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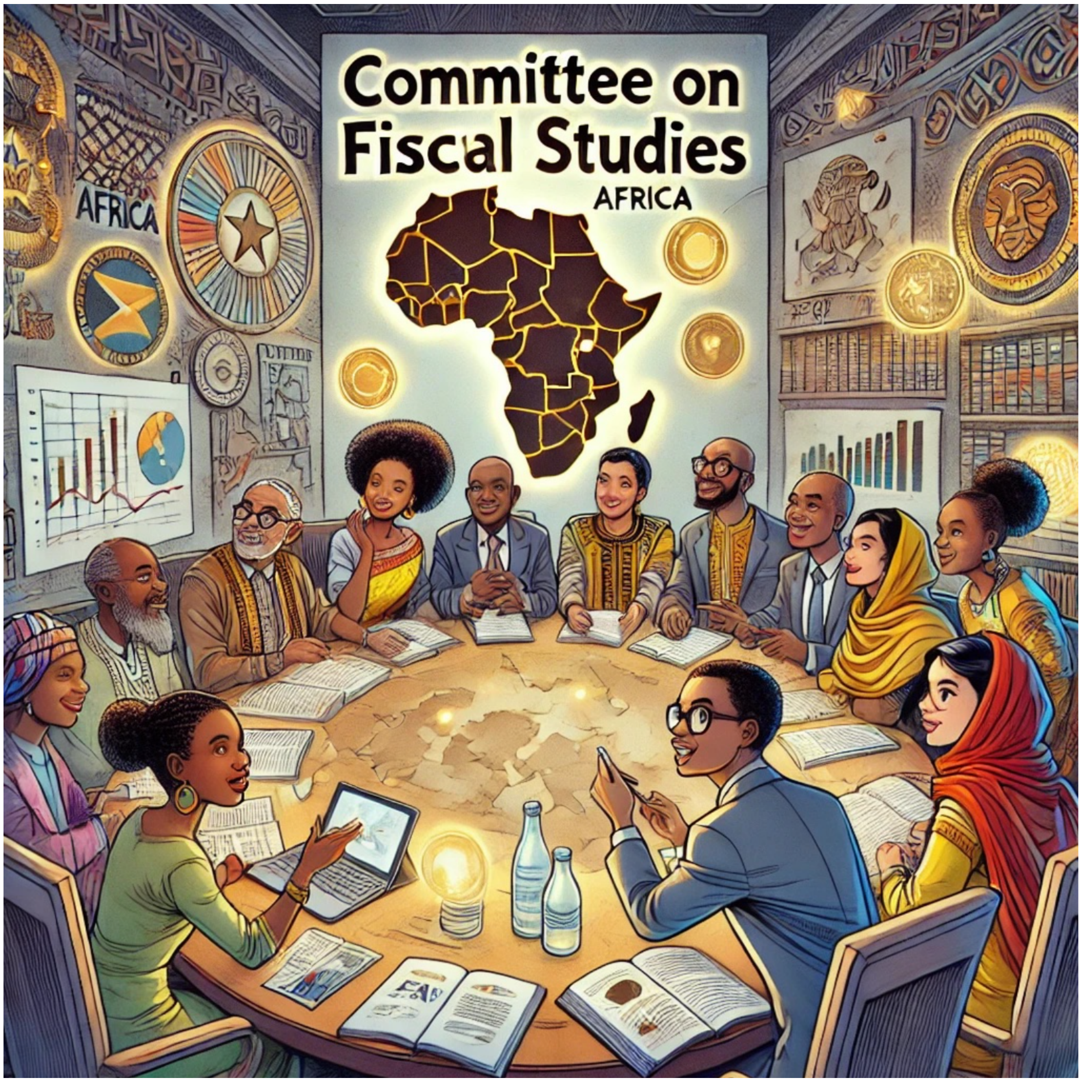

PREVENTING TAX DISPUTES BEFORE THEY ARISE:

Why Protocol 2 Negotiations in Nairobi Matter for African Revenue Mobilisation

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Historic Moment in Nairobi

The third session of the Intergovernmental Negotiating Committee (INC) on the UN Framework Convention on International Tax Cooperation took place in Nairobi this November (2025), marking a significant moment in the global restructuring of international tax governance. For the first time, substantive negotiations on tax cooperation are proceeding through a genuinely inclusive UN process rather than being dictated by OECD frameworks that historically privileged capital-exporting countries.

