investment in communication links (road, rail and shipping) and new opportunities for cooperation in the areas of energy, transportation, agriculture and manufacturing.

The emphasis will be to develop an open, inclusive relationship between countries recognizing that civilization thrives when trade growths. The Belt and Road summit for international cooperation (BRF) held in Beijing on 14–15 May 2017 brought together over 100 participants and emphasized that promoting trade, FDI and innovation will be three of pillars of this initiative, which is also seen as supporting the 2030 agenda for sustainable development.

At a time when the world is experiencing political and economic uncertainty and when the US is withdrawing from a multilateral and interconnected world, the hope is that by bringing countries together this initiative will encourage mutual respect, harmony and will provide a much-needed boost to global growth and inclusive development.

Achieving this vision will require billions of dollars of investment in infrastructure and the development of new manufacturing centres. The need for such investment was one of the reasons that led the Chinese government to create the Asian Infrastructure Investment Bank (AIIB), one of whose first actions was to set up 'The Silk Road Infrastructure Fund'. International and regional organizations support this initiative.

This note explores the question of whether tax, broadly defined, will be a facilitator or a barrier to the development of the Belt and Road initiative, and explores how think tanks and academic institutions, both in China and elsewhere, can contribute to developing proposals to remove these potential tax barriers and to ensure that the benefits of the BRI are fairly shared between the participating countries. The note first sets out the background to this initiative and then examines the relevance of tax certainty and how it could be achieved. It goes on to discuss the potential tax barriers and solutions and concludes with some broader policy questions.

In 2017, the GTPC of Vienna University of Economics and Business, working closely with the SAT and a number of Chinese research institutes,[1] created a 'BRI Tax Forum' which brings together governments, business, international organizations and research institutes along the route to explore these tax issues and to provide policy-makers with a solid array of policy-relevant research. This group has met in Vienna and Beijing in 2017, with the latest meeting being in April 2018 at WU Institute. This note draws upon these discussions. (www.wu.ac.at/taxlaw/institute/gtpc/)

2 THE BELT AND ROAD: THE TAX DIMENSION

The countries along the BRI have diverse taxes and all of these taxes – whether on profits, income, consumption, capital, financial transactions or property – will

1. Shanghai Lixin University of Commerce, Center for International Tax Law and Comparative Taxation (CITACT), Xiamen University, Central University of Finance and Economics (CUFE), Center for International Tax Law at East China University of Political Science and Law (ECUPL), Wuhan University.

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potentially impact on the decisions of both the public and private sector to undertake the long-term investments required to achieve the goals set for the BRI.

One of the key issues is: how will these different national taxes interact? Will this interaction create uncertainty and lead to double taxation and cross-border tax disputes? Or will the interaction lead to a tax environment which provides the certainty, predictability and consistency which business need to undertake these investments.

3 TAX LEVELS, STRUCTURES AND TAX ADMINISTRATIONS DIVERGE

Comprehensive data does not exist, but information provided by the IMF[2] suggests that in many of the BRI countries, tax levels are on average are less than 25% of GDP, with some countries raising less than 15% and others more than 30%. The main sources of revenues are derived from the extractive sector and VAT; profit taxes; taxes on immovable property, and payroll taxes, while personal income taxes tend to be low. The tax administrations in many of these countries are weak, and many lack the basic skills necessary to apply complex international tax rules (*see* Annex II).

4 THE ROLE OF TAX CERTAINTY IN PROMOTING FDI ALONG THE BRI

Tax certainty is a key component to provide a tax environment which is conducive to FDI in the BRI and in the long term it is in the interest of both government and business to minimize as far as possible tax uncertainty.

Tax certainty can be defined as the capacity to make an accurate assessment of the tax and compliance costs associated with an investment or a continuation of an investment in a country over the lifecycle of the investment/company, which requires the right balance between facilitating compliance and identifying and curbing aggressive tax planning. Achieving tax certainty will be difficult in a BRI context which encompasses countries with different legislation, varying tax cultures and tax capacity and MNEs with complex business operations.

Some of the fundamental requirements for tax certainty are:

(a) At the level of tax policy:
   - The legislation is unambiguous and clear, leaving no or little room for unintended misinterpretation.
   - The legislation realizes the policy aims determined by the government.
   - The law is designed to minimize administrative costs, striking the right balance between tax compliance and the burden on taxpayers.
   - The legislation will be as much as possible in line with international standards and best practices, both in terms of content and administrative practice (this includes avoidance of double taxation, not

2. *See* IMF government finance statistics (GFS), 2015.

imposing unnecessary compliance costs on cross-border activities, and preventing harmful tax competition).
- Legalization needs to be based upon a 'principle' based approach.

In the context of the BRI it is particularly important that tax incentives be designed in ways which minimize tax uncertainty by avoiding discretionary incentives, ensuring any incentives are under the control of the Ministries of Finance and are subject to regular evaluation and transparency:

(b) At the level of tax administration:
- Incentivized and capable to apply the tax legislation in accordance with the letter and spirit of the law.
- Supported by efficient and effective administrative and IT platforms.
- Social skills and tools to ensure compliant taxpayers are served as efficiently as possible by providing clarity on the taxation positions in as early as possible a stage.
- Guidelines, safeguards, tools and skills to ensure that non-compliant taxpayers are identified and appropriately curbed.
- The response of the tax administration should be proportional to the behaviour of the taxpayers.
- Checks and balances should be in place to ensure that the elements above are continuously guaranteed, including through the availability of mediation processes and well-functioning administrative and judicial appeal procedures.
- Establish metrics for evaluating measures of success in achieving high compliance that go beyond simple revenue yield measure.

BRI taxpayers also have a role to play in creating tax certainty, in part by introducing a well-functioning tax control framework, which links business reality with tax compliance, ensuring the availability of the right information at the right time, abiding by the spirit and letter of the law and ensuring that taxes are paid at the right time and in the right place.

What measures can BRI governments take to improve tax certainty?

The following paragraphs set out some proposals that BRI countries may wish to consider:

(a) *At the level of policy and implementation:*
- Engage business and other stakeholders both in policy formulation and drafting of legislation.
- Ensure tax policy makers and tax administrations are working together to formulate new policies.
- Establish transparent and open consultation processes.

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- Issue white papers that enable input from a wide variety of stakeholders before legislation is finalized.

(b) *At the level of legislation:*
- Draft legislations in clear and unambiguous ways.
- All legislation should be first issued in a draft format and go through a process of consultation.
- Ensure the purpose of specific sections of the law are clearly stated so that taxpayers and the courts have a clear basis for interpreting the more detailed and technical provisions (principles-based legislation).

(c) *Other measures can include:*
- Issuing clarifications and public rulings that are binding on the tax administration.
- Avoiding as far as possible retroactive legislation.
- Centralizing all large business cases into a large business unit so as to achieve a consistent application of the rules.
- Issuing clear guidance to regional tax offices on how they can apply legislation and tax treaties and regularly monitor that this guidance is followed.Exploring all the options to resolve issues and questions prior to the submission of tax return or an audit.
- Using a variety of methods to increase the awareness of tax officials on the way business models are evolving and the speed of change. This could take the form of regular meetings between business and tax officials and briefings by business to senior executives in the tax administration.

5 MULTILATERAL COOPERATIVE COMPLIANCE: RELEVANCE FOR BRI[3]

One particularly effective way to reduce tax uncertainty is to introduce a cooperative compliance model, which represents a shift from a retrospective and primarily repressive control to a cooperative relationship between tax administration and taxpayers that is much more likely to involve a discussion of tax treatment in real-time or even prospectively. It is intended to deliver quality compliance, which means payment of taxes due on time in an effective and efficient manner. At the heart of the concept is a simple exchange of transparency for certainty. The taxpayer undertakes to be wholly transparent about the tax positions that it has taken in its return and the transactions that are likely to give rise to a tax risk. The taxpayer does not limit this disclosure to the information required by the administrative provisions of tax law and does not seek to invoke legal privilege to prevent access to documents that could be relevant to the determination of tax liability. In return, the tax administration agrees to offer the taxpayer early certainty about the tax treatment of the taxpayer's business

3. The text is an extract from a chapter in: A. Majdanska & J. L. Pemberton, Creating a positive tax climate for complex multijurisdictional investment projects, in Lang/Owens (eds.), Removing Tax Barriers to the Belt and Road Initiative, Kluwer Law International 2018, forthcoming.

transactions. Experience shows that this is often easiest to achieve this if the discussion takes place as close as possible to the time when those transactions take place, which is why the cooperative model often encourages the parties to discuss issues before a tax return is even filed, or, in certain circumstances, before a transaction takes place.

The OECD's 2013 report spelled out the core features of the concept: justified or demonstrable trust; transparency; cooperation; collaboration; voluntary disclosure; timely advice on significant positions; and early legal certainty.[4] The cooperative compliance model works on the basis that if a taxpayer is voluntarily and fully transparent, and able to show 'how it does that', the tax administration should provide early tax certainty and do so in advance, where appropriate. Cooperative compliance is traditionally unilateral, but a number of countries are now exploring an approach which could be of interest for groups of BRI countries, perhaps combined with a focus on specific sectors.

Most of the investments in the BRI initiative will involve operations in more than one country. This will entail reviewing businesses' value chain, how tax risks are managed and what drives customer and shareholder value. Multilateral cooperative compliance could be a way of addressing any potentially contentious tax issues in advance, providing early tax certainty to participants in the BRI initiative. It could help significantly reduce tax costs of handling the tax assessment of taxpayers that operate cross-border and avoid long and costly tax disputes that may emerge once the BRI initiative unfolds.

6 POTENTIAL TAX BARRIERS[5] AND SUGGESTED APPROACHES

This section identifies potential tax barriers to the BRI and provides suggestions on how these may be addressed at the level of either individual countries or groups of countries which are engaged in specific BRI projects or sectors. Wherever possible these suggestions build on existing international best practices, but in some cases it is proposed to tailor the approach to the specific needs of the BRI.

(a) VAT Systems Deviate from the International Norm

Issues:

With the notable exceptions of Russia and China, which completed its transformation to a proper VAT system in 2017, most of the emerging and developing countries on the

4. OECD, Cooperative Compliance: A Framework – From Enhanced Relationship to Cooperative Compliance (OECD Publishing 2013).
5. For an analysis of relevant treaty policy in China's tax treaties *see* 'Tax Treaties between the Belt and Road Countries', Sathi Meyer-Nandi, David Orzechowski, Vladimir Tyutyuryukov, Vienna, in Lang/Owens (eds.), Removing Tax Barriers to the Belt and Road Initiative, Kluwer Law International 2018, forthcoming.

BRI do not operate standard VAT systems.[6] VAT refunds are paid, if at all, after long delays; services are given a broad exemption. In many cases, VAT operates more like a tax on imports and exports.

The Belt, Road Initiative project will involve VAT issues triggered by the non-harmonized national VAT rules, the lack of a comprehensive knowledge of VAT systems and the lack of qualified staff and human resources at the tax administrations. There are four main potential obstacles to cross-border transactions in the Belt, Road Initiative in the area of VAT: double taxation or non-taxation, dispute resolution, documentary requirements and irrecoverable input VAT.

The first issue, double taxation or non-taxation, follows from a lack of harmonization of taxation principles and the place of supply rules between states along the Belt, Road Initiative. Some of these states may follow the destination principle; others may favour the origin principle. Even if the countries were able to agree on these basic principles, they would need to decide on the same proxies and their interpretation to identify where the supply of goods or services should be taxed. Similarly, non-harmonized VAT rules may also lead to non-taxation, if both states allocate the taxing right to the other jurisdiction. Non-taxation has distortive effects on the competition and economy.

Recommendations:

The OECD International VAT/GST Guidelines may help to prevent double as well as non-taxation in some scenarios. These guidelines are, however, very broad and thus not every double or non-taxation case may be addressed. To make the Belt, Road Initiative a success, a dedicated BRI agreement may need to be found on how the standard supplies of goods and services should be taxed along the road.

Where there is a VAT dispute between states (or between a non-resident taxpayer and the tax administrations), there is no international legal framework to resolve the conflict. One approach is to examine the applicability of dispute resolution or arbitration rules of other treaties for VAT (double taxation treaties, investment treaties, WTO law). However, these treaties may not be sufficient help. Most importantly, dispute resolution for double taxation issues requires a legal basis to rely on and, hence, a binding bi- or multilateral VAT treaty with place-of-taxation rules in the first place. As long as there is no such bi- or multilateral treaty in place, dispute resolution for double taxation issues may be difficult. If, however, the states can agree on common VAT-principle, a dispute resolution mechanism could be implemented.

Another problem businesses have to face along the Belt, Road Initiative is the irrecoverable input VAT. VAT should not be a tax on businesses. However, many BRI states immediately use the input VAT to finance current public spending and thus may have problems to refund the input VAT. To ensure the neutrality of VAT, a mechanism needs to be found that safeguards the capability of states to refund input VAT, perhaps by developing a set of good practices.

6. For a full analysis of VAT systems *see* 'VAT Challenges in the Belt and Road Initiative', Caroline Heber, in Lang/Owens.

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Even if states follow the destination principle and apply similar place-of-taxation rules and proxies, they still also might ask for different and very burdensome documentary requirements to benefit from zero-rating, input VAT refund or other benefits.

One approach which could address many of the issues discusses above would be a general zero-rating between the entities building the infrastructure for the Belt, Road Initiative and the ones using the infrastructure for passing-through goods. In these cases, the goods and services are supplied to businesses, and thus VAT should not burden any of these transactions. Simplification can be achieved by not levying the VAT on the transaction and refund it later on. If the supplies were zero-rated, there would not be any problem with refunding the input VAT. To make the zero-rating system working, unique VAT-ID numbers needs to be issued which identify the entities engaged in building and using the Belt, Road Initiative. Only if these specific VAT-ID numbers are used, the zero-rating mechanism could be applied. If the states were able to agree on to whom a BRI-VAT-ID number should be issued, this would help resolve the place of supply rules. If the transactions are zero-rated, it does not matter where the transaction should be taxed.

