

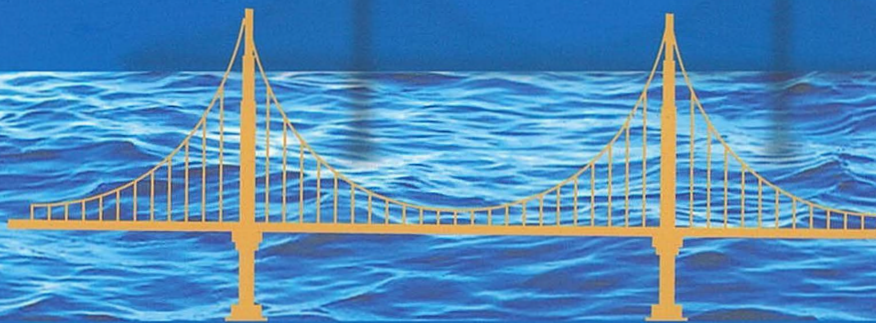


BRITACOM Special Edition

BUILDING A GROWTH-FRIENDLY TAX ENVIRONMENT

In Collaboration with

*INTERNATIONAL
TAXATION IN CHINA*



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Belt and Road Initiative: Removing Tax Obstacles and Strengthening Cooperation for Investments to Deliver Growth and Development

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Introduction

The Belt and Road Initiative (BRI) is a pioneering initiative that involves investment flows from East to West and between countries of the Global South. This represents a major shift in international investment flows, the most significant since at least the 17th century, and certainly since the First World War. By changing the traditional paradigm of the West as the primary source of capital and ideas, and the direction of international investment and technology flows from the Global South, the BRI initiative represents

a major shift in global economic relations.

The initiative is also remarkable in the way it has sought to involve a mix of public and private sector capital, with the Chinese government providing the strategic direction while the main source of investment capital is private sector institutions. Another pioneering measure has been the adoption of international best practices in procurement and environmental standards, where approaches developed by the World Bank Group are reported to have been widely utilized. While there are some questions about

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3 The authors would like to thank Messrs. Dave Hartnett, Jim Robertson, and Douglas Townsend for their review and comments. The authors, however, assume full responsibility for the content of this paper, including any errors and/or omissions.

the dominance of Chinese firms in the contracts awarded, the research shows that a number of Western firms have won sizeable contracts and investment concessions.⁴

BRI represents an opportunity for many developing countries to develop infrastructure, and to build more integrated transport, energy and information infrastructure networks. Infrastructure is needed to both attract investment and meet the requirements of growing populations. BRI policies enhance opportunities for investment by both large Chinese companies and for SMEs in both China and the BRI countries. By emphasizing the need to both revive ancient trade routes and develop capacity in new routes, the initiative also creates conditions for better trade. Simultaneous connectivity growth and upgrading infrastructure thus provide an opportunity to accelerate growth in developing countries.

However, BRI requires stronger policy coordination to ensure that the benefits of this enhanced economic and physical relationship are not constrained by inconsistencies in market access, tax, environmental, labor and safety policies. There is some high-level cooperation on environmental issues and adoption of environmental standards in contracting; the broad perception is however that investments in BRI are largely driven by commercial concerns. And while BRI countries are also addressing (in varying degrees) the need to lower barriers to trade and investment, there is perhaps a lesser degree of urgency with regard to these other areas. Since the International Tax and Investment Center (ITIC) is primarily concerned with tax and investment issues, this paper will focus on tax issues in BRI.

Tax Principles

ITIC has long considered that a country's best trade policy is its tax policies. Tax should not be a political weapon between BRI nations, nor a barrier to closer trade and investment relations. An important part of tax policy should be to

provide certainty to all potential investors and taxpayers, including BRI investors, so they have some confidence at the planning stage about the levels of tax they will be paying after the project has begun and income flows begin.

Although BRI countries will be concerned to collect the right amount of tax prescribed by their domestic law, they should also be careful not to create barriers to investment through BRI. The priority should be to look at practical solutions to remove complexities and compliance burdens on tax administrations and taxpayers. BRI countries should be looking at ways to create a favorable investment climate without giving up too much tax revenue, and without placing burdens on tax administrations with scarce resources.