At the heart of the Nairobi session was Protocol 2 on the prevention and resolution of tax disputes. Whilst this might sound technical and procedural, the stakes could not be higher. How we structure dispute prevention and resolution mechanisms will determine whether developing countries can effectively assert their taxing rights over multinational enterprises or whether they continue subsidising expensive adjudication systems that consistently favour wealthy countries' interpretations of tax rules.

Why Protocol 2 Matters

What happens when Kenya assesses taxes on a Chinese technology platform serving Kenyan users but maintaining no physical presence in the country, or when a Kenyan revenue authority challenges a multinational's transfer pricing that shifts profits to tax havens? These scenarios create cross-border tax disputes that can tie up resources for years, drain millions in legal costs, and frequently result in outcomes that curtail source countries' ability to tax income generated within their borders.

Currently, the primary mechanism for resolving such disputes is the Mutual Agreement Procedure (MAP) embedded in bilateral tax treaties. MAP requires competent authorities from both countries to negotiate toward resolution, but it suffers from several fundamental problems. First, many African countries have limited treaty networks, leaving them without any dispute resolution mechanism when conflicts arise. Second, MAP procedures are notoriously slow, with cases taking years to resolve. Third, and most critically, competent authorities have no obligation to actually reach agreement, meaning disputes can remain unresolved indefinitely.

Some developed countries have pushed for mandatory arbitration as the solution, arguing it provides certainty and timely resolution. But this misses the point. International tax arbitration has consistently produced outcomes favouring residence-based taxation and narrow interpretations of source-country taxing rights. When arbitrator pools are drawn predominantly from capital-exporting jurisdictions and from professionals serving multinational enterprises, systemic bias becomes structural rather than incidental. Moreover, arbitration costs millions of dollars that African countries could otherwise spend on schools, hospitals, and infrastructure.

What the INC Asked Member States to Address

The Co-Leads released a detailed Concept Note outlining key questions for member state consideration. These included:

- On optionality: Should the protocol offer a menu of mechanisms that countries can choose from rather than mandating specific procedures? How can optionality balance broad participation with legal certainty? What prevents countries from strategically selecting only mechanisms that favour their interests whilst rejecting those requiring real commitments?
- On scope: Should the protocol cover only cross-border tax disputes, or also purely domestic disputes? What exactly constitutes a "cross-border tax dispute"? Can the protocol address situations where two countries have no bilateral tax treaty at all?
- On prevention versus resolution: What mechanisms can prevent disputes from arising in the first place? Should prevention receive equal weight with resolution, or should it be treated as merely aspirational?
- On dispute resolution mechanisms: Should the protocol strengthen existing MAP procedures? Should it include mandatory arbitration, or only optional arbitration with safeguards? What about alternative mechanisms like mediation or conciliation?
- On institutional frameworks: What role should the United Nations play in supporting dispute prevention and resolution? Should there be a permanent UN body providing administrative support, maintaining arbitrator rosters, and developing best practices?

These questions might appear purely procedural, but each implicates fundamental choices about power, resources, and whose interests the international tax system serves.

The CFS Perspective: Prevention Must Be Primary

In our submission to the INC, the Committee on Fiscal Studies argued that the current framing inverts proper priorities. The Concept Note treats prevention as secondary to resolution, suggesting that states should focus on resolving disputes after they arise rather than preventing them from crystallising in the first place.

This gets the legal architecture backwards. The Vienna Convention on the Law of Treaties establishes that treaties must be performed in good faith. This good faith obligation extends beyond merely remedying breaches after they occur; it encompasses the prior duty to prevent disputes through proactive cooperation. The International Court of Justice has consistently held that procedural obligations requiring consultation and cooperation constitute independent legal obligations, not merely preliminary steps to substantive compliance.

Prevention must be structured across three tiers. The first tier comprises mandatory information exchange with binding technical and financial assistance provisions. African revenue authorities cannot prevent transfer pricing disputes if they lack access to comparable transaction data or information about multinationals' global value chains. But information exchange cannot mean one-way flows where African countries provide intelligence about their economies whilst receiving limited actionable information in return. Developed countries seeking information from African revenue authorities must fund the technological infrastructure enabling such exchange, provide ongoing technical support, and commit to responding to African countries' information requests within specified timeframes with penalties for non-compliance.

The second tier establishes proactive cooperation mechanisms including simultaneous tax examinations, joint risk assessments, and advance consultation procedures. These mechanisms allow competent authorities to identify and resolve contentious issues before they crystallise into formal disputes requiring expensive resolution proceedings. However, these mechanisms require administrative capacity that many African revenue authorities do not currently possess. Protocol 2 must therefore make such mechanisms voluntary until sustained capacity development support enables effective participation.

