POLICY BRIEF

Arbitration and the United Nations Framework Convention on Tax

Risks and lessons from investor-state dispute settlement

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1.0 Introduction

The negotiation of a United Nations Framework Convention on International Tax Cooperation (UN FCITC) represents a significant moment for international tax governance. States are seeking to establish a multilateral framework under the UN to address long-standing coordination gaps in the international tax system. Among the most sensitive elements of this process is the negotiation of a protocol on the prevention and resolution of tax disputes.

There is currently no comprehensive dispute settlement mechanism for international tax matters. Negotiators are exploring a range of options, including the mutual agreement procedure (MAP), as well as less commonly used approaches such as arbitration. This policy brief focuses on the latter, drawing on the International Institute for Sustainable Development's (IISD's) work on investment arbitration and ongoing reform efforts, particularly at the UN Commission on International Trade Law.

Arbitration can take different forms. In tax treaties, arbitration refers to mandatory binding arbitration (MBA), a state-to-state mechanism triggered as a continuation of the MAP. This is distinct from investor–state dispute settlement (ISDS), which is rooted in investment agreements or contracts and enables investors to bring claims directly against states.

ISDS has not yet been explicitly proposed in the UN FCITC negotiations. It has, however, entered the discussion by way of analogy, with some states citing their negative experience of ISDS to argue against the inclusion of MBA. The extent to which these two systems are, in fact, comparable is an issue explored in this brief and a follow-up publication. Moreover, negotiators have not yet specified which forms of arbitration are under consideration, leaving open the possibility of different proposals—including potentially ISDS.

The problems with ISDS, and the rise in tax-related disputes brought for settlement under this mechanism, make it necessary to address ISDS head-on, and at an early stage in the negotiations. This brief therefore has two goals: first, for the avoidance of doubt, it reiterates why ISDS should not—at any stage—be considered for inclusion in the protocol. By cataloguing the problems of ISDS and their implications for tax policy-making, the brief establishes a clear baseline against which negotiators can begin to assess the appropriateness of other forms of arbitration under discussion, notably MBA. Second, it suggests a proactive agenda for the UN FCITC with respect to ISDS, proposing that the Convention should actively discourage ISDS as a means of resolving tax-related disputes arising under, and outside, the Convention.

2.0 Background on the Protocol

The discussion on dispute resolution under the UN FCITC builds on a long-standing approach developed within the UN system. From the 1960s onwards, the UN's approach to tax dispute resolution prioritized sovereignty and administrative cooperation (Hearson & Tucker, 2023). This was reflected in the introduction of the non-binding MAP in the 1980 UN Model Tax Convention, when arbitration was deliberately avoided (UN, 1980). As cross-border tax disputes increased in the 1990s and 2000s, dissatisfaction with the MAP grew, particularly due to power imbalances between treaty partners and prolonged delays in resolving cases (Organisation for Economic Co-operation and Development [OECD], 2015). While the OECD later promoted MBA, notably through the Base Erosion and Profit Shifting process, the UN consistently resisted this approach, favouring alternatives that better reflect developing countries' capacities and concerns (Hearson & Tucker, 2023).

This historical context is important for understanding the current negotiations. In 2022 and 2023, the UN General Assembly mandated negotiations on an FCITC. From the outset, dispute resolution was identified as a core but sensitive issue, particularly for developing countries. Early discussions confirmed that tax disputes are expected to increase under new international tax rules, including those related to the global minimum tax and the digital economy, and that existing mechanisms are not sufficient to manage the expected growth. At the same time, many developing countries expressed strong opposition to the incorporation of MBA, viewing it as a potential constraint on fiscal sovereignty and an approach that could replicate existing power imbalances (Hearson & Tucker, 2023; Oguttu et al., 2025).

Negotiations continued throughout 2024 and 2025 and have revolved around fundamental design questions, including whether dispute outcomes should be binding, the role of taxpayers in dispute resolution processes, transparency requirements, and the appropriate balance between mediation and arbitration. While some delegations continue to advocate for MBA as a backstop mechanism, many countries have reiterated their preference for a staged approach emphasizing dispute prevention, consultation, mediation, and, at most, optional or non-binding arbitration, combined with strong safeguards for sovereignty and the public interest (IISD, 2024; UN, 2025). In opposing arbitration-based mechanisms and MBA, state representatives, supported by civil society organizations, have referred to their negative experience with ISDS as a point of comparison (Paul et al., 2025). Taken together, this suggests that, consistent with past practice, the UN may once again seek to resist the

institutionalization of arbitration in favour of more flexible and cooperative models of dispute resolution. At the time of writing, negotiations remain ongoing, and these issues are still under active consideration.