Collaboration between the tax administrations of BRI countries can lead to the pooling of skills and expertise on tax collection and initiatives to strengthen national tax rules in areas such as withholding tax, transfer pricing and dispute resolution to ensure that a fair amount of tax is collected. Through international cooperation within a Global South context, tax administrations in BRI countries can improve the efficiency and enforcement of domestic tax laws while maintaining an enabling environment for better trade and investment, strengthening cooperation in tax collection and management capacity building. They can also cooperate at global forums such as the UN and the OECD's Inclusive Framework to influence the international tax system to implement growth-friendly tax policies. They can improve their bilateral double tax treaty networks to modernize the provisions for exchange of information and tax collection with their treaty partners.

Owing to the diversity of tax policy and systems among BRI countries, there is a need for coordination and cooperation on tax policy. It is suggested that these approaches should be guided by a set of agreed principles that BRI countries can consider as sovereign states in making

⁴ Tania Ghossein, Bernard Hoekman and Anirudh Shingal, *Public Procurement in the Belt and Road Initiative*, MTI Global Practice, DISCUSSION PAPER No. 10; December 2018, The World Bank Group, Washington, DC.

their policy choices. Thus, BRITACOM should consider articulating a set of principles for tax policy and administration. While the principles would be voluntary in nature, cooperation between tax administrations can take into account these principles.

ITIC's *Principles for Developing Countries Hydrocarbon Investment Policies* was published as a part of the World Bank's *EISource Book*⁵. Parts of this document and ITIC's *Tax Policy Tenets* are examples for the BRI Tax Principles.

Tax Policy Considerations in BRI

The starting point for such a set of principles must be to recognize tax policy heterogeneity in BRI countries. These countries are at different stages of economic growth and political development; they have different national tax laws, legal traditions, history and capacity within their tax administrations. Further, the policy principles must recognize the sovereign status of BRI countries to make the best choices for their people. One size does not fit all. And while it is tempting to consider the example of the European Union, which has done significant work in developing common tax rules⁶, the circumstances in BRI countries are very different. Within those parameters, the policy principles with regard to domestic tax policies should take into account the following:

- The need to encourage investment, growth and development.
- Rule of Law and the abiding principles of good tax policy – equity and fairness (similarly situated taxpayers should be taxed similarly).
- Certainty and simplicity in administration.
- The need for consistency with international standards, while recognizing the relative capacity of tax policy and administration resources in most BRI countries.
- The need to take measures that build confi-

dence across BRI nations, perhaps starting with small, practical measures.

An important step has already been taken in respect to establishing a set of tax principles. The Astana Proposal⁷ includes the aim to strengthen the construction of the taxation rule of law; enhance the consistency and certainty of taxation policies; and promote high standards of law enforcement. If the rule of law is upheld, this means that the law applies equally to all and that the law is certain. The taxpayer can therefore have some certainty that the tax law will be applied in practice and this should bring more certainty to the tax consequences of particular transactions. The tax administration, as well as taxpayers, need to be accountable under the law. The laws need to be clear, stable, and available to the taxpayers. Additionally, reliable, independent, and transparent mechanisms are needed to resolve tax disputes.

Tax policies should also seek to find a balance between (1) the need to raise revenue to fund government expenditures and investment for development needs and (2) the need to have a welcoming environment for investment and growth. This does not necessarily mean the granting of tax incentives and exemptions for foreign investment; it may be that simple, stable rules for characterization of income and withholding taxes are more important. VAT/GST rules should be applied consistently and without discrimination to domestic taxpayers and residents of other BRI countries; the application of VAT refunds and credits should be made in a fair and timely manner. Also, rules that discourage illicit trade are of critical importance in indirect taxation.

On the fourth point, the current international tax policy environment is already replete with significant initiatives. Such measures include the G20/OECD Action Plan for Base Erosion and Profit Shifting (BEPS)⁸, the Com-

5 See <http://www.eisourcebook.org/>.

6 EU tax directives benefit all member countries, which still retain their tax sovereignty. In addition to harmonization of customs duties and VAT, examples would be the EU directives on Parent & Subsidiaries, Interest & Royalties, Mergers and Mutual Assistance.