(b) The Network of Bilateral Tax Treaties is Incomplete

Issues:

While China and Russia have a broad network of treaties, most of the BRI emerging and developing countries have very limited treaty networks which do not always reflect best practices (*see* Annexes I and II for details). Even where treaties are in place, they do not always reflect current economic trading patterns. There is a need for an up to date analysis of the existing BRI tax treaty network, which would identify which provisions require modification to facilitate trade and investment.[7] Countries may wish to consider developing a multilateral instrument to coordinate provisions, thereby facilitating a closer economic integration. Particular attention should be paid to the mechanisms found in treaties to minimize and resolve cross-border tax disputes, and there may be a case for initiating a BRI dispute resolution platform (*see* (e) below).

Some of the potential problems include:

(1) Incoherent and fragmented treaty wording: When looking at China's tax treaties with BRI countries, there is no consistent approach in the wording of provisions. The majority of provisions found in China's treaties with BRI countries follow the wording of either the OECD or UN Models. However, next to the variations resulting from the different versions of the Models, in multiple treaties there are further deviations from the Models, resulting in uncertainty and complexity for doing business in the region. Especially differences in the PE definition (construction and service PE in particular) increase the administrative burden of companies. A project with the same characteristics may constitute a PE in one BRI country (and entail tax and compliance issues) but not in another BRI country. These variations in the PE thresholds, together with the extreme differences in withholding tax rates, further create the potential for tax competition between BRI countries. Due to the weak anti-avoidance rules, there is also an open pathway for tax abuse by businesses.
Additionally, the special provision on interest income, which limits source country withholding taxes when the recipient of the interest income is a financial institution connected to the government of the other state, is of relevance for the BRI. Since infrastructure investments are generally highly geared and much of the debt funding will be provided via public financiers, such clause encourages infrastructure investment. However, currently, only approximately two-thirds of China's treaties with BRI countries include such provision and depending on the time of implementation, the wording of these provisions vary in their scope of application. Due to the relevance of this provision, such deviation is problematic. Additionally, BRI countries could consider broadening such clause also to capture debt provided by private financier for BRI infrastructure investment.

(2) No clear treaty policy aligned with the objectives of the BRI: It appears that China's later tax treaties with the BRI countries have a tendency to shift more towards the wording of the OECD Model, meaning being less source country friendly. Since the BRI countries will mainly constitute net capital importing countries, with the capital streaming predominantly from China into their economy, and capital income flowing the other way around, the treaties with China will most likely have an asymmetric nature. Hence, when not neutralized through sufficient gains from increased FDI, the shift in taxing powers from the source country to the residence country induced by the tax treaty, might not be sustainable in the long-term, when development of the whole region is one of the objectives.

Recommendations:

(1) Harmonization of key provisions through cooperation: The standardization of certain key provision – e.g., PE definition, the special provision on interest income and anti-avoidance rules – could improve certainty and reduce the level of complexity currently present when doing cross-border business in the BRI region. Ideally BRI countries could create a BRI Model Tax Treaty, which should be drafted in a dialogue between the key BRI countries, e.g., through the inauguration of a BRI tax treaty forum. One could also explore a process for a simplified multilateral instrument, which enables a rapid update of the most relevant key provisions in existing treaties.

(2) Agreement on specific tax treaty policy: The BRI countries together with China could try to agree on a specific BRI tax treaty policy which heeds the

7. *See* 'Tax Treaties between the Belt and Road Countries', Sathi Meyer-Nandi, David Orzechowski, Vladimir Tyutyuryukov, in Lang/Owens (eds.), Removing Tax Barriers to the Belt and Road Initiative, Kluwer Law International 2018, forthcoming. This analysis is limited to Chinese treaties with BRI countries.

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asymmetric relationship of the capital flows between China and the BRI countries. The policy should be aligned with the development objectives of the region, which presupposes sufficient tax revenues generate by all participating countries.

(3) Identify ways to update and expand the BRI treaty network: Appendix I provides some suggestions for a multilateral approach to updating treaties. One way to extend the treaty network would be for countries which have very limited networks to engage in multilateral negotiations which lead to bilateral signing of treaties. The proposed BRI Tax Academy could play a role here.

(c) Transfer Pricing Practices Need to Be Simplified

Issues:

Many of the BRI emerging and developing countries along the BRI have rudimentary transfer pricing rules. Frequently, the legislation is unclear, the information requirements are inconsistent and the experience of tax administrations in applying the rules is at a very early stage. To achieve the goals of the BRI will require greater coordination of the valuation rules of intra-multinational transactions and greater consistency of the valuations used for VAT, customs and transfer pricing purposes.

The Transfer Pricing issues in the BRI can generally be divided into six categories relating to specific areas such as manufacturing activities, service and financial transactions, intangible properties, cost contribution arrangements, documentation and advance pricing agreements.

In the case of manufacturing activities, two major problems pertain to constant lack of comparable data in many BRI countries as well as to the allocation of location savings. A number of BRI countries face a shortage of publicly available commercial databases and do not have appropriate financial registries where companies record their corporate financial information. This leads in many cases to tax authorities using secret comparables which as a consequence puts taxpayers without the access to such data at a disadvantage and may cause infringing secrecy of the data used for assessment purposes. The location saving issue is strongly related to the access to data as many BRI countries tend to (over)use foreign data due to the insufficient availability of local comparables. In relation to this issue, a potential misuse of foreign comparables in practice arises as another problem.

When it comes to services and financial transactions in BRI countries, the topic seems to have significant importance with numerous countries implementing their own rules in this regard or at least having certain practices and recommendations. Those countries include, among others, China, Singapore, Russia, Vietnam, Indonesia and Hungary. Even though some of these countries try to follow OECD respective guidance, there still might arise a problem regarding diverging legal provisions and rules binding in different BRI jurisdictions.

Further, it should be noted that there exist many issues of potentially major significance related to transactions involving intangible properties. BRI countries in general follow OECD TPG in this regard but to different extents. Nevertheless, the

general rules according to which the returns derived from the exploitation of intangibles are divided, is usually accepted. It has to be underlined, however, that certain countries either do not have specific legislation in this regard or do not follow OECD TPG, which might be detrimental to the development of the initiative. In addition, overly narrow or too broad definitions of intangibles in domestic laws of respective countries.

Another transfer pricing issue which needs to be given certain attention are the cost contribution agreements. The biggest problem in this regard for the BRI initiative comes from different approaches taken by tax authorities of diverse countries. Starting from non-acceptance of CCAs among former USSR states through missing any rules or treating CCAs as intra-group services (diverse countries in different regions) to general and formalized acceptance of CCAs (EU countries), the situation indicated generally limited proliferation of proper legislation in this regard. This further results in lack of expertise among tax authorities. In addition, CCAs raise certain doubts and suspicion among tax officers as it happens that the benefits stemming from this kind of arrangement are not explicit at first sight.

Another major transfer pricing issue is documentation. The legislation and practice of BRI countries varies greatly, reflecting different levels of transfer pricing experience of respective countries, their approach towards international developments as well as the capacity of tax administrations. However, clear trends of implementation of transfer pricing documentation can be observed in the last years, accelerated particularly by the developments of BEPS Action 13 as well as other international projects like the UN Transfer Pricing Manual. Other problems in this area include limited treaty networks in many BRI jurisdictions, which hinder the exchange of information as well as the common problem of processing transfer pricing documentation in English in certain countries.

The last potential problematic area among BRI countries is the implementation and the application of advance pricing agreements. There are various reasons why countries are cautious in this regard. Among the most important are a lack of transfer pricing experience and knowledge, lack of capacity (where tax officers are directed primarily to tax audits) and lack of trust in a cooperative character of procedure such as APA (tax authorities are reluctant towards cooperation intensively involving taxpayers).

Recommendations:

BRI countries may wish to consider the following actions:

- putting on equal footing transfer pricing rules understanding among BRI countries to build a bridge between jurisdictions with transfer pricing rules and jurisdictions without transfer pricing rules by the implementation of a commonly agreed set of guidelines among the BRI countries;
- focus further actions on development and promotion in the BRI countries of two key aspects, namely the improvement of guidance and the dissemination of the experience among the various stakeholders, e.g., by using the proposed BRI Tax Academy to develop training programmes for the target countries;

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- commissioning policy-relevant research from academic institutions;
- considering the establishment of a BRI Transfer Pricing Forum (e.g., on a similar setting as the EU JTPF) of experts from both governmental institutions and private practice that regularly meets and analyses various pre-defined transfer pricing topics, in order to produce guidance that could constitute a useful practical tool to solve specific issues.

Regarding the issues related to manufacturing activities, in particular to lack of comparables and the allocation of location savings, the following actions might be considered:

- development of a network of multilateral safe harbours among groups of countries which could enhance the solution of issues related to lack of comparables data and allocation of location savings properly addressing at the same time all the numerous areas of concern;
- the development of a database including financial data of MNEs operating in the BRI countries.

As far as issues related to services and financial transactions are concerned, countries may wish to consider:

- the guidelines provided by international organizations might constitute a good source of reference for tax administrations and taxpayers, as well as practical tools for capability building in transfer pricing matters;
- the development of a network of multilateral safe harbours among the BRI countries for low value adding services (as well as for some types of financial transactions) and the development of a database including data on services and financial transactions in the BRI countries could be beneficial solutions.

Further, with reference to the issues concerning IPs, the following solutions could be explored:

- following the OECD/UN approach, the location of DEMPE functions should be considered as a key factor in the BRI countries when undertaking transfer pricing law modifications regarding IPs;
- the legal framework for IP protection, which is very well developed in the region (including copyright law, patent law, trademark law and the laws against unfair competition), should be also carefully considered;
- as regards the definition of IP, the first action that BRI countries could take is to align the definition of intangibles with the one suggested by the OECD/UN approach.

When it comes to CCAs-related issue, it would be desirable to update local legislation to allow CCAs following the efforts of OECD and UN in promoting uniform

rules on CCA, especially considering the fact that the concept is new for many BRI countries and they will probably 'borrow' the regulations from the international bodies.

With regard to transfer pricing documentation issues, the BRI countries could consider the following actions:

- standardizing documentation requirements;
- balancing the tax administrations need for data with taxpayer's administrative burden and costs;
- requiring taxpayers to submit their transfer pricing documentation automatically in a timely manner.

Finally, the following solutions could be considered to make the application of APAs in the BRI countries more robust:

- introducing a multilateral APA programme in the BRI region (e.g., along BRI global value chains) could give businesses an opportunity to reach an agreement with the tax authorities in combination with other tax authorities on the future application of transfer pricing rules to their related party transactions;
- establishing specialized transfer pricing units separated into functional units within the same tax authority where each of those special units could work along the same special units of the other tax authorities' jurisdictions;
- determining the 'critical assumptions' in which the MAPAs are underpinned, so that if circumstances materially change on which the MAPA was agreed, parties will no longer be bounded by the MAPA;
- taxpayers should be required to lodge a brief annual report, which evidences their compliance with the agreed MAPA terms and conditions.

(d) Will Tax Incentives and Special Economic Zones Lead to a Race to the 'Bottom'?

Issues:

Governments along the BRI already make use of tax incentives to encourage FDI and an increasing number are also putting in place free trade zones. While there may be legitimate arguments in favour of these measures, they do run the risk of opening up new avenues for aggressive tax planning and undermining the tax base. They also raise the broader issue that sustainable investment should not be driven by tax considerations. BRI need to avoid a race to the bottom which could seriously undermine the tax base.

Recommendations:

BRI countries need to have a rigorous process in place to evaluate the risks and benefits of any tax incentive. This process should go through five stages:

(1) Setting out what is the longer term rationale of a policy of subsidizing investment.

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(2) Agreeing on the amount of resources that should be devoted to achieving this objective.
(3) Deciding on what is the best policy instrument to achieve the goal: tax incentives, direct subsidies, regulatory measures, the government undertaking the investment itself.
(4) Determining the framework to analyse the cost and impact of the incentives and what will be the approach to accountability.
(5) Agreeing that only the Ministry of Finance can grant tax incentives.

The BRI countries could adopt a BRI Code of Conduct which could draw upon the work of the OECD, EU and regional bodies such as SADIC. Any tax incentive or Special Economic Zone should be well designed so that they target sustainable and real activities which do not distort investment decisions or encourage Base erosion.

(e) More Effective Mechanisms are Required to Minimize and Resolve BRI Tax Disputes

Issues:

The countries along the Road have diverse taxes and all of these taxes – whether on profits, income, consumption, capital or property – will potentially impact the decisions of both the public and the private sector to undertake the long-term investments required to achieve the goals set for the BRI. One of the key questions is how these different national taxes will interact. Will they create uncertainty and be applied in ways which lead to double taxation? Or will their interaction lead to a tax environment which provides the certainty, predictability and consistency which business needs? Inevitably, due to the interaction of the different tax systems, cross-border tax disputes will arise and this will require more effective dispute resolution mechanisms.

Recommendations:

The various measures to resolve disputes can be classified in two categories: domestic or international. BRI countries will have to address domestic tax administration structures and mechanisms to resolve or minimize tax disputes, as well as dispute resolution mechanisms at the international level.

Domestic:

Apart from the measures suggested in section 4 on tax certainty above these could include:

- Non-binding mediation and use of experts.
- Administrative tribunals which are independent of the tax administrations.
- Creating a Tax Ombudsman.
- Providing training for Judges on complex tax issues.