3.0 What Types of Dispute Resolution Mechanisms Are Being Discussed Under the UN Convention on Tax

The international tax dispute resolution landscape has developed in a fragmented and incremental manner. Rather than a single coherent system, it consists of a combination of procedures (Quiñones, 2022). These include MAPs under tax treaties, MBA, domestic administrative and judicial remedies, ISDS, and, in some specific instances, trade dispute mechanisms.

This section briefly explains the main mechanisms relevant to the current debate. It also presents a high-level comparison between arbitration mechanisms, focusing on MBA and ISDS, to help inform the negotiators on the potential pitfalls of both.

The MAP is the main mechanism under consideration in the negotiations. The MAP allows a taxpayer to bring a case to the competent authority of one or both contracting states when it deems that taxation is not in accordance with a tax treaty. In practice, however, the MAP has faced persistent challenges, particularly for developing countries. Procedures can be lengthy and resource intensive, outcomes are uncertain, and there is no obligation on competent authorities to reach an agreement. As well, the MAP does not ensure consistency in treaty interpretation or application across cases, which can undermine legal certainty for both taxpayers and tax administrations (Taramountas, 2019).

In parallel, arbitration is being discussed, with MBA being its tax variation. MBA was introduced into the OECD Model Tax Convention in 2008 and into the UN Model Tax Convention in 2011. It was also included in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. Under these instruments, arbitration operates as an optional continuation of the MAP and is triggered when competent authorities fail to resolve a case within a prescribed time limit. Unlike ISDS, this form of arbitration does not produce a traditional arbitral award, that is, a binding tribunal decision directly enforceable against a state. Instead, it results in a decision that the states must implement through a mutual agreement within a set period (Maisto, 2023). Many developing countries remain cautious about arbitration in tax matters, citing sovereignty concerns linked to the transfer of interpretative authority over international tax agreements to transnational adjudicators (Hearson & Tucker, 2023). In the context of the Multilateral Convention to Implement Tax Treaty Related Measures, while 107 jurisdictions have signed up, only 32—most of them developed countries—have publicly set out their position through arbitration profiles (OECD, 2025), suggesting an uneven approach to the use of MBA.

Although not yet raised explicitly, arbitration in the form of ISDS could also emerge in the negotiations. At the same time that both the MAP and MBA have been subject to criticism, there has also been a rise in tax-related disputes brought under ISDS. ISDS refers to

international arbitration procedures based on investment treaties or, in some cases, investment contracts. It allows foreign investors to bring claims directly against states for alleged breaches of treaty or contract obligations. ISDS was originally conceived as a mechanism to provide investors with access to a neutral forum, on the assumption that domestic courts in host states might lack independence or impartiality. It was believed that ISDS might "depoliticize" investment disputes. However, what began as a protective mechanism has increasingly been used by investors to challenge a wide range of regulatory measures, including those adopted in pursuit of public policy objectives (Ostřanský et al., 2025). ISDS has drawn several criticisms due to concerns about sovereignty, costs, inconsistency, and constraints on regulatory autonomy or developing countries. These criticisms are elaborated in Section 3.0.

During the protocol negotiations, some states have sought to compare MBA to ISDS, citing their negative experience with the latter to argue against the former. Box 1 and Table 1 present a brief explanation of arbitration as a dispute resolution mechanism and a high-level comparison of MBA and ISDS. This comparison will be further developed and analyzed in a follow-up publication from IISD.

Box 1. What is arbitration, and how do MBA and ISDS differ?

Arbitration is a method of dispute settlement. Broadly speaking, it is a process in which parties agree to submit a dispute to a non-governmental decision-maker rather than to a domestic or international permanent court. These decision-makers issue a binding decision after hearing both sides and applying neutral adjudicative procedures (Born, 2021).

International arbitration can take different institutional forms. Some cases of arbitration are conducted under the rules of an arbitration institution, which may assist with appointing arbitrators and administering the procedure. Others are conducted on an ad hoc basis, meaning that the parties rely only on their own agreements and applicable national arbitration law, without an administering institution.

Importantly, arbitration is not a single or uniform mechanism. Different forms of arbitration exist, depending on who the parties are and the subject matter of the dispute. Common forms include investor–state arbitration (ISDS); MBA in tax treaties; commercial arbitration, which typically involves disputes between private parties arising from commercial contracts; and state-to-state arbitration, used to resolve treaty-based disputes between states, often in areas of public international law.