The third tier comprises binding advance resolution mechanisms like multilateral advance pricing agreements. These prevent disputes by establishing agreed methodologies prospectively rather than fighting over them retrospectively. But African countries must not be locked into unfavourable outcomes negotiated when they lacked full information about multinational value chains. Protocol 2 must include sunset provisions allowing renegotiation, unilateral withdrawal rights where circumstances change materially, and voidability where agreements were obtained through incomplete or misleading information from taxpayers.

The No-Treaty Problem: Digital Economy Taxation

One of the most contentious issues concerns what happens when two countries have no bilateral tax treaty but a dispute arises. This is not a hypothetical concern. Many African countries have limited treaty networks. When a dispute arises with a country with which they have no treaty relationship, existing frameworks provide no resolution mechanism.

This problem becomes acute with digital economy taxation. For instance, Kenya and China have no bilateral tax treaty addressing digital services. A Chinese technology platform serves Kenyan users, collects data on Kenyan consumers, and derives revenue from Kenyan advertisers whilst maintaining no physical presence in Kenya. Kenya amends its domestic law to assert taxing rights over digital services provided to Kenyan users regardless of physical presence. China objects, arguing that without a bilateral treaty, Kenya lacks jurisdiction to tax a Chinese company with no permanent establishment under traditional international tax principles.

This creates a genuine cross-border tax dispute arising not from differing interpretations of a shared treaty but from the absence of any agreed framework allocating taxing rights. Does Protocol 2 address such situations? If so, what substantive law would dispute resolution mechanisms apply when no treaty establishes the legal framework?

We proposed that Protocol 2 should distinguish three categories of no-treaty disputes. Category A covers disputes regarding digital economy taxation falling within Protocol 1's scope where both countries are parties to that protocol. In such cases, Protocol 1 provides the substantive law and Protocol 2 provides resolution mechanisms. Category B addresses other cross-border disputes where both countries are Framework Convention parties but have no bilateral treaty. Here, the Framework Convention's Article 4 principle that source countries have taxing rights where value is created provides the substantive standard, but submission to Protocol 2 mechanisms requires both countries' agreement. Category C covers situations where at least one country is not a Framework Convention party, leaving domestic judicial systems to govern.

This framework preserves sovereignty whilst providing international alternatives where both parties agree. Critically, Protocol 2 must explicitly preserve domestic judicial jurisdiction. The case between Barbados and Trinidad and Tobago that ultimately reached the Judicial Committee of the Privy Council demonstrates that domestic courts can and do resolve international tax disputes absent bilateral treaties.

Preventing Discriminatory Optionality

The Concept Note correctly identifies that broad participation requires optionality, allowing countries to choose mechanisms suited to their legal systems and capacities. But optionality without safeguards creates problems. Powerful countries might agree to apply certain mechanisms with some partners whilst denying equivalent mechanisms to others facing comparable disputes. This selective application violates the good faith obligations under the Vienna Convention and reproduces the asymmetries that necessitated this UN process in the first place.

Protocol 2 should include a "comparable treatment clause" establishing that once a country accepts a mechanism with any partner for a particular dispute type, there exists a rebuttable presumption that the same mechanism is available to other parties with similar disputes. Countries can rebut this presumption by demonstrating material differences justifying different treatment, but they must provide written justification subject to review by a designated body.

This preserves sovereign choice regarding which mechanisms to adopt whilst ensuring that once adopted, mechanisms are made available on a non-discriminatory basis. It prevents wealthy countries from cherry-picking mechanisms that serve their interests whilst declining those that would benefit developing countries.

Rejecting Mandatory Arbitration

Many developing countries, including most African states, have rejected mandatory arbitration. This rejection rests on solid ground. International tax arbitration has systematically favoured restrictive interpretations of source-country taxing rights. Even when individual arbitrators maintain personal impartiality, the composition of arbitrator pools creates structural bias. When arbitrators are drawn predominantly from capital-exporting jurisdictions and from professional practices serving multinational enterprises, interpretive frameworks inevitably privilege residence-based taxation.

Furthermore, arbitration costs create asymmetric barriers. Legal fees, arbitrator compensation, expert witnesses, and administrative expenses can run into millions of dollars. African revenue authorities with limited budgets cannot afford to arbitrate every significant dispute, meaning many legitimate claims go unpursued. When developing countries do arbitrate, resource constraints may prevent effective case presentation.