International:

- MAP: implementing the four minimum standards in BEPS Action 14, which have now been endorsed by many of the BRI countries and also looking at whether in the context of the BRI some of the best practice in Action 14 could also be endorsed.
- Using the upcoming UN Handbook on MAP as a basis for discussions between BRI countries and putting in place training programs for competent authorities based upon the Handbook. This could be carried out by the proposed BRI Tax Academy.
- Putting in place multilateral framework agreements between BRI competent authorities.

Apart from these specific measures, BRI countries or groups of countries may wish to establish dedicated technical platforms which would facilitate contacts between CA, assisting in documentation and filing requirements, improve communication with taxpayers on the progress of their case and help build up a picture of the main types of disputes on the BRI.

In the medium term there may also be a case to establish a BRI dispute resolution panel which countries would be able to consult to resolve cross-border disputes between groupings of BRI countries.

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(f) Excises and Tariffs Need to Be Harmonized

Issues:

In many of the countries along the overland route, tariffs and excises are relatively low, except for agricultural goods. Exports and imports between these countries remain limited (less than 1% of China exports and imports go into countries in the Eurasian region). The exception is the inter-regional trade in the areas of natural resources, reflecting the construction of a number of regional distribution networks over the last ten years. Despite the low rates of these excises, there remains scope for greater coordination between countries in the design and implementation of these duties and to eliminate non-tariff barriers.

Recommendations:

The BRI countries should accelerate their cooperation with the WCO to minimize customs duties and to remove non-tariff barriers, identifying best practices. There is also scope for exploring how Blockchain technology can be used to simplify custom procedures drawing upon some of the pilot studies that the WCO, IBM and a number of shipping companies (e.g., Maersk) have recently carried out. The BRI countries could also look at the experience of other economic blocks such as the EU and the EEC.

from other corporate rights that are deemed to be income from shares and is also taxable under the law of the contracting state in which the profit-sharing company is resident. The dividends article of a tax treaty usually limits the taxing rights of the source state by specifying a reduced tax rate. The tax treaties differ from one country to the next as regards the standard of allocating the right of taxation.

Under the Chinese tax treaties with Albania, Azerbaijan, Bahrain, Bangladesh, Belarus, Bosnia and Herzegovina, Hungary, India, Indonesia, Iran, Israel, Kazakhstan, Kyrgyzstan, Malaysia, Nepal, Pakistan, Poland, Qatar, Romania, Russia, Slovakia, Sri Lanka, Turkey, Uzbekistan and Vietnam, when a dividend of the contracting state resident company is paid to a resident of the other contracting state, if the recipient is the beneficial owner of the dividend, the tax may not exceed 10% of the total dividend. In China-Egypt treaty, the applicable tax rate is 8%, while the rate is 7% in the treaty between China and the United Arab Emirates. The tax rate is 5% in the treaties between China and Brunei, Bulgaria, Croatia, Laos, Kuwait, Macedonia, Mongolia, Montenegro, Oman, Saudi Arabia, Serbia and Slovenia.

In addition, under Chinese tax treaties with Belt and Road countries, the source states tax the beneficial owner in different rates according to the different proportion of the shares that the company paying the dividend holds.[8] The higher the proportion of the shares in the dividend paying company, the lower the tax rate applicable in the source state. Chinese tax treaties with some countries have limitations on the nature of the beneficial owners of dividends, such as the tax treaties with Singapore, Tajikistan and Turkmenistan. The beneficial owners of dividends may only be corporations, excluding partnerships.

In the process of going global, if a Chinese enterprise finds that the source state imposes a higher withholding tax rate on dividends than the applicable treaty rate, the dividends paid to domestic shareholders may benefit from a lower rate by applying for preferential tax treatment overseas, and the income tax paid in accordance with the tax treaty rate may be credited in the home country.

8. Specifically, it includes:

(1) 0% (dividends beneficiary owners directly or indirectly own dividend paying companies at least 50% shares and invest EUR 2 million in the company): Georgia;
(2) 5% (dividends beneficiary owners directly or indirectly own dividend paying companies at least 10% shares and invest EUR 100 thousand in the company): Georgia;
(3) 5% (the beneficial owner of the dividends is a company, partnership and except direct ownership of the company paying the dividends of shares at least 25% cases): Singapore, Tajikistan, Turkmenistan, Armenia, Syria, Czech Republic, Estonia, Latvia, Lithuania, Ukraine, Moldova, and the national agreement (the beneficial owner of the dividends paid directly with the dividend shares less than 25% cases at a rate of 10%);
(4) 10% (dividends holders are directly entitled to pay at least 10% shares of the dividend company): Philippines (with the above national agreement, the beneficial owner of dividends has the right to pay dividends directly, the company's share is less than 10%, the tax rate is 15%).
(5) 15% (the beneficial owner of the dividends is a company, not including a partnership, and has at least 25% shares of the company paying the dividends (case): Thailand and the national agreement stipulates the beneficial owner of the dividends have direct payment of dividends of shares of the company less than 25% cases at a rate of 20%).

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2.3 Royalties Article in Tax Treaties

The term 'royalties' usually refers to money paid as remuneration for the use of, or the right to use literary, artistic or scientific works, including film, radio or television broadcasting film, tape copyrights, patents, trademarks, designs or models, drawings, secret formulas or processes, as well as money paid as remuneration for the use of, or the right to use industrial, commercial or scientific equipment, scientific experience and information received as consideration. The Chinese tax treaties with Georgia, Tajikistan and Turkmenistan stipulate that the concept of royalties does not include payments for the use of, or the right to use the other industrial, commercial and scientific equipment. The royalties article usually limits the tax rights of the source state by specifying a reduced tax rate.

Most Chinese tax treaties with Belt and Road countries stipulate that, when royalties arising in a contracting state and paid to a resident of the other contracting state are taxed in the contracting state in which the royalties arose, under the law of that contracting state, if the beneficial owner of the royalties is a resident of the other contracting state, the tax payable may not exceed 10% of the gross amount of the royalties. In the tax treaties with various other Belt and Road countries, the rate is lower or higher than 10%. For example, in the treaty with Georgia, the applicable tax rate is 5%; Latvia and Romania, 7%; Egypt and Tajikistan, 8%; Pakistan, 12.5%; and Nepal and Thailand, 15%.

There are different types of royalties with different tax rates in some Chinese treaties, for example under the tax treaty with Poland, for the use of, or the right to use industrial, commercial or scientific equipment, the applicable tax rate for the remuneration is 7%, but for the use of, or the right to use literary, artistic or scientific work, including film, radio or television broadcasting film, tape copyrights, patents, proprietary technology, trademarks, designs, models, drawings, secret recipes and secret programs, the tax rate is 10%. With the exception of certain countries,[9] the tax rate for royalties under Chinese tax treaties with forty-two Belt and Road countries is 10%. In addition, the Chinese tax treaty with Malaysia contains a special rule under which,

9. Specifically, it includes: (1) Georgia: 5%; (2) Laos: 5% (limited to Laos, 10% in China); (3) Romania: 7%; (4) Latvia: 7%; (5) Poland: 7% (limited to the use, the right to use industrial, commercial, scientific equipment to pay a variety of payments. To use or the right to use literary, artistic or scientific works, including film, radio or television broadcasting film, tape copyright, patents, proprietary technology, trademarks, designs, models, drawings, secret recipe, secret program to pay all money as reward for the tax rate of 10%); (6) Egypt: 8%; (7) Tajikistan: 8%; (8) Pakistan: 12.5%; (9) Thailand: 15%; (10) Nepal: 15%; (11) Philippines: 15% (limited to the right to use or have the right to use literary, artistic or scientific works, including films, videos, television or radio the copyright of the tapes paid by various payments. Pay to use or the right to use the patent, trademark, design or model, drawings, secret formula or process as well as the use of, or the right to use, industrial, commercial, industrial, commercial or scientific equipment, scientific experience as all kinds of money reward information applicable tax rate is 10%); (12) Malaysia: 15% (limited to the right or the right to use literary or artistic works, including film, radio or television broadcast, film and tape, the copyright paid by the various payments. To use or the right to use the patent, proprietary technology, trademarks, design or model, drawings, secret formula or scientific program, copyright, or use, the right to use industrial, commercial or scientific equipment or related industrial, commercial or scientific experience and information received as a consideration for the applicable tax rate 10%).

where the royalties obtained by a Chinese resident are subject to movie leasing tax under Malaysia's movie leasing tax law, the fee is exempt from such tax in Malaysia.

Under Chinese bilateral tax treaties with Belt and Road countries, when tax treaty provisions and domestic tax laws are inconsistent, if the treaty rate is less than the tax rate prescribed under domestic tax laws and regulations, the treaty rate will prevail; if otherwise, the domestic laws and regulations will prevail. Therefore, when Chinese enterprises make investments in Belt and Road countries with which China has signed tax treaties, they first should be familiar with the provisions of the applicable tax treaty, especially the preferential treatment of interest, dividends, royalties and other relevant items of income, and obtain a lower tax rate by applying overseas for benefits under the applicable tax treaty.

In order to prevent the abuse of tax treaties, anti-tax avoidance provisions are often included in the interest, dividends and royalties articles, such as beneficial owner provisions, the principal purpose test (PPT) and a limitation on benefits (LOB).[10] Therefore, going-global enterprises should pay special attention to these provisions when designing their overseas investment structures, so as to avoid being identified as abusing tax treaties and therefore not entitled to tax treaty benefits.[11]

At present, ten Belt and Road countries do not have tax treaties with China, namely: Afghanistan, Bhutan, Burma, East Timor, Iraq, Jordan, Lebanon, Maldives, Palestine and Yemen. If a going-global enterprise invests in a country that has not signed a tax treaty with China, tax will be paid solely in accordance with the domestic law of the host country.

3 IMPACT OF THE OECD/G20 BEPS PROJECT ON THE APPLICATION OF PREFERENTIAL TREATMENT UNDER TAX TREATIES

Due to the restriction and influence of various factors, countries lack effective cooperation and coordination in tax collection and the management of transnational economic activities. Taxpayers take advantage of the tax differences among jurisdictions and the mismatch of rules to carry out lawful tax planning, which artificially causes taxable profits to 'disappear' or profits to be transferred to low-tax countries (regions) with little or no substantive business activities, resulting in a serious erosion of the tax base and damage to the interests of tax collection in the relevant countries. This caused not only by the increasingly serious erosion of the tax base and the loss of tax sources but also by the distortion of market resource allocation and damage to the environment of fair competition. Especially in the era of the digital economy, a variety of new tax planning methods adopted by multinationals has made this problem more serious and prominent.

10. For example, article 23 of 'double taxation and anti-tax avoidance and evasion treaty between China and Russia' (signed on 13 Oct. 2014, in effect from 9 Apr. 2016).
11. *See* 'Using Tax Treaties to help 'Belt and Road' Enterprise 'Going Global'', PwC China: http://www.pwccn.com/webmedia/doc/635731546577072907_chinatax_news_jul2015_34_chi.pdf (accessed 22 Jun. 2016).

In September 2013, the G20 summit commissioned the OECD to start the implementation of an international tax reform project, namely the OECD/G20 Base Erosion and Profit Shifting (BEPS) project. The purpose of this project is to modify international tax rules; curb multinationals' avoidance of global tax obligations and erosion of national tax bases; and coordinate and equitably balance tax collection and tax allocation among countries in transnational economic activities.

After three years' discussion, in October 2015, the OECD released fifteen final reports under the Action Plan, as well as an explanatory statement. These results were approved in November of the same year by the G20 summit in Antalya, and many countries – including China – are committed to the implementation of the output of the BEPS project. The BEPS Action Plan and the measures in the Final Reports represent the first substantive change in international tax rules by the international community in over almost 100 years. With the official implementation of the output of the BEPS project, at present, the international community and individual countries have gradually entered into a post-BEPS era in which they are now translating BEPS outputs into domestic implementation.

Therefore, against the new background of changing international tax rules and domestic laws, the preferential arrangement in Chinese tax treaties with Belt and Road countries will face new challenges. When a Chinese enterprise makes an investment along the Belt and Road, on the one hand it should make full use of existing preferential treaty provisions to maximize tax benefits; on the other hand, because existing preferential tax treaties will absorb the new constraints and adjustments under the BEPS project, Chinese enterprises will face constraints from these new conditions while seeking to maximize tax benefits and interests. The prominent and immediate issue to be resolved concerns how to seek a balance between ensuring China's compliance with the BEPS project outputs on the one hand, and maintaining the interests of enterprises to continue to enjoy preferential treatment and facilitate their investment in Belt and Road countries on the other hand.

3.1 Provisions on Treaty Shopping under BEPS Action 6

Regarding the preferential provisions of tax treaties and the specific application thereof, the main problems and challenges faced by Chinese enterprises in seeking and realizing the maximization of those treaty benefits lie in the stricter regulatory requirements imposed by BEPS Action 6 in response to the problem of treaty shopping. Under BEPS Action 6, to prevent the abuse of tax treaty benefits, the minimum standard is – at least in bilateral tax treaties – that effective rules should be adopted to deal with treaty shopping. First, the title and preamble of a treaty should clarify that the parties to the treaty intend to prevent the creation of conditions for non-taxation or reduced taxation caused by evasion of taxes, including treaty shopping.

Second, to implement the common will of the contracting states, the treaty will:

- combine the use of the principal purpose test (as a general anti-abuse rule) and a limitation on benefits (as a specific anti-abuse rule);

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- incorporate the principal purpose test; or
- incorporate a limitation on benefits, complemented by mechanisms against conduit arrangements, for example by applying the principal purpose test to conduit financing arrangements.

