and agriculture as technical service fees and management fees may lower the host State's tax base.

b. Developing new approaches to taxing income from services

14. The discussion of common fact patterns also elicited participants' views regarding justifications for possible new nexus rules for services. Participants emphasized that the primary goal of any new rules should be to support domestic resource mobilization by providing for a fair allocation of taxing rights. Other goals are to eliminate barriers to cross-border trade and investment, economic efficiency and ensuring tax neutrality, and simplicity and administrability. It was also agreed that any new nexus rules must be "future-proof" by satisfying these criteria even as business models change in ways that are impossible to now foretell.

15. As noted in paragraph 7, a number of Member States tie deductibility of payments to withholding tax because a deduction to the payer with respect to the payment for services represents a cost to the jurisdiction that, in their view, should be offset by taxation of the recipient. A different argument in favor of a new nexus is based on the fact that the non-resident benefits from access to the market. Supporting this view is the contribution of users to the generation of income with respect to many services; the presence of users within their jurisdictions shows that real economic activities are taking place there.

16. For other participants, physical presence in a country continues to provide a strong justification for taxation by that country as it indicates that business activities are taking place there. They take the view that income from services is most appropriately treated as business profits taxed on a net basis. They cautioned that gross taxes on cross-border transactions may create economic distortions and, in the case of services, a barrier to the provision of such services that may inhibit such activity, particularly on services with a low profit margin. They also see no reason for different treatment as between the provision of services and sales of goods. However, as noted above, they did not foreclose the possibility of including additional rules to address situations involving remote services and services provided digitally, although some questioned why mere access to a market in itself indicates value creation.

17. Several participants suggested that it may be appropriate to apply different rules with respect to different types of services such as, for example, intra-company payments. Others noted, however, that it is often difficult to distinguish between services performed through a physical presence, those performed remotely and those performed digitally. If that is the case, rules that produce different results depending on how the services are performed would violate the principle of neutrality, particularly given the ease with which many services can be performed from any location. Such rules would also potentially discriminate against local brick-and-mortar businesses with local ownership, which pay taxes locally and would find it hard to compete against remote businesses that might not pay the same level of taxes. Some participants argued that it can be difficult to determine the "correct" amount of source State taxation because different companies have different profit margins, affecting whether the residence State can actually exercise any residual taxing rights.

18. Participants also discussed the idea of "value creation" more generally and considered whether it is a useful tool for establishing nexus. Several argued that the interplay of supply and demand drives value creation – the development of a product is meaningless if there is no demand for that product. Thus, the market jurisdiction contributes to value and should receive a portion of the tax revenue generated, no matter where the services are physically performed. Another participant pointed out that this argument supports shared taxing rights, not exclusive source-State taxing rights. In later discussions, some participants argued that "value creation" has no independent economic meaning, but was a concept developed during the OECD/G20 BEPS project to reflect both nexus and income allocation; as such, they argued that it may not be helpful in establishing new nexus rules. However, others suggested that "value creation" could be considered as a basis for creating a new nexus for taxation, and should not be limited to the interaction between demand and supply, but should also include other valuable contributions made by users in a jurisdiction (such as user data and user participation).

19. Several participants mentioned the adoption in their countries of a new nexus, the "significant economic presence" test. This test, which applies to both goods and services, allows taxation when a non-resident enterprise's activities in the jurisdiction produce more than a specified threshold of revenue, it conducts certain marketing activities there or there are other indicia of deliberate targeting of the jurisdiction's market. The monetary thresholds can be tailored to the size of the relevant economy. The workstream did not discuss the approach in great detail but is likely to come back to it after the August 2025 Sessions.

c. Scope of the protocol

20. Because the focus of discussions in the workstream was on the provisions of bilateral tax treaties that currently restrict or eliminate source State taxation, that led the discussions also to focus on the types of taxes currently covered by such treaties – that is, in general, income taxes. However, it was also noted that there are significant ambiguities regarding the classification of various types of relevant taxes. There was, for example, previously a proposal from the Commission of the European Union, that was never adopted by the Member States, that would have viewed digital services taxes ("DSTs") as indirect taxes. Other potentially relevant terms, such as "excise taxes", do not have direct translations into certain languages. Accordingly, the workstream tentatively concluded that it will need to define coverage of the protocol by reference to the nature of the tax, not what it is called. Discussions on this issue will continue.