Table 1. High-level comparison between MBA and ISDS

Feature	MBA	ISDS
Standing and parties	State to state, but taxpayers can trigger the initiation of the process or consent to it.	Investors to state. Investors have direct standing—no requirement to pursue settlement through domestic courts.
Scope	Limited to disputes over the interpretation or application of tax treaties.	Investment agreements (such as bilateral investment treaties), investment contracts, or (rarely) investment laws.
Purpose	Designed to resolve disputes that the MAP cannot settle.	Designed to enforce investment protection in a "neutral" forum for foreign investors.
Enforcement	Implementation is through the tax authorities. Taxpayers can reject the outcome. States can agree on a different resolution.	Decisions are binding and enforceable through judicial mechanisms; no appeal possible.

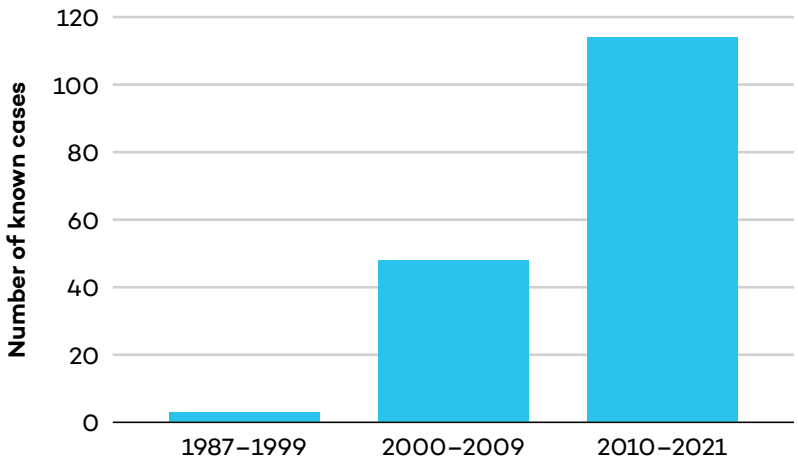
Source: OECD, 2019; Ostřanský et al., 2025; Owens, 2018.

The next section focuses directly on ISDS. It sets out the shortcomings of ISDS and the implications for tax policy-making. The objective is twofold: first, to reiterate, once again, the inappropriateness of ISDS for tax disputes—both under and outside the Convention; and second, to provide a baseline for evaluating other arbitration options under the UN FCITC, notably MBA.

4.0 Why ISDS Is Problematic for Tax Disputes

Tax-related ISDS cases have become increasingly common over the past two decades. Between 2000 and 2021, tax-related claims accounted for about 15% of the 1,190 publicly known treaty-based ISDS cases filed overall (United Nations Conference on Trade and Development [UNCTAD], 2022). Of the 165 tax-related ISDS cases identified during this period, only 51 occurred before 2009, while 114 were initiated between 2010 and 2021. Tax-related disputes under investment contracts have also risen (Morris et al., 2024). The distribution of these cases also reflects broader structural patterns in investment arbitration. Investors bringing tax-related ISDS cases predominantly consist of parties in North America and Western Europe bringing claims against states in South America, Eastern Europe, and Central Asia, and with a growing tendency for claims to challenge multiple tax measures simultaneously (Morris et al., 2024).

Figure 1. Growth of tax-related ISDS cases over time (1987–2021)



Source: UNCTAD, 2022.

Beyond their increase in number, these cases raise fundamental policy and governance issues. This section examines the main structural shortcomings of ISDS to explain why it should not be included as a dispute settlement mechanism under the UN FCITC and why its use to resolve tax-related disputes under and outside this framework should be actively discouraged. These shortcomings can be used as a benchmark against which any arbitration-based alternatives considered for the protocol, including MBA, can be judged.

4.1 Structural Shortcomings

ISDS has been the subject of sustained criticism for many years. While it was originally introduced as a mechanism to protect investors against arbitrary state conduct, its operation in practice has revealed a number of structural shortcomings.

High Costs and Administrative Burden

On average, an ISDS case lasts approximately 3½ years. Participation in ISDS entails substantial financial exposure regardless of the outcome. Legal costs are significant for both parties, rounding off at around USD 4.7 million for states and USD 6.4 million for investors. Successful investors recover costs in roughly 62% of cases, while states do so in only about 52% (Ostřanský et al., 2025).