Entities that serve only as conduits and transfer gains to investors in a third country are not allowed to enjoy treaty benefits. These different rules have their own functions and roles: specific anti-abuse rules can provide greater certainty, but can deal only with known tactics of abuse; general anti-abuse rules have less certainty of judicial principles, but are able to deal with unknown or unsolved transactions of abuse. These two methods to resolve treaty abuse are equally effective, but due to the different legal environment and policy orientation, therefore, while the minimum standards can ensure that the abuse of a treaty can be effectively countered, countries have flexibility to determine what rules to use.

3.2 The Connotation and Application Requirements of the LOB Rules

In 2002, OECD issued a report on restricting the entitlement to treaty benefits.[12] This report asserted that the conventional method could only serve as a guiding principle, and that more specific rules should be implemented to deal with treaty shopping As a result of this report, new provisions were added to paragraphs 10, 11 and 12 of the OECD Income and Capital Model Convention and Commentary (OECD Model Commentary) on Article 1 regarding 'improper use' of the Convention. OECD adopted the entire LOB provision based on the 1996 US Model Convention (US Model), and an objective-oriented anti-abuse provision (paragraph 21.4 of the OECD Model Commentary on Article 1) based on the UK practice. A LOB provision was also included in the BEPS Action 6 Discussion Draft published in 2014,[13] which is more detailed than the LOB provision recommended in Article 20(1) of the OECD Model.

The purpose of the LOB provision is to prevent the residents of a third country from obtaining the preferential treatment enjoyed by the residents of a contracting state under the reciprocal treaty. It is mainly based on the objective criteria of a legal nature, ownership and daily activities of the residents of the contracting states to classify the scope of residents that are entitled to enjoy treaty benefits. The basic concept is that tax incentives are applicable only to taxpayers that have real commercial purposes or are fully connected with the residence state. On the surface, each item of the LOB provision is very different, but the essence of them all points to these two important factors. The provision provides for the scope of 'qualified residents' that may enjoy treaty benefits, including 'qualified residents', companies or entities that meet the test on active operating activities, entities that meet the exemption provisions at the discretion of the competent authorities, entities that meet the requirement of a 'derivative benefits'

12. OECD, *Restricting the Entitlement to Treaty Benefits* (OECD 7 Nov. 2002).
13. OECD, Discussion Draft, *BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (OECD Publishing 14 Mar. 2014).

provision (the newly added BEPS Action 6).[14] It can be seen that the application scope of LOB provision under BEPS Action 6 has been expanded, so that some normal transactions or arrangements will not be excluded from tax treaty benefits. On the other hand, the requirements under the provision of limited taxation of interest are more stringent, and the crackdown on treaty shopping is thereby strengthened.

The LOB rules are more detailed, which can provide an objective standard for the competent authorities to make determinations; reduce the difficulty of application; and reduce execution time and expense. However, at the same time, the provision is more complex, and its application needs to consider the interaction between many other treaties. This compounds the complexity of treaties, and increases the possibility of tax arbitrage, so it is suitable to apply the PPT rules in practice to supplement the LOB rules.

3.3 Connotation and Application Requirements of the PPT Rules

Paragraph 9.5 of the OECD Model Commentary on Article 1 sets a guiding principle: if the principal purpose of certain transactions or arrangements is to obtain better tax status, and obtain better treatment, then it is in violation of the objectives and purpose of relevant provisions, and therefore it should not be granted treaty benefits. Article 21.4 of the Commentary on Article 1 provides a sample clause for the PPT rules, 'A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.'

Compared with the PPT rules in the OECD note, BEPS Action 6 clearly suggests that the PPT rules be included in the OECD Model, and explain the key terms in the article in detail, and use the examples to guide the court to explain this subjective principle. The Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6-2015 Final Report (Final Report of BEPS Action 6) stipulates a proposed Article X (7) of the OECD Model as follows:

> Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that it reflects a genuine economic activity or that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention. [OECD, *Action 6 Final Report*, at 55]

> Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that

14. State Administration of Taxation: 'Preventing Improper Grant of Preferential Tax Treaties (Action Plan No. 6)', China Tax Press, 2015, p. 21.

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> obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.[15]

The provisions on the PPT rules in the Final Report of BEPS Action 6 do not require that obtaining the treaty benefits be the *sole* purpose of a special arrangement; it requires only that it be *one of* the main purposes. The concept of treaty benefits includes all restrictions on the taxation right of the source state (such as tax relief, exemption, deferred tax or refund) under Articles 6 to 22 of the treaty, eliminating double taxation under Article 23 and non-discriminatory protection of national residents and residents of a contracting state in Article 24, and other similar restrictions. However, if it is possible to prove that the preferential treatment accords with the purpose and objective of the relevant provisions of the applicable treaty, the PPT rules are not applicable.

3.4 Suggestions for Balancing Compliance with the BEPS Project and Access to Treaty Benefits

The BEPS project puts forward new frameworks and requirements for shaping and deepening international tax cooperation. China needs to participate in the further adjustment and implementation of the BEPS project at the international level. The Belt and Road Initiative, which the Chinese government has proposed, injects new vigour and vitality into Chinese enterprises, strongly promotes foreign investment by Chinese enterprises and creates conditions and convenience for enterprises to further enhance their competitiveness on the international market. However, while Chinese enterprises make investment in Belt and Road countries, it is the time that the BEPS project should be implemented in various countries. International cooperation on anti-tax avoidance targeted at developed countries will bring about huge challenges and impacts for Chinese businesses attempting to go global. Countries have been revising their domestic tax laws to implement the output of the BEPS project, and the investment structure of Chinese going-global enterprises could be in conflict with laws against cross-border tax avoidance and tax evasion in various countries after their tax laws are revised.

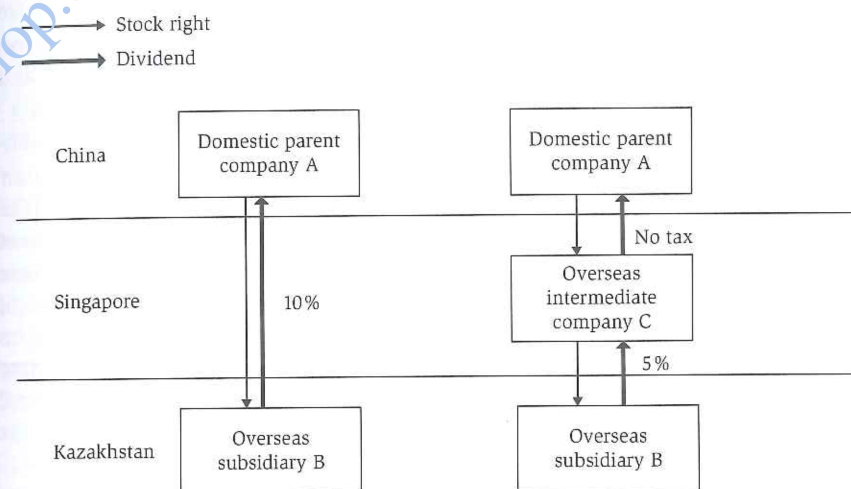
More importantly, with the deepening of Chinese advances in trade and investment in Belt and Road countries, China needs to further improve and strengthen cooperation with countries as regards anti-tax evasion, properly balancing the appeal of their tax benefits, according to the BEPS project's framework and requirements. However, one needs to be aware of the effects of strictly following the BEPS project's framework and requirements regarding Chinese tax benefits, particularly the potentially adverse effects. Therefore, it is necessary to research further and adopt a flexible and creative cooperation and implementation strategy according to the BEPS project, as well as further improve and strengthen cooperation with Belt and Road countries on

15. Previously cited 12, State Administration of Taxation book, p. 79.

anti-tax avoidance through the inclusive framework. At the same time, China should better support the development of the Belt and Road Initiative and the growth of Chinese enterprises.

Consider the example of Chinese enterprises investing in Kazakhstan. Chinese enterprises often choose the path of indirect investment by setting up intermediate holding companies, which are often based in Singapore. This is because the China-Kazakhstan tax treaty provides that the dividends Chinese enterprises receive from Kazakhstan are subject to 10% corporate income tax as non-residents, while the Kazakhstan-Singapore tax treaty provides that for dividend and bonuses from Kazakhstan, Singapore businesses need to pay only a 5% withholding tax. Under the China-Singapore tax treaty, the dividends received by Chinese resident enterprises from Singapore are not subject to corporate income tax as non-residents. In this way, a Chinese enterprise that wants to invest in Kazakhstan can first set up an intermediate holding company in Singapore, and then invest into Kazakhstan through the intermediate holding company. This will save the 5% corporate income tax as a non-resident (Figure 5.2).

Figure 5.2 Kazakhstan Investment Framework



According to the requirements of BEPS Action 6, if Kazakhstan strengthens the regulation of intermediate holding companies, Chinese enterprises will bear 5% of the income tax more than Singapore enterprises do without having to change the China-Kazakhstan tax treaty. This will increase the tax burden of Chinese enterprises and, furthermore, affect their competitiveness on the international market – all while China has not obtained any tax benefits from it. This is not conducive to the development of the Belt and Road Initiative and the growth of enterprises. In fact, there may be various reasons and considerations for a country to provide differential tax treatment to different countries; in fact it does affect and distort the market environment of fair competition. Therefore, to solve the treaty shopping problem, China must put the market environment with fair competition into perspective. In this regard, China

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should carry out specific cooperation and coordination with Kazakhstan as regards the implementation of BEPS Action 6. The basic strategies and methods include:

(1) adjusting the preferential tax rate for dividends, interest and royalties that resident enterprises are entitled to enjoy in the original tax treaty, to a preferential level compared with other countries in future. Do include a most-favoured-nation treatment provision in future regional tax coordination between China and Kazakhstan, providing that Chinese enterprises automatically obtain preferential tax rates;
(2) without changing the original income tax rate for non-resident enterprises, China should seek an exemption or loosened regulation for Chinese enterprises under BEPS Action 6.

For example, according to the connotation and application requirements of the PPT rules, if one can prove that granting the tax benefit is in line with the purpose of the relevant provisions of the treaty, the PPT rules are not applicable. In the face of the unfair tax environment that Chinese enterprises encounter, China could engage in consultations and negotiations with the host country to ensure that Chinese enterprise investment and specific arrangements are in accordance with the purpose and objective of the tax treaty, so as to avoid being characterized as treaty shopping and subsequently being denied preferential tax treatment.

Therefore, Chinese enterprises must take into account the change in Kazakhstan's domestic tax laws and regulations when making investments, especially the new amendment regarding anti-tax treaty abuse under domestic law, according to the LOB and PPT rules proposed in the BEPS Action 6 Final Report. Chinese enterprises must redesign their own transactions, and never simply set up a number of intermediate holding companies for the sake of tax avoidance. Going-global enterprises should strengthen the whole investment structure and commercial purposes according to anti-treaty abuse rules in the host countries, in order to ensure that the holding company in the intermediary state has a reasonable business purpose, has substantial business activities, independent of its people and property. This will help to avoid tax risk and save tax expense.

On the other hand, countries should make adjustment accordingly in the high-level design of national tax benefit distribution systems, especially to start with negotiations with Belt and Road countries regarding the revision of tax treaties. This should first be based on the principle of mutual benefit and reciprocity. It is necessary to select those countries with a larger number of Chinese foreign direct investments now or in future, and countries that have relatively higher levels of investment directly into China, and lower the tax rate to 5% to 8% (from the existing 10%) on dividends, interest and royalties. More preferential tax treatment, on the one hand, makes Chinese enterprises no longer need to lower their taxes by establishing intermediate holding companies in third countries, thereby avoiding a potential anti-avoidance investigation triggered by tax planning arrangements. Meanwhile, under the precondition of complying with the BEPS project requirements, China can exercise its tax sovereignty rights

to decide the tax rate, tax type and scope of taxation under its domestic laws, save capital structure expense and tax expense for enterprises, further promoting the investment by Chinese enterprises in Belt and Road countries.

4 EMPIRICAL ANALYSIS OF THE PREFERENTIAL TAX TREATIES USED BY CHINESE GOING-GLOBAL ENTERPRISES

Because foreign investment by Chinese enterprises is still in its infancy, some going-global enterprises do not understand tax treaties. Indeed, some are not even aware of their existence, to speak nothing of the ways and tactics to maximize tax treaty benefits. According to a survey conducted by the Beijing municipal office of State Administration of Taxation in 2014 of 281 going-global enterprises, nearly 90% had never received the proper tax treatment abroad under applicable tax treaties. There is little consultation applied by taxpayers with other countries about tax disputes. This chapter takes interest, dividends and royalties as an example, and makes an empirical analysis of relevant cases, with a view to providing guidance for Chinese going-global enterprises to maximize their enjoyment of tax benefits.

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4.1 Case of Chinese Unicom Red Chip Company: Dividend Discount

4.1.1 *Facts of the Case*

The actual name of Chinese Unicom Red Chip Company is Chinese United Network Communications (Hong Kong) Limited Company, and it belongs to Chinese Unicom Group listed in Hong Kong. The Hong Kong Stock Exchange has so-called 'red chip' and 'blue chip' stock. Red-chip companies are those Hong Kong-listed companies the largest holding power of which is directly or indirectly affiliated to institutions or enterprises from Mainland China, i.e., Chinese enterprises listed on the Hong Kong Stock Exchange. The headquarters and actual administration of Chinese Unicom Red Chip Company are located at Financial Street, Xicheng District, Beijing. Wei Yanwei, the chief of Large Enterprises and International Tax Management Department of Xicheng District Tax Bureau in Beijing stated that although Chinese Unicom Red Chip Company is listed in Hong Kong, it is also a Chinese resident enterprise. Under the regulation of National Taxation Administration (2009 No. 82), overseas registered Chinese-invested enterprises are to be characterized as resident enterprises in China. Based on 'actual management standards', Chinese Unicom Red Chip Company was identified as a Chinese resident in November 2010.