21. The examples discussed by the workstream included a variety of services and situations, including intragroup payments for technical and managerial services, payments to unrelated parties for remote services and automated digital services. Although the workstream discussed the possibility of having different rules for different types of services, it did not otherwise address the question of the scope of the protocol. Discussions on this issue will take place between the August 2025 Sessions and the November 2025 Session.

d. Summary

22. Overall, the workstream was moving towards consideration of shared taxing rights with respect to income from the provision of services, which may recognize taxing rights for source countries subject to limits so that the residence State retains taxing rights. As it continues its discussions regarding possible new rules, the workstream will further explore whether it is appropriate to apply different rules with respect to different types of services or as between services and sales of goods. Discussions also will continue with respect to the manner of taxation, as some participants prefer gross-basis withholding taxes (with some suggesting considering different rates depending on the service provided) and others prefer net-basis taxation.

IV. Issues for the Committee

23. The Committee is asked to consider:

(a) whether Section III(a) comprehensively describes current rules for the taxation of services and the reasons behind the call for change, or whether there are additional considerations that should be taken into account in the workstream's discussions;

(b) what considerations are most important in developing possible new rules for the taxation of services; and

(c) how the workstream can best define the scope of the protocol in terms of the taxes and services that it will cover.

Issues overview by the Co-Leads of Workstream III

I. Introduction

1. Workstream III of INC/Tax is charged with developing the second early protocol, on the "prevention and resolution of tax disputes"[11] (the "protocol"). Under the Terms of Reference (ToR)[12] adopted by the General Assembly in December 2024, the text of the draft protocol will be submitted, along with the draft text of the UN Framework Convention on International Tax Cooperation and the draft text of the first protocol on the "taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy" to the UN General Assembly for its consideration in the first quarter of its 82nd session in the second half of 2027.

II. Procedural Background

2. At its organizational session, INC/Tax considered four possible topics for the second early protocol, based on a note by the Secretariat, A/AC.298/CRP.4. The four topics were:

a. taxation of the digitalized economy;

b. measures against tax-related illicit financial flows;

c. prevention and resolution of tax disputes; and

d. addressing tax evasion and avoidance by high-net worth individuals and ensuring their effective taxation in relevant Member States.

3. That note describes the proposal for work on prevention and resolution of tax disputes as follows:

> As business models and value chains have become increasingly globalized and dis- persed and international tax rules increasingly complicated, cross-border tax disputes become increasingly frequent and difficult to resolve. The effective and efficient prevention and resolution of cross-border tax disputes has thus emerged as a pressing issue for governments and taxpayers alike, promising to reduce cost and increasing legal certainty for cross-border business activity and investments. Such tax disputes can arise from the interpretation or application of the international tax provisions of domestic law or tax treaties. In addition, the UN Framework Convention and the early protocols, like every tax agreement, may themselves become subject to tax disputes.
>
> There are several limitations in bilateral treaty dispute prevention and resolution mechanisms, some of which are addressed in the Handbook on Dispute Avoidance and Resolution developed by the UN Committee of Experts on Cooperation in International Tax Matters.[13] The tax treaty rules are complemented by a patchwork of additional administrative and legal tools outside of the tax treaty network, including the use of mandatory binding

[11] See A/AC.298/CRP.5.

[12] See A/AC.298/2.

[13] See United Nations, *Handbook on the Avoidance and Resolution of Tax Disputes*, 2021, ISBN: 9789212591896.

arbitration under international investment agreements to address tax-related disputes. Again, member States have different views as to the inclusiveness, effectiveness, and fairness of these approaches. Hence, a more multilateral approach to these issues could help stabilize and bring greater certainty and fairness to the international tax environment. Generally, avoiding tax disputes from arising may alleviate the pressure on dispute settlement mechanisms.