Compensation awards in ISDS are high and have increased over time. More than USD 100 million has been awarded in over a quarter of all ISDS cases won by investors. In some instances, compensation has amounted to several percentage points of a respondent state's GDP, creating serious fiscal risks (Paparinskis, 2022). The average damages award between 2014 and 2023 was approximately USD 256 million (Ostřanský et al., 2025).

The growing involvement of ISDS in taxation matters makes these financial risks particularly concerning. In *Yukos Universal Limited (Isle of Man) v. Federation of Russia* (2014), for example, the tribunal found unlawful expropriation in relation to the enforcement of a tax assessment and awarded approximately USD 50 billion in compensation (Meerdink et al., 2024; Menon,

2022). More broadly, in publicly known tax-related ISDS cases with available compensation data, the average compensation granted, excluding Yukos, amounts to approximately USD 321 million, with the majority of awards rendered over the past 15 years (UNCTAD, n.d.).

Inconsistent and Unpredictable Decision Making

ISDS has long been subject to legitimacy concerns. One central issue is inconsistency in decision making. Because the system is decentralized and lacks a doctrine of precedent that would bind future tribunals, arbitral panels have interpreted investment treaty obligations in divergent ways, resulting in a lack of predictability.

This unpredictability makes it difficult for states to assess legal risk ex ante and, paradoxically, can encourage additional claims, as investors may perceive greater chances of success in an uncertain system (Ostřanský et al., 2025).

Tribunals have reached different conclusions on whether tax measures constitute indirect expropriation. In *Antoine Goetz et consorts v. République du Burundi* (1999), the withdrawal of tax and customs exemptions was found to deprive investors of the economic value of their investment, amounting to expropriation. A similar conclusion was reached in *Ampal-American et al. v. Arab Republic of Egypt* (2017) concerning the removal of a long-term tax-free zone regime. By contrast, in *Occidental Exploration and Production Company v. The Republic of Ecuador* (2004), the tribunal rejected the claim that refusal to refund the value-added tax constituted indirect expropriation, as the investor had not been substantially deprived of the investment's value.

Opportunistic Use and Regulatory Chill

ISDS is an unbalanced system in which only investors have the standing to initiate claims, while states have very limited possibilities to counterclaim. This structure might create incentives for the opportunistic use of the system, as a government's best-case outcome is often to avoid an adverse award while bearing substantial unrecoverable costs. The mere threat of lengthy and expensive proceedings, combined with the possibility of very high compensation, can place pressure on states to settle disputes or refrain from certain regulatory actions, commonly known as "regulatory chill" (Ostřanský et al., 2025).

Exposure to tax-related ISDS claims has prompted some states to act to avoid a potential regulatory chill. In *Vodafone International Holdings BV v. Republic of India* (2020) and *Cairn Energy PLC and Cairn UK Holdings Limited v. Republic of India* (2020), investors successfully challenged the retrospective application of capital gains tax measures. In *Cairn*, the tribunal awarded approximately USD 1.2 billion in damages. In response, India adopted a new Model BIT explicitly excluding taxation from its scope (Ostřanský & Pérez Aznar, 2021; Pathak & Singh, 2023). This approach has also been followed by several developed countries, including Canada, the United States, Japan, and the United Kingdom (Morris et al., 2024).

Third-Party Funding Encourages ISDS Litigation

The rise of ISDS has been further facilitated by third-party funding (TPF). ISDS has become increasingly attractive to specialized litigation funders, who finance claims in exchange for a share of any compensation awarded. Several features of ISDS make it particularly conducive to this model. States are always respondents and cannot go bankrupt, investment law remains inconsistent but often investor friendly, and compensation awards can be very high. The availability of TPF lowers the financial risk for investors and contributes to an increase in the number of claims filed (Ostřanský et al., 2025).

TPF remains a largely opaque practice in ISDS (Chen, 2024). While several cases are known to have involved TPF, including *Infinito Gold v. Costa Rica, South American Silver v. Bolivia, Cortec Mining v. Kenya*, and *Churchill Mining and Planet Mining v. Indonesia* (Guven et al., 2021), no publicly disclosed examples exist to date in tax-related ISDS cases. However, given the lack of transparency in TPF, its use in such disputes cannot be ruled out.

Vested Interests

ISDS has given rise to an arbitration industry with a vested interest in the continuation of the system. This industry includes legal counsel, arbitrators, arbitral institutions, funders, experts, and associated professional networks. Regardless of the outcome of individual cases, the arbitration industry benefits from the volume, duration, and complexity of ISDS proceedings (Ostřanský et al., 2025). This dynamic has implications for reform efforts, as this interest group is often the most vocal in opposing significant change, frequently framing their positions in neutral terms.