In March 2011, based on corporate tax data, the Large Enterprises and International Tax Management Department of Xicheng District Tax Bureau in Beijing learned that, in 2009, China Unicom signed a strategic alliance agreement and mutual investment equity subscription agreement with a Spanish telecommunications company, Telefónica Internacional S.A.U (Telefónica), with the two companies holding each other's shares. In May 2011, Telefónica distributed dividends to Chinese Unicom Red Chip Company four times. Under Spanish tax law, Telefónica withheld and

remitted tax on the dividends. The tax rate was 18% before 31 December 2009, and 19% thereafter. Telefónica withheld a total of EUR 22.64 million (approximately CNY 210 million).

It seems reasonable to obtain dividends from foreign shares and pay taxes under local law. However, Chinese Unicom Red Chip Company was identified as a Chinese resident enterprise from 1 January 2008; it should enjoy tax treaty treatment accordingly. China and Spain signed an income tax treaty early in November 1990, Article 10 of which provided that the source state is to cap the tax rate for dividends at 10%. When a Spanish resident pays dividends to a Chinese resident, the tax rate should not exceed 10% of the total dividend. Accordingly, the Xicheng District Tax Bureau stated that China Unicom should enjoy a preferential rate of 10% on income. The company agreed with this, and actively pursued relevant procedures, and jointly asserted its own tax interests and national tax sovereignty with the tax department.

In April 2011, Chinese Unicom Red Chip Company communicated with the Spanish tax authorities on many occasions to apply for treatment under the applicable tax treaty. Chinese Unicom Red Chip Company also requested that the authorities refund the Spanish tax from 2009 to 2011, which was more than the required minimum, totalling EUR 10.62 million.[16]

4.1.2 Analysis of the Legal Issues

The focal issue of the Chinese Unicom Red Chip Company case is tax residence status. If any Chinese resident goes abroad to engage in business activities, it may request the related treatment stipulated in the applicable tax treaty. Because the tax treaty is applicable only to 'the residents of contracting states', going-global enterprises must first prove their Chinese tax residence status. Because Chinese Unicom Red Chip Company is listed in Hong Kong, and this place of registration is not in the mainland of China, it could not be seen as resident enterprise of Mainland China without a special procedure to indicate its identification. However, if it were identified as a Mainland China resident enterprise under the mainland corporate income tax rules, the applicable tax treaty benefits would be completely different.

Under regulations of the National Taxation Administration, going-global enterprises should complete the application form for a Chinese tax residence certificate and submit it to the local taxation administration in the foreign jurisdiction. The Chinese tax authorities responsible for such matters under the provisions of the application matters, in accordance with the corporate income tax law, individual income tax law and tax treaties for residents, render an opinion on the applicant's Chinese residence certificate which is issued by the Chinese Director General of Taxation. Residence certificates for Chinese companies are issued by the tax authorities of the place where the taxpayer's headquarters is located.[17]

16. Liu Guangming et al., *How nearly 100 Million Yuan of Overpayments Are Returned to China from Spain*, China Revenue News (29 Aug. 2011), 5th edition.
17. According to the Notice of the State Administration of Taxation on Relevant Matters Concerning the Issue of 'the Identity Certification of Chinese Tax Residents' on 28 Jun. 2016 (No. 40 of 2016

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Chinese Unicom Red Chip Company's way to safeguard its own rights began with the Chinese tax residence certificate. The Xicheng District tax bureau studied Chinese Unicom Red Chip Company, and immediately issued a notification to the enterprise in order to remind the enterprise to apply for a Chinese tax residence certificate as soon as possible, and timely apply for treaty benefits with the Spanish tax authorities.

4.2 Case of Huaxin Cement Limited Company

4.2.1 Facts of the Case

As a key project in the Belt and Road Initiative, Huaxin Cement Limited Company established a subsidiary, Yawan Company, in Tajikistan which was responsible for carrying out the business in Tajikistan. It was reported that in December 2012, the Yawan Company took a USD 78 million loan for a period of seven years from the National Development Bank of China, paid interest of USD 3.94 million in 2013, paid income tax of USD 470,000 at the rate of 12% under Tajikistani domestic law, paid interest of USD 4.45 million in 2014 and did not pay income tax. However, under the China-Tajikistan tax treaty, the interest could be tax exempted. After application of the tax exemption by Yawan Company to the Tajikistan Tax Bureau, the latter replied on 3 November 2014 and agreed that the annual interest would be taxed at the 8% rate stipulated by the tax treaty, but not including taxes payable on interest in 2013 and 2014. To this end, Yawan Company repeatedly communicated with the Tajikistan Tax Bureau, seeking to exempt the 2014 interest from income tax under the tax treaty and obtain a tax refund for 2013.

However, the Tax Bureau did not agree and urged Yawan company to pay USD 530,000 for the withholding tax on interest in 2014; otherwise it would be subject to penalties. Because at that time the Yawan Company had signed a loan agreement for the USD 100 million investment in a second-tier project with the National Development Bank of China, if it could not benefit from tax treaty treatment, the company would have to pay nearly USD 5 million income tax. Therefore, because efforts to cooperate failed, Huaxin Cement Company had to request help from the local tax authorities, namely the Tax Bureau of Huangshi City.

On 2 February 2015, the Tax Bureau of Huangshi called the National Tax Bureau of Hubei Province to report the problem. On 4 February 2015, the National Tax Bureau of Hubei Province fully collected the information and reported the details to the National Taxation Administration. After having been informed, the National Taxation Administration immediately launched a Mutual Agreement Procedure (MAP) under the tax treaty; wrote to the Tajikistan Tax Bureau; and requested a tax exemption on the interest paid by Yawan Company to the National Development Bank of China under the tax treaty. Through efforts to cooperate by the Chinese embassy in Tajikistan, the

by the State Administration of Taxation). The domestic and overseas branches of Chinese resident enterprises shall, through their head office, apply for the issuance of 'Certificate of Resident of Tax Resident' in any one calendar year in which they constitute the tax resident in China.

Tax Bureau of Tajikistan confirmed that it received the letter, and finally agreed to grant the tax exemption under the tax treaty.

This has brought approximately USD 5 million in profit for Yawan Company. Thus, through the joint efforts of the Tax Bureau of Hubei Province and the Tax Bureau Huangshi, which lasted thirty-six days, Hubei's first case to safeguard its rights in taxation on the road to investment in a Belt and Road country, was finally settled.[18]

4.2.2 Analysis of the Legal Problems Involved

The first issue in the Huaxin Cement Company case is to determine whether the interest should be paid in Tajikistan. In this case, Yawan Company is a resident enterprise in Tajikistan. It obtained loans from the National Development Bank of China, and paid interest to the National Development Bank of China. Under the China-Tajikistan tax treaty, the interest is deemed to arise in Tajikistan (under Article 11(6)).[19] Article 11(2) of the tax treaty stipulates that the interest that arises in one contracting state and is paid to a resident of the other contracting state, may also be taxed in the state where the interest arises under the laws of the state. However, if the interest beneficiary is a resident of the other contracting state, the tax may not exceed 8% of the total interest. Therefore, under the above provisions, the interest paid by Yawan Company to the National Development Bank of China is taxable under Tajikistani domestic law, and the income tax is to be paid at 8% (the treaty tax rate) instead of 12% (the domestic tax rate).

However, under Article 11 section 3 of the tax treaty, notwithstanding the provisions of Article 11 section 2, interest arising in a contracting state and paid to the government, local authorities, the central bank or any financial institution wholly owned by the government of the other contracting state, or interest arising from one contract state and paid for a loan that is guaranteed and insured by the government, local authorities, central banks of the other contracting state or financial institutions wholly owned by the government, is entitled to tax exemption in the first mentioned contracting state. As the National Development Bank of China is a tax-exempt financial institution under the above provisions, the interest paid by Yawan Company to the National Development Bank of China should enjoy tax exemption in Tajikistan.[20]

At present, among the fifty-four Chinese bilateral tax treaties with Belt and Road countries, forty-nine stipulate that the source state of interest must grant a tax exemption to, or does not enjoy the right to tax interest of the other contracting state, an administrative subdivision or a local authority and the central bank or financial institutions wholly owned or controlled by government. Furthermore, twelve of those tax treaties have specified the scope of 'financial institutions completely owned and controlled by the government', namely the Development Bank of China, the

18. Zhu Yan et al., *Cross Border Taxpayers Should Pay Special Attention to the Taxation*, China Tax Newspaper, A01 (23 Mar. 2015).
19. Article 11(6), China-Tajikistan tax treaty ('if the interest payer is the resident of one contracting state, the interest shall be deemed as have occurred in this contracting state'.).
20. Tax treaty between China and Tajikistan.

Agricultural Development Bank of China and the Export Import Bank of China; some of these treaties include the National Social Security Fund Council, the China Investment Corp. and other policy non-bank financial institutions.[21] The remaining thirty-seven tax treaties[22] contain only an exemption principle, without explicitly specifying a list of financial institutions. In addition, five tax treaties, namely those with Bosnia and Herzegovina, Israel, the Philippines, Russia and Slovenia, do not grant a tax exemption for interest paid to financial institutions controlled or owned by the government.

On the other hand, recently, newly signed treaties and revised tax treaties have relaxed the scope of financial institutions owned or controlled by the government, from the original 'full ownership' to 'main ownership', and the scope of financial institutions that are granted tax exemption is gradually expanding. Taking the revised China-Romania tax treaty (signed on 4 July 2016) as an example, paragraph 3 of Article 11 stipulates that notwithstanding the provisions of paragraph 2, interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State to the extent that such interest is paid: a) in respect of indebtedness arising as a consequence of the sale on credit of any equipment, merchandise or services; or b) on any loan of whatever kind granted by a financial institution of that other State; or c) to that other State or a political subdivision, local authority or administrative – territorial unit thereof, or any entity wholly or mainly owned by that other State. The term 'mainly owned' refers to ownership of more than 50%.

The tax treaty with Cambodia (signed on 13 October 2016) also stipulates the same. For the purpose of paragraph 3, Article 11, the understanding of 'any financial

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21. For example, the tax treaty with Pakistan includes only the People's Bank of China and Bank of China; the tax treaty with Turkey includes the People's Bank of China, Bank of China and Industrial Bank of China International Trust and Investment Corporation; the tax treaty with Laos and Oman stipulates that only the People's Bank of China, the State Development Bank of China, the Export-Import Bank of China and the Agricultural Development Bank of China; and Indonesia Agreement on Tax stipulates that "any financial institution" refers to the China Development Bank Corporation, the Agricultural Development Bank of China, the Export-Import Bank of China, the National Council for Social Security Fund and the China Investment Corporation; the tax treaty with Brunei includes the People's Bank of China, the State Development Bank of China, the Export-Import Bank of China, the Agricultural Development Bank of China, the National Council for Social Security Fund; the tax treaty with Singapore, Turkmenistan and Tajikistan includes the People's Bank of China, the China Development Bank, the Agricultural Development Bank of China, the Export-Import Bank of China, the National Council for Social Security Fund and the China Export & Credit Insurance Corporation; the exchange of Notes with Malaysia tax treaty also includes the China Development Bank Corporation, the Agricultural Development Bank of China, the Export-Import Bank of China, the National Council for Social Security Fund, the China Export & Credit Insurance Corporation, the China Investment Corporation and the silk Road Fund Co., Ltd.; Agreement with Azerbaijan tax includes: the State Development Bank of China, the Export-Import Bank of China, the Agricultural Development Bank of China, the National Council for Social Security Fund, the Bank of China, the Construction Bank of China, the Industrial and Commercial Bank of China and the Agricultural Bank of China.
22. Including Thailand, Vietnam, Nepal, India, Bangladesh, Sri Lanka, Kazakhstan, Kyrgyzstan, Uzbekistan, Egypt, Mongolia, Belarus, Ukraine, Moldova, Georgia, Armenia, Albania, Croatia, Czech Republic, Slovakia, plus Leah, Estonia, Lithuania, Hungary, Latvia, Macedonia, Montenegro, Romania, Poland, Serbia, Kuwait, the United Arab Emirates, Bahrain, Qatar, Saudi Arabia, Syria, Iran.

institution or statutory body mainly owned by the Government of the other Contracting State' in China refers to: the National Development Bank of China, the Agricultural Development Bank, the Import and Export Bank of China, the National Social Security Fund Council, the China Export and Credit Insurance Corp., the China Investment Corp., Industrial and Commercial Bank of China, the Bank of China, the Construction Bank of China, the Agricultural Bank of China, and any institutions or legal entities that are mainly owned by the Chinese government, and which the competent authorities of the two contracting states may agree at any time.

4.3 Case of Jerry Petroleum Company

4.3.1 Facts of the Case

Yantai Jerry Petroleum Company (referred to here as Jerry Company) is a locally listed company based in Yantai, Shandong Province. In 2010, Jerry Company established a wholly owned subsidiary in Kazakhstan, leasing its own equipment to the subsidiary and charging a leasing fee. The total price of the equipment was approximately CNY 19.56 million, and the leasing income was approximately CNY 53 million over six years. The Kazakhstani tax authorities become aware that the subsidiary paid a huge amount of fees to the parent company, and therefore immediately withheld 15% income tax from the leasing fee paid overseas under its domestic tax law.