Under a protocol on the prevention and resolution of tax disputes, existing tools could be strengthened, and new tools could be tested. Potential measures on avoiding disputes may encompass, for example, strengthening coordinated advance agreements and administrative assurance as well as increasing the efficacy of cross-border cooperation in respect of joint tax audits. As to cross-border tax disputes, the legal basis both within and outside the current tax treaty network may be strengthened. This may include mutual agreement procedures, confidentiality and secure document exchange, arbitration, and non-binding dispute resolution. However, any measure will have to balance Member States' interest in effective and efficient resolution of tax disputes with the imperatives of and concerns for national sovereignty. Furthermore, the INC-Tax may decide that the institutional provisions of the Framework Convention should encompass mechanisms for the prevention and/or resolution of disputes arising from the implementation of the framework convention. The Framework Convention may also cover aspects of prevention and/or resolution of cross-border tax disputes. Developing a protocol on the prevention and/or resolution of tax disputes may thus need design decision by the INC-Tax on the approach taken as well as careful coordination with provision in the main convention.

4. As noted in paragraph 3, Member States have different views regarding the various mech- anisms mentioned in that short description of the issues. Accordingly, although the INC/Tax decided on dispute prevention and resolution as the topic for the second early protocol, that decision does not suggest any particular approach or scope to be taken in the protocol. The workstream therefore began its review of the topic *de novo*, with the task of providing an overview of the issue and then, after the August 2025 Sessions, proposing possible options for measures.

5. This note follows discussions within Workstream III held in multiple meetings under the co-leadership of Marlene Nembhard-Parker (Jamaica) and Michael Braun (Germany). Its issuance is in accordance with the work plan for Workstream III, which calls for the development of a note providing an outline of the issue overview and scope of the protocol ahead of the INC's August 2025 Sessions. The purpose of this note is to assist in obtaining targeted input from multi-stakeholders in the preceding consultations and to inform discussions of the INC Plenary, which is expected to provide direction on the scope of the protocol at those Sessions.

6. The ToR refer to disputes three times. In addition to references to a possible early protocol in paragraph 16, paragraph 10 provides that the Framework Convention should include a commitment on "the effective prevention and resolution of tax disputes" and "dispute settlement mechanisms" are mentioned as an "other element" in paragraph 13. Drafting of these provisions are within the purview of Workstream I, although the work plans of both provide for coordination between Workstream I and Workstream III to ensure legal and technical alignment between both instruments. Participants in both workstreams

were kept informed of the relevant discussions in the other workstream and, in some instances, participated in both.

III. Issues Overview

a. *Reasons for work on dispute prevention and resolution*

7. Litigation of tax disputes frequently is time-consuming and resource-intensive for both taxpayers and tax authorities. Final resolution of a cross-border tax dispute through domestic courts may take years, and there is no guarantee that a court decision will be accepted by any other countries whose tax revenues are at stake, meaning that the risk of double taxation may persist. It is also often the case that tax authorities are at a significant disadvantage in litigation because of information asymmetries – the taxpayer, either an individual or a corporation, knows its own situation and has access to information that a tax authority does not. The tools available to tax authorities in connection with fact-finding vary with the procedural rules and their application in different jurisdictions, as well as with the legal basis available for intergovernmental administrative cooperation. While these conditions have existed for decades,[14] the urgency to address them has increased as individual taxpayers are more mobile, business structures and supply chains touch more jurisdictions, and underlying transactions become more complex.

8. For these reasons, tax authorities over time have developed various mechanisms aimed at either preventing tax disputes from arising in the first place or resolving them without resorting to court proceedings. Successful use of such mechanisms can be in the best interests of both taxpayers and tax authorities by conserving resources. However, this is the case only if the processes are fair, independent, accessible, and effective in resolving disputes in a timely manner for both taxpayers and the tax authorities involved.

9. The ultimate goal of work on effective prevention and resolution of tax disputes is to increase domestic resource mobilization by increasing cross-border trade and investment. An effective system can do so by providing legal certainty and lessening compliance burdens.

b. Cross-cutting challenges

10. There was a strong convergence of views among participants in the workstream on the types of cross-border disputes that are most common. The disputes were said to mainly concern corporations, but also arise with individual taxpayers. Many concern transfer pricing, permanent establishments, and issues regarding the residence of taxpayers, while others involve the treatment of digital services, other tax treaty aspects and the taxation of capital gains on the disposal of assets, including offshore indirect transfers. In these areas, disputes could arise either (a) because of the ambiguity or complexity of the relevant substantive and procedural rules, (b) because the parties have different interpretations or applications of those rules or the facts or (c) because there is no treaty between the two countries so there is no common set of rules to apply, with each country applying its domestic rules. Some participants highlighted their experience with multinational enterprises ("MNEs"), drawing attention to international transactions related to payments made for the provision of intra-group services that are stated to be 'low-value adding'. Often these services are found to lack commercial substance and the payments

[14] In fact, calls from business to provide for tax dispute resolution mechanisms date back to the same period in which tax treaties were being developed.

made do not appear to adhere to the arm's length principle.