7 Astana Proposal by BRITCC Participating Jurisdictions for Enhancing Cooperation in Tax Matters.

8 See <http://www.oecd.org/ctp/beeps-2015-final-reports.htm>.

mon Reporting Standard (CRS)⁹ and national policy measures such as FATCA¹⁰, and other initiatives concerned with raising revenue for investment to achieve the SDGs¹¹. While it is necessary to maintain consistency with these standards, it is also perhaps appropriate to consider whether a more pragmatic approach is possible within a Global South initiative such as BRI. Countries should therefore consider BRI as a mechanism through which the strengthening of international tax rules and guidelines can take place without necessarily adding layers such as BEPS.¹² Simplicity and clarity of tax laws helps the taxpayer to understand the laws and avoid tax disputes; they also enable tax administrations to assess and collect tax without exceeding available resources.

On the fifth point, there is probably some immediate scope to leverage the BRI mechanisms on trade to develop some initial cooperative mechanisms in taxation. For example, the discussion on trade would necessarily include tariff classifications. It would perhaps be worthwhile to consider using harmonization of classifications for both trade and internal tax (i.e., VAT/GST and excise) purposes. Similarly, another early starting point could be to consider a harmonized classification of services for VAT/GST purposes across BRI countries, as these would have immediate impact on BRI-related projects which necessarily involve a significant amount of cross-border services. A third area to consider might be working on an agreed “place of supply” rule for VAT/GST purposes.

The above measures, along with the necessity of working through arrangements with a number of countries to facilitate BRI, could also create some opportunities for simplification of taxes and tariffs. As policies are coordinated,

many of the developing countries involved in BRI may be able to see the real value of tax simplification based on the suggested BRI tax principles. Such simplification will allow developing countries with limited capacity for tax administration to focus on the highest risk areas for themselves.

Finally, policy re-examination in preparation for BRI may also be an opportunity to develop new tax and tariff structures that will drive efficiencies and attract investment. These steps will result in the BRI countries becoming more competitive and attractive for all investors, foreign and domestic alike.

Tax Treaty Networks to Build BRI Tax Relationships

Double tax treaties are the primary mechanism for countries to allocate taxing rights between them and to provide for relief from double taxation. They also provide for neutral treatment of taxpayers, exchange of information and, in some treaties, assistance in the collection of taxes. While some BRI countries have an extensive network of double tax treaties, other countries are still working to expand their number of treaty partners. An important question both for the number and quality of tax treaties concluded is the extent of resources available to the tax administration, including the number of staff available for involvement in international tax and treaty negotiation and the skills/experience available to ensure a thorough and consistent application.

Many of the countries involved in BRI, including China itself, base their treaty negotiation position on the UN Model¹³. The UN Model tax convention is available for reference in negotiating and implementing double tax treaties.

9 OECD’s Common Reporting Standard, see <http://www.oecd.org/tax/automatic-exchange/common-reporting-standard>.

10 US Foreign Account Tax Compliance Act, see <https://www.irs.gov/businesses/corporations/foreign-account-tax-compliance-act-fatca>.

11 Sustainable Development Goals, see <https://www.un.org/sustainabledevelopment/sustainable-development-goals/>.

12 It is estimated that the BEPS guidance alone now amounts to 1500 pages of text on standards to be achieved.

13 UN Model Tax Convention between Developed and Developing Countries, see: https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf.

For the UN Model, the issue of fair taxation by the source country of income arising in its territory is an important concern. Further, there is guidance in the UN Practical Transfer Pricing Manual¹⁴ that can help in implementing existing domestic law or drafting new legislation to protect the tax base against base erosion and profit shifting. With so many nations basing their treaty structures on the UN Model, there is already a baseline of experience and practice on which to build further cooperation.