In 2011, when Yantai Tax Bureau was making the final settlement for income tax of Jerry Company, it questioned whether Article 12 of the China-Kazakhstan tax treaty stipulated that for the leasing income obtained from the Kazakhstani investment, royalties are to be taxed at 10%. Jerry Company submitted a tax refund application to the competent tax authorities in Kazakhstan, but the Kazakhstani competent tax authorities insisted in applying domestic law and rejected Jerry Company's application. The company's effort to protect its rights was very passive in Kazakhstan. The Tax Bureau of Yantai selected key personnel to intervene decisively under the article concerning MAP of the China-Kazakhstan tax treaty, and coached the enterprise on how to complete the application for a MAP, submitted the request to the Chinese tax administration via the provincial tax bureau and started negotiation procedures with Kazakhstan.

After rounds of intense bilateral consultations and negotiations, Kazakhstan finally agreed to offer the refund. On 20 February 2012, the State Administration of Taxation issued a notice to Jerry Company, stating that Kazakhstan must tax the leasing income at 10% under the royalties article of the tax treaty. Jerry Company could pay CNY 2.65 million less to Kazakhstan. Kazakhstan also notified Jerry Company that it agreed to impose a 10% leasing tax rate on Jerry's leasing income obtained in Kazakhstan and was prepared to refund the excess tax collected previously. Therefore, the income tax liability was reduced to CNY 5.3 million (from CNY 7.95 million). Kazakhstan also agreed that, in future, the maximum rate under the tax treaty would

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be applied directly without the taxpayer having to seek a refund. Having received the notice from the Kazakhstani tax authorities, Jerry Group prepared files and submitted its tax refund application.[23]

4.3.2 Analysis of the Legal Issues Involved

This case involves the tax rate applicable to income from related-party equipment leasing and the means of tax collection and payment. Jerry Company and its subsidiaries in Kazakhstan are tax residents of China and Kazakhstan, respectively. They may apply the China-Kazakhstan tax treaty. Under Article 12 of that treaty, equipment leasing fees are royalties.[24] Kazakhstan has the right to levy taxes, and it may impose tax under its national laws, i.e., at the 15% tax rate.[25] However, Jerry Company is the recipient and ultimate beneficiary of the leasing fee from the equipment. Kazakhstan should apply a maximum rate of 10% when it levies taxes under its own law.[26] At the same time, as the tax treaty does not stipulate how to execute these tax rate caps, the host countries apply the rate in accordance with the relevant provisions of domestic law, some countries give refund after collection, and some countries apply the tax cap when the taxpayer makes a declaration. But in recent years in the negotiation of a new tax treaty or amendment of an old tax treaty, China normally seeks to have it stipulated that the tax cap will be applied directly rather than in the form of a refund after collection, so as to reduce the tax expense of going-global enterprises.

This suggests that Chinese enterprises need to actively understand and take advantage of preferential treatment provided by tax treaties, and clarify the relationship between tax treaties and domestic tax laws in the process of going global. When a tax treaty and domestic tax law are not consistent, most countries generally stipulate that the treaty will prevail. If the treaty tax rate is less than the rate under domestic law, the preferential tax rate under the tax treaty is allowed (although there are exceptions, the United States). When a treaty is given the priority, the knowledge and application thereof can bring significant tax benefits for enterprises.

5 SOLUTION TO ADDRESS DISPUTES REGARDING TAX TREATIES BENEFITS

In the case of Huaxin Cement, the relevant interest should enjoy tax exemption in Tajikistan. The Yawan Company consulted with the Tajikistan Tax Bureau many times, but the latter not only refused to grant a tax exemption for 2014 and refund the interest income tax paid in 2013 but even urged Yawan company to pay interest accrued taxes of USD 530,000 in 2014. The enterprises represented by Huaxin Cement

23. Zhang Tongpeng, *Five Shandong 'Going Global' Companies Telling How to Crack Three Corporate Tax Revenue Problems*, China Tax News (22 May 2015), B1.
24. Article 12(3).
25. Article 12(1) & (2) China-Kazakhstan tax treaty.
26. Article 12(2) China-Kazakhstan tax treaty ('but if the recipient is the beneficiary of the royalty fee, then the tax payable shall not exceed 10% of the total amount of the royalty fee'.).

Company face the issue of how to safeguard their rights when they have tax disputes with the tax authorities in the host country in the process of going global. In the theory and practice of international tax law, enterprises can generally start with the following ways to safeguard their rights.

5.1 Local Relief in the Host Country as the Main Solution

In the long history of international practice, as for how to resolve disputes between foreign investors and host countries, the territorial supremacy of host countries has been universally respected and recognized by the international community. Among them, for the majority of developing countries that have suffered external interference and coercion over the course of history, they particularly care about the territorial supremacy as hosts when resolving disputes and conflicts of interest with foreign investors. They maintain that disputes need to be resolved by local relief from the host country, as is required by domestic law and foreign policies. Most Belt and Road countries are developing countries, and their territorial superiority as host countries should obviously be highly respected by China, Chinese enterprises and individual investors. In the event of disputes with Belt and Road countries, individual investors and Chinese enterprises should fully respect and make use of Belt and Road countries' local relief to resolve the disputes.

However, there are obvious deficiencies in the awareness and ability of Chinese enterprises and individual investors to apply the legal rules to seek local relief in the host country. To this end, the Chinese government should strengthen and improve the awareness and ability of Chinese enterprises and individual investors to pursue local relief options in the host country from many perspectives. From the perspectives of individual investors and Chinese enterprises, they should further strengthen the awareness and ability to utilize domestic and international tax law experts to timely prevent and control tax disputes; when disputes arise, taxpayers should be able to rely on the support of tax law experts at home and abroad to help resolve tax disputes by pursuing local relief options in the host countries. From the perspective of the Chinese domestic support system, the Chinese government can provide support and assistance for Chinese enterprises and individual investors to use host-country local relief options through establishing and using various consulting and service mechanisms. In this regard, the State Administration of Taxation has established two support institutions for international tax law and policy services, namely, the 12366 Beijing Tax Service Centre and the Shanghai Tax Service Centre.

5.2 Diplomatic Protection as Auxiliary Solution

Diplomatic protection refers to the responsibility of a country to invoke another country's responsibility in the name of the state through diplomatic actions or other peaceful solutions due to the internationally wrongful act of another country that has inflicted harm upon the first country's nationals, so as to enable the country to fulfil its responsibilities. Generally speaking, whether to exercise diplomatic protection is a

right of the state decided at its own discretion, not the obligation for its citizens. There are three prerequisites for the exercise of diplomatic protection. *First*, the damage to nationals in a foreign country must be caused by the international wrongful act of the foreign country. *Second*, the requesting state must be able to prove that the victims are its own nationals. *Third*, the local relief options must have been exhausted.

A request for diplomatic protection may be filed without the exhaustion of local relief options if: (i) there is no reasonable and available local relief, or local relief options provide no reasonable possibility of such remedy, (ii) the relief process involves undue delay, and that delay is caused by the country which is alleged to be responsible, (iii) the victim is apparently precluded from pursuing local relief and (iv) the state alleged to be responsible has conceded the exhaustion of local relief. In the judgment in the Diallo case in May 2007 (preliminary objection), the International Court of Justice once again confirmed the two principles of nationality and exhaustion of local relief which are universally recognized conditions for the exercise of diplomatic protection.

As a rule of customary international law, with the development of international practice and the draft articles on diplomatic protection compiled and adopted by the International Law Commission in 2006, there have been some new developments in the diplomatic protection system and its interpretation. Furthermore, the exemption rules have increased such as the standard of nationality; rights and responsibilities; and the demand for local judicial relief. China has actively participated in the whole process of international legislation of Draft Articles on Diplomatic Protection and put forward its own proposal and position for it.

At the same time, facing the huge outbound flow of enterprises and citizens, China is still exploring ways and means to effectively protect overseas interests, and overseas interest protection still has a long way to go. In short, the diplomatic protection system and its interpretation are undergoing new changes, but the exercise requirements and basic framework have not changed fundamentally, especially as regards the exhaustion of local relief requirement. Therefore, addressing disputes over preferential tax treatment via diplomatic protection remains limited to harsh conditions. Moreover, as diplomatic protection covers a wide range of areas, with a high level of political sensitivity, China is unlikely to readily resort to using diplomatic protection to resolve disputes on tax treaty benefits, especially between Belt and Road countries.

5.3 MAP Between Contracting Countries

The MAP under tax treaties opens up an effective international relief channel for going-global enterprises and helps to properly resolve the tax disputes abroad for such enterprises. Chinese tax treaties with Belt and Road countries include a mutual agreement provision, which stipulates that when authorities of the contracting parties cannot reach an agreement regarding the interpretation or application a tax treaty provision, or one country's tax collection practice leads to double taxation, they may consult together to resolve the international tax dispute.

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which they operate). To this end, the development of efficient and effective advanced pricing agreement (APA) programmes will be fundamental. This will be analysed in section 2.6.

This chapter will address the above-mentioned topics by providing, first, a background on each one, taking into account the main features from a general international perspective as well as those specifically related to OBOR countries, and, then, some conclusions and proposal for future developments.

2 RELEVANT AREAS OF STUDY

2.1 Manufacturing Activities

Manufacturing activities give rise to some of the most common kind of transactions around the world. In general, businesses can operate with three types of models, namely toll manufacturers, contract manufacturers and full-fledged manufacturers. Toll and contract manufacturers operate in a quite similar way. They are limited-risk service providers, producing goods strictly under specifications and selling everything back to the principal. Other than plant, machinery and routine manufacturing skills, they do not own valuable IP, such as patents and secret formulas. The main difference between the two business models is seen in the fact that the toll manufacturer does not bear any inventory risk, while the contract manufacturer procures and owns raw materials and takes title to the finished products, thereby bearing the related inventory risks. In contrast, the functions of a full-fledged manufacturer cover, for example, manufacturing, procurement, inventory management and customer negotiations, as well as sometimes research and development (R&D) and marketing activities. Furthermore, a full-fledged manufacturer generally possesses various inventory and valuable IP,[6] such as industrial/technical know-how and secret formulas. As a result, the risks undertaken by a full-fledged manufacturer are substantial and material.

For transfer pricing purposes, the nature of transactions between related parties arising from the manufacturing activities should comply with the arm's length principle. This often requires the performance of an accurate comparability analysis, by means of a comparison between terms and conditions agreed between related parties and those agreed between unrelated parties. Due to the differences in risk profiles, it is the general understanding that toll and contract manufacturers are, in principle, remunerated with relatively low but stable returns, while full-fledged manufacturers can claim the residual profits (or suffer considerable losses). In this context, the comparable uncontrolled price (CUP) method, the cost-plus method and the transactional net margin method (TNMM), typically applied in practice, rely heavily on

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6. Another type of manufacturer that literature often mentions is the licensed manufacturer. The functional profile of a licensed manufacturer is generally the same as that of a full-fledged manufacturer. However, a licensed manufacturer does not perform R&D activities, and does not have product- or manufacturing-related intangibles. For production purpose, the licensed manufacturer uses intangibles via license agreements with an associated entity or third party.

comparables data. As a result, two main issues are often identified, especially within developing countries, namely the lack of comparables data[7] and the allocation of location savings.[8]

Regarding the lack of comparables data, developing counties are faced with a shortage of commercial databases, publicly available, for the purpose of finding comparables data. It is undisputed that the likelihood of non-OECD countries not having access to a commercial database with company financial or pricing of transactions is much higher than that of OECD countries. The main reasons are that those countries do not have resources available to purchase databases and/or lack skilled personnel to manage and operate these databases. Furthermore, for some countries that have access to these databases, the data that are relevant to their audit may not be sufficient. In 2015, 106 countries had no more than ten independent records with revenue and net margin information, and thirty countries had approximately 10–100 such records. Many OBOR strategic countries, including Albania, Armenia, Azerbaijan, Bahrain, Belarus, Brunei, Croatia, Georgia, Iran, Kyrgyzstan, Laos, Moldova, Mongolia, Nepal, Qatar, Syria, Tajikistan, Turkmenistan, Uzbekistan, and the United Arab Emirates were on that list. The issues are caused by the fact that these countries do not have proper financial registries where local companies can record their corporate financial information that could be also used for transfer pricing analyses. This issue, to some extent, often ends up with tax administrations using 'secret comparables' in tax audits. However, such use of secret comparables may infringe the tax secrecy of taxpayers the tax data of which are taken for assessment use, and, in addition, the assessed taxpayers would not be able to properly defend their results because they lack access to the secret data.[9] As a result of the conflicting interests against taxpayers' rights, the use of secret data could discourage MNEs from establishing business operations in the concerned jurisdictions, potentially harming the success of the OBOR project.

In China, tax administrations may use public information (e.g., the databases of the National Bureau of Statistics and the Bureau van Dijk), as well as non-public

7. For guidance on these topics, *see* The Platform for Collaboration on Tax, *Discussion Draft: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* (January 2017); European Commission, Dir.-Gen. Taxation & Customs, EU JTPF, *Report on the Use of Comparables in the EU* (Oct. 2016), JTPF/007/2016/FINAL/EN.
8. For guidance of these topics, *see* OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing 2010), D.6.1. Location savings, amended by OECD, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8–10 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 5 Oct. 2015); UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.2.3.47.-B.2.3.2.61.; Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, p. 218–219.
9. The OECD is generally opposed to the use of secret comparables. OECD Guidelines (2016), para. 3.36. The view of the UN is rather flexible (UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.1.6.30.-B.1.6.32) that the tax authorities may use secret comparables in a transfer pricing audit; however the tax authorities should (within limits of confidentiality) disclose the data to the taxpayer so as to assist the taxpayer in defending itself against an adjustment. The World Bank Transfer Pricing Handbook contends that, in practice, non-pubic information is often used by tax administrations for risk-assessment purposes, rather than for transfer pricing adjustments, and such information is practically useful to establish a safe harbour margin. Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, at 1501–51.

information, to prove compliance with the arm's length principle during transfer pricing audits.[10] To do so, they may collect secret comparables during transfer pricing audits to use them as comparables in other audits in the same industry.