11. In particular, in connection with transfer pricing, a number of participants cite lack of relevant information as a significant problem. There is no publicly available database that govern- ments can access to identify and examine comparable transactions. Participants described difficulties in using commercial databases to establish comparable transactions, either because of their cost or finding that the transactions in such databases were not appropriate for use in their circumstances, due to a lack of relevance or because the data was not up to date. The lack of access to country-by-country reports, gaps in the reports and their limited scope also are a problem for some countries. In addition, some participants described concerns as to the credibility of the information provided in order to ascertain costs and apply allocation keys in cost contribution arrangements. These information problems may be compounded when many years have passed between the time a transaction took place and when it is being examined.

12. Some participants emphasized the potential benefits of systematically embedding digital solutions, such as online platforms for administrative support, throughout dispute prevention and resolution processes, recognizing that digitalization could significantly streamline such processes and improve efficiency and accessibility.

13. In the view of some participants, subparagraph (f) of paragraph 10 of the ToR is not limited to cross-border transactions. In their views, taxpayers are equally in need of tax certainty with respect to purely domestic tax issues (i.e., those that do not involve transactions that take place cross-border). However, there was no similar convergence of views regarding the most common issues that arise in the purely domestic context.

c. Prevention of tax disputes

14. Dispute prevention traditionally has been a matter primarily of domestic law. It starts by ensuring that taxpayers understand their tax obligations by providing clearly drafted legislation. This is facilitated by clearly establishing tax policy goals before drafting tax legislation and then, after legislation is enacted, assisting taxpayers in complying by providing easily accessible supplementary guidance. This requires significant investment in capacity development, including human and technological resources, but such capacity development should reap substantial benefits in terms of more efficient tax administration.

15. The goal of tax administration should be to ensure that the taxpayer pays the correct amount of tax, no more and no less, and at the right time. The structure of the tax administration can help to further that goal. Many countries provide, under their domestic law, various types of internal appeal or review processes that allow for a "second look" by someone other than the auditor before an adjustment is made. Some countries have found that adopting a practice of "cooperative compliance" with large taxpayers, which involves constant communication with the goal of resolving issues before a return is even filed, is a good use of scarce resources.

16. Another common approach to preventing tax disputes is the development of programs for Advance Pricing Agreements ("APAs"), which generally apply to transfer pricing and income allocation issues. APAs allow the taxpayer and tax authorities to discuss complex factual and legal transfer-pricing questions in a cooperative manner. Ideally, questions are settled before returns are filed, and countries may allow "roll-backs" to tax years for which the statute of limitations has not run. APAs address the constant problem

of asymmetry of information between the taxpayer and tax authorities. Taxpayers who voluntarily apply for APAs can be required to provide information regarding their business operations as part of the process. From the tax authorities' point of view, this reduces their risk as they otherwise would have to try to get that information during the course of an audit. From the taxpayer's point of view, an APA is desirable because it can provide certainty for years regarding how its operations will be taxed. Bilateral or multilateral APAs can further enhance legal certainty by ensuring consistent treatment across jurisdictions, avoiding the prob- lems associated with unilateral determinations. A formal process with clear procedural rules and strict documentation requirements—including risk analyses—can be particularly helpful in providing transparency and predictability for both sides. Similar benefits might be achieved through advance agreements on other issues, but those are less common.

17. APA programs are clearly more common in developed countries, with some developing countries noting that they do not currently have a legal framework to allow for such agreements. Even those developing countries that have adopted such programs, or that are in the process of doing so, noted that the resulting APAs or other rulings will, in most cases, be unilateral, either as a result of legal restrictions or the practical consideration that they do not have large tax treaty networks that would allow bilateral or multilateral APAs. They acknowledge that unilateral APAs could resolve domestic issues but also could lead to more cross-border disputes because there is no guarantee that other tax authorities would accept the results.