The coordination of international tax rules between BRI countries can follow the principles determined in their national tax law with the double tax treaties as the basis for cooperation between the tax administrations. Since extensive research on treaty networks of BRI nations was presented at the Astana meeting, this paper will avoid covering the same ground. It is useful to mention, however, that BRI countries can take into account the agreed principles above as they expand their bilateral tax treaty networks to protect the tax base, provide more tax certainty for taxpayers, and provide a legal framework for companies to apply for the Mutual Agreement Procedure (MAP).

Tax treaties are concluded with the objective of eliminating double taxation, providing certainty to foreign investors, and setting out procedures to minimize tax disputes and resolve them if possible. In addition to providing the legal basis for administrative assistance among tax authorities, tax treaties also provide a basis for exchanging tax information. They provide the framework for tax authorities to cooperate in countering non-compliance, profit shifting and base erosion. It is worthwhile to consider in the context of the BRI initiative whether tax treaties can create a legal framework for cooperation between the tax authorities.

Although considerable resources are needed by tax administrations to negotiate tax treaties, they should build up treaty expertise and capacity of the whole tax administration at the same

time. The limited resources need to be taken into account before commencing treaty negotiations and countries should also realize that they must have sufficient resources to implement the treaty provisions when they are agreed with the treaty partners. BRITACOM should additionally consider what support can be provided by the more advanced tax administrations within the BRI countries to share expertise on treaties. Further, they may consider how BRI-specific issues could be included in treaty frameworks, perhaps through an additional Model Protocol to treaties that BRI countries can use to negotiate specific agreements on a bilateral basis.

As part of this, BRI countries could consider setting out a policy rationale, including an economic analysis using the above BRI Tax Principles, to explain what the country considers desirable policy goals that can be achieved by extending the treaty network and identifying potential treaty partners. Consultation with businesses operating or intending to operate in the country and with other interested parties should be carried out beforehand. Based on the conclusions from these consultations, the respective Ministries of Finance/Tax Authorities can draft the type of provisions to be included in the treaty. Each country could consider drafting its own model treaty to form the basis of tax treaty negotiations.

Tax Administration Issues

The Astana Proposal notes that by improving taxpayer services, a tax administration can protect the rights of taxpayers; promote tax compliance; and reduce the cost of tax collection. Improved taxpayer services can create an improved business environment and facilitate investment flows. Taxpayer services can be improved by capacity building within the tax administration and further development of digital services, both for tax returns and assessments and dissemination of information and guidance for taxpayers. This should include standardization

14 UN Practical Manual on Transfer Pricing for Developing Countries, see <https://www.un.org/development/desa/capacity-development/tools/tool/united-nations-practical-manual-on-transfer-pricing-for-developing-countries-2017/>.



of tax dispute settlement procedures and improvement of tax dispute mechanisms. This can improve the effectiveness of the tax dispute settlement mechanism and improve tax certainty.

Further digitalization of tax administration services can help to improve services to taxpayers and educate and inform taxpayers through online information and communications. It can also increase the efficiency of processing tax returns and thereby facilitate the process of assessing tax. It will also reduce opportunities for actual or perceived corruption by the staff of tax administrations. Intra BRI cooperation, and sharing of technology solutions, knowledge and peer experiences can greatly improve digitalization and reduce compliance costs. The latter can be achieved by reducing the compliance costs of submitting and processing tax returns. Digitalization opens up new opportunities to check the validity of returns, cross-check from third party data and analyze the tax gap. BRI countries could again start from the trade-related procedures (e.g., Single Window Clearance), move to the settlement of import VAT/GST/excise issues, and then progress towards a more cooperative relationship amongst BRI countries based on the above principles.

Mutual Agreement Procedure (MAP) negotiations between tax treaty partners help multinational corporations avoid double taxation and tax discrimination. China has signed more than 100 tax treaties or arrangements and its treaty partners can use treaty provisions to enhance certainty for taxpayers in the dispute reso-

lution process. This requires enforcement of domestic law provisions in relation to tax dispute resolution and may require further tax administration capacity building to ensure that the MAP process is available to taxpayers and functions correctly. Currently, tax officials do not always understand the MAP and are reluctant to accept applications from taxpayers for dispute resolution under the process. Tax authorities in various BRI countries are faced with the challenges of insufficient professional skills, limited resources, a large backlog of MAP cases, and the need to improve laws and regulations. BRITACOM can play the role of the catalyst in sharing peer experiences in prioritizing tasks and building capacity and cooperative efforts to solve these constraints.