Likewise, the law of Kazakhstan envisages the use of the following sources of information on market prices (in the order of priority): (i) officially recognized sources of information, (ii) stock exchange quotations, (iii) price information maintained by Kazakh state authorities and (iv) software issued by the authorities, information provided by taxpayers and other sources of information.[11] However, a major challenge for taxpayers in Kazakhstan is that the process leading to transfer pricing assessments undertaken by tax authorities is often non-transparent, and the tax authorities typically do not disclose either the source of data used or the methodology they have applied.[12] In Russia, the databases used are RUSLANA and SPARK. Taxpayers may use foreign comparables, although local data are preferred. In addition, the use of a 'secret source of information' or information that is inaccessible under Russian law is explicitly prohibited, unless the information is derived from tax audits.[13] Therefore, both tax administrations and taxpayers may rely only on publicly available sources of information. In contrast, sources on comparables data are not yet available for Georgia or Belarus.

Regarding the allocation of location savings, tax administrations in OBOR countries may tend to use foreign comparables that are often more available, however adjusted in order to consider the specific geographical conditions by virtue of 'location savings'. The views on this topic from the OECD and the UN have been more aligned by the OECD/G20 BEPS project. As a general rule, local comparables, if available, should override foreign comparables, and the arm's length nature of a transaction should be determined by reference to the former kind of comparables.[14] In this context, there will be no need to perform a separate adjustment to account for location savings. However, foreign comparables, adjusted to take into account location savings, could be used to derive the arm's length nature of a transaction when local comparables are absent.[15] Finally, if there are no comparables at all, the proposed solution would lead to splitting the benefits derived from location savings between the involved enterprises based on the bargaining power of each.[16]

10. 第三十七条，《国家税务总局关于发布(特别纳税调整及相互协商程序管理办法)的公告》（国家税务总局公告2017第6号），2017年3月17号。.
11. **KZ**: Law 67-IV, Article 18.
12. A. Zhabbarov & A. Kulisheva, *New Transfer Pricing Law in Force*, **17** Intl. Transfer Pricing J. **4**, at 304 (2010).
13. E. Veter, H. Hansen & R. Radzhabov, *New Transfer Pricing Rules*, **18** Intl. Transfer Pricing J. **5**, at 340 (2011).
14. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 1.142; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, para. B.2.3.2.50.
15. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 1.143; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, para. B.2.3.2.50.
16. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 1.143; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, para. B.2.3.2.56. More often than not, this solution is applied in cases of full-fledged manufacturers, where comparables might often not be available. As a result, the compensation usually requires a more detailed study of its contribution to the value chain, behind which are functions, risks and assets.

On the other hand, some countries (especially developing countries, which certainly include quite a number of OBOR countries) assert that the economic benefits arising from location savings should accrue to the country where the operations actually take place. The Chinese tax authorities, for example, are a leading proponent of such view. Particularly, the Chinese tax authorities provide a six-step approach to determine the transfer price for a Chinese enterprise to allow for the location-savings benefits.[17] The application of this six-step approach will align the profitability, which is equal to full cost mark-up multiplied by the margin, of the Chinese enterprise with that of the foreign enterprise, which is mostly selected from developed countries.[18] Ultimately, all the benefits derived from location savings are officially allocated to the Chinese enterprise. The approach taken by the Chinese tax authorities may generate concerns for MNEs that have manufacturing activities out in China, due to the deviations of this approach from the international standards set out by the OECD and the UN. On the other hand, Chinese MNEs investing abroad could face similar challenges from local jurisdictions declaring location savings.

India is also known to apply the concept of location savings quite often in practice. The Indian tax authorities hold that transfer prices determined by virtue of good local comparables, if available, are at arm's length and capture the effects of location savings.[19] Both China and India leave the option open of applying the profit split method in this context.[20]

In addition, an increasing number of countries are exploring the application of location savings in their domestic transfer pricing laws. The tax administrations in South Africa and Vietnam, for example, following the practice of China and India, are currently considering the use of the concept of location savings in their tax audits.[21,22] In effect, issues surrounding location savings again highlight the problem of the insufficient availability of local comparables data, which to some extent results in an overuse and potential misuse of foreign comparables in practice.

2.2 Services and Financial Transactions

Intra-group services include a vast variety of transactions, ranging from management and administrative services to marketing services, technical services, as well as intra-group financial transactions. A review of the arm's length nature of intra-group services normally requires a two-steps analysis.[23] The first step is to determine the

17. UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, para. B.2.4.4.9.
18. *Ibid.*
19. UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, para. D.3.7.4.
20. *Ibid.*, paras. B.2.4.6.13. and B.3.7.3.
21. *Ibid.*, para. D.5.8.4.
22. VN: Quy định về quản lý thuế đối với các doanh nghiệp có giao dịch liên kết (Regulations on the Tax Administration of Enterprises with Related-Party Transactions) (21 Nov. 2016), Article 6(3)(d).
23. For guidance of these topics, *see* OECD, *Transfer Pricing Guidelines* (2010), Chapter VII, 'Special Considerations for Intra-Group Services', amended by *Action 8–10 Final Reports*; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, Chapter B.4., 'Intra-Group Services'; Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, at 205–209; EU

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chargeability of the concerned intra-group activities via the so-called 'benefit test'. Pursuant to this test, two conditions are to be satisfied, namely: (i) the activity at stake has provided or is expected to provide economic value to the concerned parties and (ii) a third party in comparable circumstances would have been willing to pay for the provision of the activity or would have performed the activity in-house.[24] In particular, shareholder activities,[25] mere duplications of services[26] and the provision of incidental benefits[27] are not classified as chargeable intra-group services under this test.

The second step, then, is the determination of the arm's length compensation for the chargeable services in three further steps, namely assessing costs of the concerned service; choosing the proper charging method (direct or indirect) to allocate the costs; and applying the most appropriate transfer pricing method to calculate the proper amount of remuneration. In this regard, the CUP method, the cost-plus method and the TNMM are used most frequently in practice. Within this framework, safe harbour rules, in the specific context of low value-adding services[28] and minor expenses,[29] could be applied in certain cases.

Regarding the specific category of financial services, the above-mentioned general principles apply equally in order to obtain their arm's length nature. Nevertheless, special considerations should be paid as regards the category of arrangement. In this context, the CUP method is often applied to locate the arm's length rate of interest or credit rating, although the cost-plus method and profit split method could also prove useful. For example, for intra-group interest rates, the information derived from third-party syndicated loans, price quotes[30] and other information contained in publicly available databases[31] can be beneficial;[32] for intra-group financial guarantee fees, instead, the information derived from third-party financial guarantees, price quotes,[33]

JTPF. *See* European Commission, Dir.-Gen. Taxation & Customs, EU JTPF, *Report on Cost Contribution Arrangements on Services not Creating Intangible Property* (2012), JTPF/008/FINAL/2012/EN.

24. OECD, *Transfer Pricing Guidelines* (2010), para. 7.6; OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 7.6; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, para. B.4.10.
25. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 7.9; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.4.2.13.–B.4.2.17.
26. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 7.11; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.4.2.18.–B.4.2.20.
27. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 7.12; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.4.2.21.-B.4.2.24.
28. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, paras. 7.43–7.65; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.4.5.3.– B.4.5.10.
29. UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.4.72-B.4.13.5.
30. These quotes, however, may not be accepted as the primary method in certain jurisdictions. Nevertheless, they could still be used as a corroborative method.
31. For example., Thomson Reuters Loan Connector™, Bloomberg Professional® and information found on the websites of stock market exchanges.
32. For more detailed guidance on this topic, *see* R. Petruzzi, *Transfer Pricing Aspects of Intra-Group Financing* (Wolters Kluwer 2016).
33. These quotes, however, may not be accepted as the primary method in certain jurisdictions. Nevertheless, they could still be used as a corroborative method.

bankers' acceptances, credit default swap fees, letter of credit fees, commitment fees, various types of insurance, as well as put options can be beneficial.[34]

In the context of the OBOR countries,[35] the topic of intra-group services (including financial transactions) plays a relevant role. The Chinese tax authorities, as an echo to the BEPS project, have amended the domestic transfer pricing guidelines to ensure alignment with international standards, following the release of Bulletin 42,[36] Bulletin 64[37] and Bulletin 6.[38] Concerning intra-group services, the benefit test will be taken into account to assess the deductibility of service payments, and in particular shareholder activity, duplicated activities and incidental benefits are non-chargeable.[39] In particular, the enhancement of the credit rating which is solely attributable to being part of an MNE group, will not be characterized as an intra-group service.[40]

Singapore suggests a 5% mark-up on 'routine services' provided by the parent or a group service company for 'business convenience and efficiency reasons',[41] and a 0% margin on cost pooling arrangements.[42] As regards the related cross-border loans, an internal comparable between the Singaporean associated entity and the third-party entity is strictly preferred in comparison to an internal comparable with a third-party bank.[43] It is also prescribed that the arm's length interest rate usually consist of a base reference rate[44] and a credit spread or margin.[45,46] Instead of conducting a detailed transfer pricing analysis, taxpayers may choose to apply the indicative margin to each related-party loan that does not exceed SGD 15 million at the time the loan is obtained or provided.[47]

Russian transfer pricing rules do not include a safe harbour rule on low value-adding services. However, regarding intercompany loans, the interest for tax purposes is defined by law and, therefore, interest rates that are not within the defined

34. For more detailed guidance on this topic, *see* Petruzzi, *supra* n. 32.
35. A study by the Chinese Ministry of Commerce shows that, in the first half of 2015, Chinese enterprises invested in 48 countries along the OBOR zone, totaling USD 7.05 billion, mainly in the ASEAN region, Russia and Kazakhstan. For reason of materiality, the analysis of this section is deliberately focused on the ASEAN region, Russia and Kazakhstan.
36. CN:《国家税务总局关于完善关联申报和同期资料管理有关事项的公告》（国家税务总局公告2016第42号），2016年6月29号。
37. CN:《国家税务总局关于完善预约定价安排管理有关事项的公告》（国家税务总局公告2016第64号），2016年10月11号。
38. CN:《国家税务总局关于发布〈特别纳税调整及相互协商程序管理办法〉的公告》（国家税务总局公告2017第6号），2017年3月17号。
39. CN: 第三十五条，《国家税务总局关于发布〈特别纳税调整及相互协商程序管理办法〉的公告》（国家税务总局公告2017第6号），2017年3月17号。
40. CN: 第三十五条，《国家税务总局关于发布〈特别纳税调整及相互协商程序管理办法〉的公告》（国家税务总局公告2017第6号），2017年3月17号。
41. SG: IRAS, *IRAS e-Tax Guide: Transfer Pricing Guidelines* (2017), paras. 12.26–12.27.
42. *Ibid.*, paras. 12.31–12.32.
43. *Ibid.* 13.16.
44. The base reference rate is usually a publicly available rate such as the Singapore Inter-Bank Offered Rate, the London Inter-Bank Offered Rate or prime rates offered by banks.
45. The margin is mainly to compensate the lender for bearing the credit risk of the borrower defaulting on the loan.
46. IRAS, *supra* n. 41, paras. 13.17–13.19.
47. *Ibid.* 13.27–13.34.

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range will be subject to standard transfer pricing rules.[48] Specifically, the Russian tax authorities do not assess for transfer pricing purpose: (i) transactions involving the provision of guarantees where all the parties to the transaction are non-bank Russian companies or (ii) transactions involving the provision of interest-free loans between Russian related persons.[49]

In Indonesia, under domestic transfer pricing rules, taxpayers are obligated to charge a market interest rate on loans granted.[50] During a tax audit, the Indonesian tax authorities will assess four aspects of intra-group loans to ensure fairness, namely: (i) analysing whether the debt is needed, (ii) verifying that loans from affiliated parties actually occur, (iii) testing the reasonableness of the debt-to-equity ratio and (iv) testing the reasonableness of the interest rate or other expenses related to intra-group loans.[51] Furthermore, the CUP method can be used to test an interest payment transaction. It is also provided that an intra-group guarantee should also be priced at the market rate. Nevertheless, the Indonesian transfer pricing rules do not distinguish between implicit and explicit guarantees. In that case, taxpayers may use the CUP method to support the arm's length nature of the guarantee.

Vietnamese transfer pricing rules currently do not contain specific provisions on inter-group loans. However, it is suggested that the CUP method is appropriate in establishing the arm's length result under a loan contract.[52] Particularly, where loans are provided by an overseas entity, a Vietnamese company will need to register its medium- and long-term foreign loans (for a term of one year or more) with the State Bank of Vietnam. If local companies fail to do so, the interest expense generated as such is not deductible.

Neither the Indonesian tax authorities nor the Vietnamese tax authorities provide any safe harbour provisions under domestic transfer pricing law. On the other hand, Hungary includes special treatment for low value-adding intra-group services in a non-exhaustive list, taking into account the work of EU JTPF[53] on this matter.