18. Another possible approach to dispute prevention is conducting simultaneous controls or even joint audits with tax authorities in other relevant jurisdictions to ensure consistent analysis of the facts and law. This can also be a way to build capacity in countries with less experience, as pursued, for example, under the Tax Inspectors Without Borders programme. However, these mechanisms require that there be a bilateral tax treaty, information exchange agreement or other legal instrument that allows the tax authorities to share taxpayer information and to cooperate in these specific manners.

19. Over the past decade or so, there has been increasing private sector and academic interest in the use of mediation for tax disputes. Some countries have reported positive experiences in using mediation as between taxpayers and the tax authorities to resolve domestically disputes before they go to trial. However, most participants did not have much, if any, experience with mediation, making it difficult to draw conclusions regarding its usefulness as compared, for example, to collaborative compliance which has received more positive reactions.

d. *Resolution of tax disputes*

20. With respect to the cross-border issues that have been identified as the most pressing concerns, the primary legal framework providing substantive rules for the allocation of taxing rights is the network of over 3000 bilateral tax treaties. It is important to remember that, while this workstream process addresses situations where disputes arise, the substantive rules included in these agreements provide legal certainty for millions of transactions that take place every day, facilitating cross-border trade and investment.

21. In addition to the substantive rules, tax treaties provide for government-to-government resolution of disputes pursuant to the Mutual Agreement Procedure ("MAP").

Under this process, taxpayers may bring to the attention of the "competent authorities"[15] taxation not in accordance with the rules of the treaty. If a competent authority agrees that there is taxation not in accordance with the convention but cannot unilaterally resolve the case, the relevant competent authorities are to endeavour to resolve the case through a MAP. Under the model conventions and many tax treaties, the competent authorities may also resolve cases of double taxation not addressed in the tax treaty.

22. Some of the most frequent concerns raised by taxpayers regarding the MAP are the fact that the competent authorities are not required to reach an agreement and the length of time it takes to conclude an agreement. They also express concerns about access to MAP. Some countries describe being burdened by the absolute number of open MAP cases (close to 6500 at the beginning of 2023 but declining to just over 6000 at the end).[16] In fact, the size of the inventory may suggest that taxpayers continue to believe that the MAP provides a useful approach to resolving potential cases of double taxation. While some participants in the workstream said that taxpayers prefer domestic court proceedings in their countries because the MAP does not require the competent authorities to reach a resolution, others noted that the MAP is the only way to ensure that the tax authorities of the state of residence will relieve double taxation.

23. OECD statistics[17] regarding the MAP show that taxpayers received either full or partial relief, whether under the treaty or by domestic remedy, in approximately 75% of cases in 2023. Moreover, while a commonly-stated goal is to resolve disputes in under 24 months, the average time to completion of transfer pricing cases was 32.01 months and of other cases was 23.36.[18] This longer period likely reflects the relative complexity of transfer pricing cases. At the beginning of 2023, the inventory included 1042 cases that had been received prior to 2016 or the year in which a relevant party had joined the OECD/G20 Inclusive Framework on BEPs (the "IF"). Of these, 213 were closed in 2023, leaving an inventory of older cases of 813. (One indication of the effect of these older cases on the statistics is that the average time to complete a bilateral MAP with respect to post-2015 cases was 29.46 months for transfer pricing cases and 23.04 months for other cases.) At the same time, 2388 newer cases, received after 2016 or the year in which relevant parties joined the IF, were closed, so that the inventory of such cases declined slightly from 5413 at the beginning of 2023 to 5362 at the end. The statistics include MAP cases where at least one of the parties is a member of the IF. However, a number of IF members indicated that they have not been involved in a MAP case.

24. Many developed countries described the importance of mandatory arbitration as a way to resolve cross-border tax disputes.[19] They noted that the inclusion of such a provision does not result in many actual arbitrations; rather, it creates an added incentive for the competent authorities to resolve cases during MAP in order to avoid arbitration. Developing countries are generally more wary of such provisions. They may have had negative experiences with investor-state arbitration under bilateral investment or other agreements. Some countries may be concerned that their relative lack of experience in the resolution of tax disputes will put them at a disadvantage in arbitration. Another concern

[15] Under the UN Model Tax Convention, the case must be brought to the competent authority of the country in which the taxpayer is are a resident (or in the case of the non-discrimination, a national) while, under the OECD Model, the case can be brought to either competent authority.