The experiences with investor-state dispute settlement (ISDS) under bilateral investment treaties provide cautionary lessons. ISDS arbitration has systematically curtailed developing countries' regulatory sovereignty, imposed massive damages for legitimate policy measures, and created chilling effects preventing welfare-enhancing regulation. Several developed countries have themselves moved away from ISDS, recognising its deficiencies. Protocol 2 should learn from these experiences rather than reproducing them in the tax context.

Instead of mandatory arbitration, Protocol 2 should establish mediation and conciliation as the primary dispute resolution mechanisms beyond mutual agreement procedures. These mechanisms cost less, preserve state sovereignty by ensuring no solution is imposed without consent, enable consideration of broader context including fiscal situations and development priorities, and allow creative solutions better serving both parties' interests. Where countries mutually agree to arbitration, safeguards must ensure balanced arbitrator selection with at least half drawn from developing countries, interpretive principles explicitly recognising that source-country and residence-country taxing rights have equal status, and equitable cost allocation with least developed countries bearing minimal costs.

A UN Tax Dispute Resolution Centre

Protocol 2 should establish a UN Tax Dispute Resolution Centre to maintain rosters of qualified mediators, conciliators, and arbitrators; provide administrative support for proceedings; develop and publish best practices for dispute prevention; provide technical assistance to countries building capacity; maintain public databases of resolved disputes; and prepare annual reports for the Conference of States Parties.

Critically, the Centre must be governed by a board with majority representation from developing countries, balanced regional representation, and membership including not just government tax administrators but also judicial officers, academics, and civil society representatives. This ensures that the institutional culture prioritises development objectives and recognises diverse national circumstances rather than merely replicating OECD frameworks with a UN label.

Why This Matters for Africa

The choices made in Protocol 2 will determine whether African countries can effectively mobilise domestic resources through taxation of multinational enterprises or whether they continue losing billions annually to profit shifting, transfer pricing manipulation, and strategic treaty shopping.

African countries lose an estimated USD 88.6 billion annually to illicit financial flows, with tax-related outflows comprising a substantial portion. When multinationals shift profits to tax havens whilst maintaining genuine economic activity in African markets, this is not merely an abstract technical problem. It represents resources that could fund education, healthcare, infrastructure, and social protection systems.

Effective dispute prevention and resolution mechanisms are essential for domestic resource mobilisation. If African revenue authorities know that asserting their taxing rights over multinational income will lead to protracted disputes, expensive arbitration proceedings, and outcomes that consistently favour multinational positions, they will be discouraged from enforcing their tax laws. Conversely, if Protocol 2 establishes prevention mechanisms that reduce disputes, resolution procedures that African countries can afford to access, and institutional frameworks ensuring balanced representation, it will strengthen African countries' ability to tax income generated within their borders.

This connects directly to sustainable development financing. The Addis Ababa Action Agenda recognised that domestic resource mobilisation is foundational to financing the Sustainable Development Goals. International tax cooperation either supports or undermines this objective depending on whose interests it serves. Protocol 2 represents an opportunity to ensure that dispute prevention and resolution mechanisms support rather than constrain African countries' domestic resource mobilisation.

Looking Forward

The negotiations in Nairobi demonstrated both progress and persistent challenges. There is genuine willingness to consider alternative approaches to the OECD-dominated frameworks that have governed international tax cooperation for decades. The fact that these negotiations occurred in Nairobi rather than Paris or Geneva carries symbolic and substantive significance.

However, powerful countries' representatives continue pushing for mandatory arbitration despite developing countries' clear rejection. Technical discussions about "optionality" and "core mechanisms" can obscure fundamental questions about power and whose interests are served. The challenge for African negotiators and civil society is to ensure that the technical architecture ultimately adopted actually serves African countries' interests rather than merely providing procedural fig leaves for substantive outcomes favouring wealthy countries.

Protocol 2 will not solve all the problems in international taxation. But if properly structured with prevention as the primary obligation, safeguards against discriminatory optionality, rejection of mandatory arbitration in favour of mediation and conciliation, and institutional frameworks ensuring Global South representation, it can contribute meaningfully to African countries' ability to mobilise domestic resources through fair taxation of multinational enterprises.

The negotiations continue. African countries must engage actively, informed by rigorous analysis of how procedural choices affect substantive outcomes. The Committee on Fiscal Studies remains committed to supporting negotiators with the technical expertise and policy analysis necessary to ensure that the UN Framework Convention serves humanity's interests.