The OECD's Base Erosion and Profit Shifting (BEPS) project is monitoring the efficiency of MAP procedures among countries and participating countries must implement improvements to tax dispute resolution procedures and accept peer reviews by the OECD. Countries are participating through the Inclusive Framework to improve mechanisms for tax dispute resolution. China, as a G20 nation, can help other BRI countries navigate the peer review process.

Some taxpayers lack a technical understanding of tax treaties, not knowing how to protect their rights and interests through MAP, and therefore do not initiate MAP applications. If national laws lack clear regulations on the specific MAP application requirements, it is difficult for the taxpayers to prepare the documentation required in support of an application. After

a MAP case is concluded there may be delays with implementing adjustments or refunding tax. Tax administrations need to improve taxpayer education and issue guidance to clarify the requirements for a MAP application. Therefore, the BRI countries need to further strengthen cooperation in the taxation field, improve procedures, establish a rapid solution mechanism for MAP, increase staff numbers and professionalism, and effectively remove obstacles for cross-border investment.

BRI countries need to promote the negotiation of bilateral or multilateral Advanced Pricing Agreement (APA) to provide enterprises with tax certainty. This involves putting in place the relevant double tax treaty provisions and mutual agreement procedures. An APA can give taxpayers certainty on the tax consequences of specific transactions for some years into the future and can therefore facilitate long-term planning and tax certainty. Before implementing APAs, the tax administration must have adequate resources in place. BRITACOM could consider the development of a model APA for use in BRI countries.

Tax administrations in BRI countries can benefit from cooperation with the leading countries in capacity building to increase their ability to protect the tax base and implement the MAP as noted above. Finally, the BRI mechanism can help them improve taxpayer services and guidance, the implementation of further technology to facilitate the tax return, and assessment process and tax dispute resolution.

Conclusion

Current BRI investments are large-scale, long-term infrastructure projects that will result in further foreign investment facilitated by the improved infrastructure development. BRI also has the potential to advance many of the SDGs. BRITACOM has an important role to play in ensuring that tax policies in BRI countries do not become a constraint in that investment, but rather stimulate investment, growth, and development. This can be based on tax policy principles developed through the BRITACOM process that are then implemented by each country,

taking into account its current situation.

At the same time, BRITACOM can help BRI nations achieve their tax capacity development needs to collect the correct amount of tax from businesses operating in the BRI while creating a favorable climate for foreign investment. Tax administrations need to collect tax according to international standards of neutrality and non-discrimination and provide procedures for relief of double taxation and tax dispute resolution. This requires cooperation between tax administrations of BRI countries and the conclusion of an appropriate network of double tax treaties containing the relevant provisions. This paper has presented a set of ideas on how these can be achieved.

Further, capacity building will be required within tax administrations to improve the efficiency of tax compliance procedures, negotiate and implement tax treaties, operate effective dispute resolution procedures, and exchange tax information with other tax administrations. Cooperation between tax administrations in BRI nations can promote capacity building and improve cross-border information exchange, tax collection, and dispute resolution procedures. Again, this paper has presented some ideas on how this can be achieved.

ITIC stands prepared, within its current mandate and with its extensive experience in tax policy and administration issues in key BRI nations such as Kazakhstan, Myanmar, Malaysia and many African and Arab countries, to support the BRITACOM process. ITIC has more than 20 years of experience organizing regional workshops on tax and investment policies where countries share experiences with their peers to gain insight in the latest developments in tax policy and administration. ITIC could develop regional tax forums around BRI Tax Cooperation to share thoughts and experiences and advance the policy goals expressed above. To that end, we would propose that a concrete work program be designed at BRITACOM with working parties to focus on each of the above areas. Such a work program could then develop specific outputs and execute on the tasks to the extent of resources available.