[16] https://www.oecd.org/en/data/datasets/mutual-agreement-procedure-statistics.html. The burden is not spread equally, with some countries having substantial inventories while others have only a few.

[17] The OECD statistics include all members that joined the Inclusive Framework prior to 2024.

[18] The 2023 statistics may have been affected by the inability of competent authorities to meet in person during the pandemic.

[19] The OECD Model has included mandatory binding arbitration since 2008. The UN Model added it as an alternative in 2011.

was that the arbitrators may not rely on principles that are ascertainable and known before the arbitration is launched. Some countries seemed open to the idea of exploring ways in which to structure arbitration (for example, determining the composition of panels, so as to enhance transparency, and by providing institutional support mechanisms to ensure a level playing field and facilitate impartial outcomes).

25. At the same time, other countries rejected arbitration entirely, noting that constitutional limits prevent them from settling tax disputes through arbitration. The workstream considered the possibility that mediation of tax disputes might be useful as a substitute with respect to cases involving countries that cannot agree to arbitration, but would have to learn more about whether mediation has been used in government-to-government dispute resolution and, if so, what procedures had been adopted in such cases.

26. While the MAP process, with or without arbitration, resolves many disputes that arise under tax treaties, many countries have limited tax treaty networks but a large amount of cross-border trade and investment. As a result, many of their cross-border disputes are not governed by tax treaties, leaving them without an intergovernmentally-agreed mechanism to resolve any disputes that may arise. In almost every meeting, developing countries returned to this fundamental problem. They encouraged the workstream to consider using the protocol to provide a legal basis for resolving such disputes, at least when the domestic law of each country is sufficiently similar (e.g., when each country uses the arm's length method with respect to transfer pricing). Several countries refused to adopt such an approach, with some stating that they are not permitted to deviate from their domestic law unless a treaty sets out the substantive basis for agreement.

27. Participants also noted that one of the potential strengths of the protocol could be to provide a basis to resolve multilateral disputes.

e. *Possible Scope and Approach to the Protocol*

28. Participants also differed in their views regarding the possible scope of the protocol. Several took the view that the protocol should only serve to resolve disputes arising under the Framework Convention and its protocols. These participants emphasized that the commitment under the Framework Convention should not affect existing obligations regarding resolution of tax disputes, including those that may arise under bilateral tax treaties, free trade agreements, bilateral investment agreements, the General Agreement on Tariffs and Trade, the General Agreement on Trade in Services, the Multilateral Instrument on BEPS and the European Union Tax Dispute Resolution Directive. On the other hand, at least one participant expressed the view that taxpayers already have many means of resolving disputes and indicated that the protocol could help to rationalize and provide a hierarchy for different mechanisms. As noted in paragraph 26, other countries view the protocol as an opportunity to provide a mechanism for resolving cross-border tax disputes in cases where there is no existing tax treaty relationship, while others rejected this possibility.

29. One participant noted that not every possible approach to dispute prevention and resolution is susceptible to multilateral solutions. Therefore, the workstream should consider whether some possible approaches should be addressed through the sharing of best practices rather than obliga- tions in the protocol.

30. The protocol provides an opportunity to provide a series of mechanisms that could

be used in a wide range of situations (a "universal" framework for dispute resolution). However, as not all countries would be equally interested in various provisions, the workstream discussed the concept of optionality within the protocol (noting that the decision whether to become a party to the protocol is also optional). Most countries acknowledged that achieving broad participation may require a level of optionality. If the concept of such optionality by virtue of an opt-in or opt-out to certain mechanisms is acceptable to the INC Plenary, its exact scope with respect to each provision would have to be considered as the protocol is developed.

IV. Issues for the Committee

31. As noted in paragraph 4, the purpose of this note is to provide an overview of the issues; the Workstream III work plan provides that proposed solutions are to be addressed in later notes after the August 2025 Sessions.

32. **The Committee therefore is invited to discuss:**

(a) whether Section III describes the primary barriers to prevention and resolution of tax disputes that Member States encounter;

(b) whether the protocol should address only tax disputes involving cross-border transactions, or whether it might be appropriate to include mechanisms for the prevention or resolution of purely domestic disputes; and

(c) whether the concept of optionality with respect to mechanisms provided in the protocol is generally acceptable to the Committee (with specifics to be elaborated as the protocol is drafted).