ISDS has long been dominated by a tight-knit, Northern hemisphere–based community of elite law firms and arbitrators. In 2012, reports indicated that legal fees could reach thousands (in USD) per hour, while arbitrator remuneration could amount to hundreds of thousands (Eberhardt & Olivet, 2012). By 2025, publicly known ISDS cases had reached 1,401, with approximately 75% initiated in the previous 15 years (UNCTAD, 2025), suggesting that the arbitration industry has remained active and continued to expand.

4.2 Pursuing a Proactive Agenda on ISDS Under the UN FCTIC

Considering the shortcomings of ISDS, the UN FCITC is a key opportunity for states to actively discourage its use for tax-related disputes, and in doing so draw a clear line between tax dispute settlement and investment arbitration.

Taxation has often been described as the last bastion of unencumbered state sovereignty, closely tied to state capacity and the fiscal contract between governments and citizens (Hearson & Tucker, 2023). ISDS shifts decisions over fiscal sovereignty to a forum not equipped for that purpose, making it a poor fit for tax disputes. In that context, even state-to-state MBA has historically been controversial precisely because it involves ceding judicial sovereignty over the interpretation of international tax agreements to transnational adjudicators.

ISDS goes further. It gives a private actor standing to challenge tax measures through investment protection standards, in proceedings that are not anchored in the cooperative logic of tax treaties and that can generate binding outcomes with significant fiscal consequences. It also suffers from systemic shortcomings, and addressing them requires substantial institutional effort. These issues go to the core of how the system operates and the incentives it creates.

At a minimum, the dispute resolution protocol should include safeguards that discourage recourse to ISDS in relation to tax. States could consider a carve-out clause, following the approach employed in the 2025 UN Model Tax Treaty; this clause clarifies that taxation measures implemented in accordance with the UN FCITC are considered not to breach any other treaties (such as international agreements), and should not be submitted to dispute settlement mechanisms under those other agreements (Michel, 2025).

5.0 ISDS Reform Efforts and Lessons for the UN FCITC

The problems of ISDS have been widely recognized by states across different regions and have triggered a growing number of reform efforts at the national,[1] bilateral,[2] regional,[3] and multilateral levels.

The most significant reform process is taking place under UNCITRAL Working Group III (WG III). UNCITRAL is composed of 70 member states elected by the UN General Assembly for 6-year terms, with membership structured to reflect geographic diversity as well as the world's principal economic and legal systems. In 2017, states placed ISDS reform on the agenda of the UNCITRAL WG III to restore confidence in the system (UN General Assembly, 2017). WG III was initially expected to deliver reforms within 3 years. It is now in its seventh year, with no definitive end date in sight and several core reform questions still unresolved.

The situation that developed with WG III illustrates both the systemic nature of the problems associated with ISDS and, more broadly, how complex it can be for states to negotiate and agree on the design of an international arbitration mechanism.

[1] Alternative treaty models have emerged that move away from ISDS, such as Brazil's cooperation and facilitation investment agreements.

[2] Most developed countries have removed ISDS from investment agreements concluded among themselves (e.g., the EU–Canada Comprehensive Economic and Trade Agreement, the Canada–United States–Mexico Agreement, and the Australia–United Kingdom Free Trade Agreement), but retained it in treaties concluded with developing and emerging economies (e.g., the European Union's Model Clauses with Third Countries [2023], the Canada–Indonesia Comprehensive Economic Partnership Agreement [2025], the Bahrain–Hungary Bilateral Investment Treaty [2023], and the Colombia–Spain Bilateral Investment Treaty [2021]).

[3] The negotiation of the African Continental Free Trade Area Investment Protocol reflects a collective attempt by African states to rethink investment protection and dispute settlement. In parallel, the European Commission has advanced proposals for a standing multilateral investment court as an alternative to ISDS.

Uncertain Implementation and the Risk of Institutional Lock-In

WG III illustrates the risks of adopting a dispute settlement mechanism without clarity on how it will ultimately be implemented. After several years of negotiations, states have not reached an agreement on whether WG III reform outcomes should be operationalized through a single multilateral instrument, an opt-in or opt-out system, or a combination of approaches. This lack of clarity has prolonged discussions and reinforced a status quo bias, as debates continue to revolve around hypothetical implementation scenarios rather than concrete institutional choices.

Similar implementation uncertainties are emerging under the UN FCITC. During the negotiating rounds in Nairobi in November 2025, extensive debate focused on whether dispute prevention and resolution mechanisms should be optional, how optionality could be operationalized in practice, and whether any mechanisms should have a superseding effect over existing arrangements (Paul et al., 2025). These discussions closely mirror the experience of WG III. If an arbitration-based mechanism were incorporated into the UNFCITC, comparable ambiguities around optionality and interaction with other tax dispute settlement mechanisms would likely arise, increasing the risk of overlap, incoherence, and institutional lock-in that would be difficult to correct *ex post*.

Gaps in Expertise and Asymmetric Influence in Negotiations

The difficulties WG III has encountered also highlight how imbalances in expertise and capacity can shape negotiation outcomes. WG III's discussions have often been influenced by delegates and observers with deep familiarity with ISDS, including government officials who work primarily on investment arbitration and actors from the arbitration community. Their technical fluency allows them to frame certain design features as unavoidable or purely technical, making it difficult for less specialized delegations to challenge underlying policy choices.

A similar dynamic could arise in the context of the UN Tax Convention. Most negotiators involved in the discussions on dispute settlement are tax policy-makers rather than ISDS or arbitration specialists. Introducing arbitration into this process risks shifting influence toward those with industry expertise, potentially narrowing the range of options considered and biasing outcomes toward familiar, but problematic, models.

Time, Resources, and Reform Fatigue

The drawn-out debates of WG III also underscore the significant time and resource demands associated with reforming ISDS. WG III was originally mandated to complete its work within 3 years. It is now entering its eighth year, with sessions scheduled through at least 2027. This reflects not only the technical complexity of the issues, but also the political difficulty of reconciling divergent interests within a consensus-based process. Sustained participation requires repeated attendance at lengthy negotiating sessions, substantial technical preparation, and coordination across ministries, which place considerable strain on public resources, particularly for developing countries.

Over time, these pressures can generate fatigue. As negotiations drag on, momentum for ambitious reform weakens, while pressure grows to settle for incremental or least controversial

outcomes. This experience is particularly relevant for the UN Tax Convention, whose negotiations are also scheduled to run for 3 years. As the process enters its second year, the risk of compressed timelines and compromise-driven outcomes becomes more acute. Introducing a complex and contested mechanism such as ISDS would heighten the risk that unresolved design questions are settled in favour of familiar but flawed solutions.

ISDS is not only problematic because of its substantive shortcomings, but also because reforming it once adopted would be institutionally complex, resource intensive, and politically difficult. This underscores why any arbitration-based options under the dispute resolution protocol should be designed from the outset to avoid replicating the features and incentives of investment arbitration.

6.0 Conclusion

Over the past 15 years, investors have increasingly resorted to ISDS to resolve tax-related disputes. This trend has raised concerns among governments and has prompted questions about whether it reflects shortcomings in other tax dispute resolution mechanisms. This remains an open question that requires further examination. As part of our engagement with the UN FCITC process, IISD will focus on this question while examining the experience of parties with MBA, as well as its implications and links with ISDS, to help inform the design of the dispute resolution protocol.

Irrespective of these debates, the UN FCITC should not adopt or replicate an ISDS-based approach. To do so would speed up the transfer of decisions over fiscal matters to a forum not adapted to adjudicate tax policy that also suffers from structural shortcomings, including costly and long processes and inconsistent decision making. The UN FCITC also offers an opportunity for states to discourage the use of ISDS for tax-related disputes more broadly.

Reform efforts under UNCITRAL WG III illustrate how difficult it is to negotiate and agree on an arbitration-based system at the international level. After more than 7 years of discussions, agreements have been scarce, and reform remains limited. It also highlights the need for closer coordination between tax and investment policy communities to better understand the implications of ISDS and to avoid importing its flaws into any arbitration option that may be considered under the UN FCITC or elsewhere. IISD will continue to support this process by fostering dialogue across these two communities and developing knowledge products that promote more coordinated approaches to tax dispute resolution.

The negotiation of the UN FCITC represents a critical moment for the international tax community to address long-standing fragmentation in tax dispute settlement. Rather than opting for ISDS or replicating its shortcomings in a new arbitration mechanism, negotiators should use this opportunity to pursue a more coherent and tax-specific approach to dispute prevention and resolution.

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Cover photo: Chair Ramy M. Youssef gavels INC3 to a close.
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