2.3 Intangible Property

IP is defined in the Actions 8–10 Final Reports[54] as 'something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances'.[55] The transfer pricing issues connected to intra-group transactions involving IP are numerous and of high relevance, considering the increasing importance of their

48. RU: Tax Code Articles 43(3) & 269(1).
49. RU: Tax Code, section V.1.
50. ID: Income Tax Law, Article 18.
51. ID: PER-22 of the Directorate General of Taxes Regulation.
52. VN: Transfer Pricing Circular 6.
53. EU JTPF, *Report on Cost Contribution Arrangements on Services not Creating Intangible Property*, *supra* n. 23.
54. OECD, *Actions 8–10 Final Reports*, *supra* n. 8.
55. *Ibid.*, para. 6.6.

value within MNEs.[56] One of the most relevant of these issues concerns how to attribute the value generated by IP amongst the various members of an MNE, i.e., how to allocate IP-related returns between related parties. Indeed, although the legal ownership of IP might be easily identifiable, the arm's length nature of the allocation of the IP-related returns should rather focus on the specific contribution to the important functions and risks related to the development, enhancement, maintenance, protection and exploitation (DEMPE) of the IP, as the OECD stated in the Actions 8–10 Final Reports.[57]

In this regard, the UN Manual also identifies the importance of the special contributions made with respect to DAEMPE (development or acquisition, enhancement, maintenance, protection and exploitation) of the intangibles involved.[58] Additionally, the World Bank Handbook supports the DEMPE concept in general, although it underscores the uncertainty and lack of resources for tax administrations to apply the DEMPE concept in practice.

In the context of the OBOR countries, China has come a long way from having a dearth of transfer pricing rules to now being one of the earliest adopters of the outcomes of the OECD/G20 BEPS project despite some divergences. For example, for purposes of Chinese transfer pricing law, 'ownership' is not limited to a strict legal sense. Rather, the Chinese tax authorities typically apply the concept of 'economic ownership', especially in the case of marketing intangibles and IP resulting from R&D activities, in order to preserve China's taxing rights over value created within its boundaries. Furthermore, in the case of marketing intangibles, to the extent that the Chinese enterprise would bear a substantial amount of marketing expenses, the Chinese position is that the Chinese enterprise should be entitled to at least a portion of any excess economic profit associated with the marketing intangibles resulting from the marketing activities within the jurisdiction.[59] Moreover, although China follows the OECD approach as regards ownership and the DEMPE functions, its view on the functional analysis is broader in the sense that it sets out a 'DEMPEP' approach. This means that it goes one step further by adding 'promotion' to the definition of activities that entitle returns on IP. By adding 'promotion' to the DEMPE standard, China reinforces its view that market premium could rise to the level of a unique and valuable intangible. It emphasizes the contribution of manufacturers and marketers to the enhancement of IP asset value, and downplays the significance of high-level strategic planning and control of IP asset development. In other words, the Chinese approach

56. For guidance of these topics, *see* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 2, Chapter VI, 'Intangible Property', amended by OECD, *Actions 8-10 Final Reports*, *supra* n. 8); UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, Part B.5, 'Transfer Pricing considerations for Intangible Property'); Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, at 212, Chapter 5, 'Selected Issues in Transfer Pricing' – 'Intangibles').
57. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, para. 6.32.
58. UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. B.5.3.13.–B.5.3.14.
59. China (People's Rep.), *Transfer Pricing*, Topical Analyses IBFD (accessed 28 Aug. 2016).

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deviates from the OECD approach, which pursues to allocate value creation based on decision-making as a control factor, which clearly is more beneficial to developed countries.[60]

The majority of OBOR countries (Albania, Bangladesh, Belarus, Bosnia and Herzegovina, Bulgaria, China, Croatia, Czech Republic, Estonia, Georgia, Hungary, India, Indonesia, Israel, Kazakhstan, Kuwait, Kyrgyzstan, Latvia, Lithuania, Malaysia, Mongolia, Oman, Philippines, Qatar, Romania, Russia, Saudi Arabia, Serbia and Montenegro, Singapore, Slovakia, Slovenia, Sri Lanka, Tajikistan, Turkey, Ukraine and Vietnam) to a greater or a lesser extent, follow the OECD Guidelines. This means that the legal owner of intangibles will be entitled to retain all ex-ante returns derived from the exploitation of such intangibles only if it performs and controls all of the DEMPE functions; provides all assets, including funding, necessary for the DEMPE functions; and assumes all risks related to the DEMPE functions.

Despite the widespread adoption of the OECD Guidelines among OBOR countries, there are some jurisdictions that do not follow the OECD and apply only the transfer pricing rules envisaged under their domestic tax system, such as Egypt, Iran, Macedonia, Nepal, Pakistan, and Turkmenistan. Nevertheless, as regards the allocation of returns on intangibles, they do not have specific rules, which inevitably might trigger disparities among the region when determining the proper transfer price in connection with intangibles, if they do not pursue a move to the OECD/UN (post-BEPS) approach. As mentioned before, countries such as Armenia, Azerbaijan, Bahrain, Brunei, Kuwait, Moldova, Syria, the United Arab Emirates and Uzbekistan do not have transfer pricing rules in their tax systems – which might also be detrimental to OBOR development.

Moreover, as regards the definition of IP, difficulties can arise during a transfer pricing analysis as a result of definitions of the term 'intangibles' that are either too narrow or too broad under domestic laws. On the one hand, if an overly narrow definition is applied, certain IP could fall outside the definition and therefore be able to be transferred or used without separate compensation. On the other hand, if an overly broad a definition is applied, the use or transfer of IP in transactions between associated enterprises could require compensation in circumstances where no such compensation would be provided in transactions between independent enterprises.[61]

2.4 Cost Contribution Arrangements

The OECD defines CCAs as 'special contractual arrangements among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of IP, tangible assets or services with the understanding that such IP, tangible assets or services are expected to create benefits for the individual

60. C. Chi, J. Kondos, S. Liu & K. Liao, *China's New Transfer Pricing Guidelines and BEPS*, in *China – Looking Ahead, Intl. Tax Rev.*, at 19 (2015), http://www.internationaltaxreview.com/IssueArticle/3511707/Archive/Chinas-new-transfer pricing-guidelines-and-BEPS.html (accessed 12 Dec. 2017).
61. UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, Part B.2.2.

businesses of each of the participants'.[62] CCAs often pursue two distinctive purposes, namely: (i) the joint development, production or obtaining of assets[63] and (ii) the sharing of costs for obtaining intra-group services.[64] MNEs have used CCAs since 1950s as a cost-effective means of carrying out their activities based on economies of scale and sharing of risks and resources. Their distinct benefit vis-à-vis traditional multilateral agreements or a web of bilateral ones is a more streamlined system of sharing contributions, remuneration and risks.

CCAs can involve numerous transfer pricing issues that must be carefully considered. These include the determination of the participants; their contribution to the CCAs as well as their expected benefits form the CCAs; and the quantification (and classification) of balancing payments and of any payment for entry, withdrawal or termination of the CCA.[65]

As far as the OBOR countries are concerned, there are some recent developments to be considered. China first adopted CCA rules in January 2009 (effective from 1 January 2008)[66] and amended the reporting and administration process in June 2015.[67]

62. *See* OECD Guidelines, Chapter VIII ('Cost Contributions Agreements'), amended by the Actions 8–10 Final Reports. OECD, *Actions 8–10 Final Reports*, *supra* n. 8, at 161.
63. CCAs of the first type resemble joint ventures (or consortia), where the parties partially unite forces, assets and activities to implement a certain project. The practical difference between CCAs and joint ventures (or consortia) is that the former are commonly agreed among related parties, while the latter are agreed among unrelated parties. In OBOR countries, consortia are popular in industries such as mineral extraction and construction, and the respective agreements may be concluded on intergovernmental level or closely observed by the governmental agencies.
64. CCAs of the second type are arrangements where several members of an MNE contribute to the group's internal activities (becoming, in a way, 'cost centres'), while other group members cover their respective costs based on certain allocation keys. These arrangements can cover the use of intangibles owned, IT, logistics, accounting and other management services performed by designated companies of the group. The difference from common arrangements for intra-group services is the more complex nature of relations, whereby the same companies are both providers of some services and recipients of others. The costs are split among members of the group (potentially) benefiting from such intangibles or services in proportion to their sales revenue, profit, number of staff, number of software licenses or other relevant indicator or set thereof. While the 'beneficiaries' regularly pay for such services and use of intangibles, the volume of benefits obtained in a given period does not necessarily correlate with the amounts paid in the same period; however this may happen among independent companies in the case of subscription-type arrangements.
65. For guidance of these topics, *see* OECD, *Transfer Pricing Guidelines*, Chapter VIII, 'Cost Contribution Arrangements', amended by OECD, *Actions 8–10 Final Reports*, *supra* n. 8); UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, paras. 1.6.11–1.6.12 and 7.4.6.13–7.4.6.14; Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, Chapter 5, 'Cost Contribution Arrangements'; EU JTPF, *Report on Cost Contribution Arrangements on Services not Creating Intangible Property*, *supra* n. 23. Communication from the Commission to the European Parliament, the Council and the European economic and social committee COM (2012) 516 final dated 19 Sep. 2012, http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf/2012/2012-09_com516_en.pdf). The EU JTPF found that by 1 Jul. 2011, only a few EU Member States had law or guidance on CCAs, namely Denmark, Estonia, Italy, Lithuania, the Netherlands, Spain, Portugal, Slovenia and the United Kingdom. Earlier, it also acknowledged that 'tax auditors ... may not be familiar with such arrangements'.
66. CN: Implementation Measures of Special Tax Adjustments (Guoshuifa [2009] 2).
67. CN: Announcement on Standardizing the Administration of Cost Sharing Agreement (Announcement 45).

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These rules allow both of the above-mentioned types of CCAs, and prohibit accrual and payment of any additional royalties for the IP developed or transferred under a CCA. They also include limitation on benefits clauses; establishing five conditions when the respective costs cannot be deducted; namely a lack of economic substance; deviation from the arm's length principle; costs not matching revenues; non-compliance with documentation requirements and reporting requirements; and a timeframe of less than twenty years. The documentation and reporting requirements include a list of minimum contents for a CCA, a list of supporting information and rights of the tax authorities to review the arrangement and amend the price. The emphasis of CCA rules in China is on the deductibility of the incurred expenses.

Among former USSR countries, there are only three that have detailed transfer pricing rules, namely Kazakhstan, Russia and Ukraine, although they do not provide for acceptance of CCAs. Practitioners confirm that in Russia, CCAs are not legally possible due to contract requirements and difficulties with cost justification. As a result, a business is forced to use 'cover' transactions (i.e., bilateral service contracts with management companies or license payments).[68] However, there remains a risk of exposure during tax audits, and in 2013 there were numerous Russian court cases involving this issue. The corporate and tax rules in other former USSR countries (such as Azerbaijan, Belarus, Georgia, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) contain limited transfer pricing provisions, which are similar in respect of non-acceptance of CCAs, and no publications considered this issue. Armenia and Moldova have no transfer pricing rules and therefore CCAs are not accepted.

Among EU OBOR countries, some have designated CCA rules, such as Estonia, Poland, and Romania, which include detailed provisions on the content of respective documentation (including proof of benefits of domestic company, allocation keys and consistency use thereof, breakdown of costs). Croatia, Czech Republic, Hungary, Latvia, Lithuania, Slovakia and Slovenia normally accept CCAs, but the deductibility of respective costs is determined on a case-by-case basis.

In the maritime OBOR countries, Indonesia briefly touches upon the issue of CCAs in its tax rules, and practitioners believe that the OECD approach is acceptable. Malaysia applies dedicated guidance based on the OECD Guidelines. That guidance contains a chapter on CCAs which sets forth only basic rules (definition, arm's length rule, suggested allocation keys and economic substance); in practice, the tax authorities tend to apply rules on intra-group services instead (if there is no development of IP). Singapore does not have specific rules on CCAs and tends to treat 'service' CCAs as intra-group services (with respective requirements) and 'IP' CCAs as either the acquisition of IP or license fees, depending on the facts of the case.

68. R. Avalyan, Антиофшорный Закон вернул лишь шестую часть бизнеса в Россию (Интервью с А.В. Гуськовым) [Anti-Offshore Law Returned Only One Sixth Of Business to Russia (Interview with A.V. Guskov)], in Налоговый учет для бухгалтера [Tax Accounting for Accountants], issue 6, at 11–17 (2016); A. Smekhova, Налоговики стараются не выносить заведомо проигрышные решения (Интервью с М. Орловым) [Tax Officers Tend to Avoid Issuing Definitely Losing Decisions (Interview with M. Orlov)], Российский налоговый курьер (Russian Tax Courier), issue 11, at 86–90 (2014).

Bangladesh, India, Israel, Philippines and Sri Lanka generally accept CCAs and allow the deduction of respective payments; no formal guidance is available. Turkey also generally accepts CCAs, and in 2016 it published Draft Guidance on the subject which is generally a translation of the OECD Guidance. In particular, it requires proof that the services in question were actually necessary for recipient and duly rendered (in addition to the arm's length nature of price and proper documentation).

Albania, Bulgaria, Egypt, Iran, Kuwait, Macedonia, Mongolia, Pakistan, Qatar, Saudi Arabia, Serbia and Montenegro and Vietnam do not have any rules on CCAs, and the local tax authorities may have issues with recognizing such arrangements. A few additional countries, such as Bahrain, Brunei, Oman and the United Arab Emirates, do not have any transfer pricing rules, and provisions on CCAs are thus also absent.

The above review of CCA practice in OBOR countries suggests that the main issues are the limited spread of CCAs and the consequent lack of related experience within the tax authorities. Moreover, in some countries, inexperienced tax officers are suspicious of the nature of CCAs, as there may be no explicit economic benefits for a particular company against incurred costs, especially when there is no direct supplier-customer relationship and no fixed price. This is mitigated in part by rules requiring proof of necessity and actual delivery of the service (as in Turkey). The World Bank Handbook cites the following CCA-specific issues:[69] (i) valuation of buy-in and buy-out payments, (ii) valuation of participants' contributions, for both IP and services, (iii) determination of participants' expected benefits, (iv) determination of the cost base (e.g., inclusion of the costs of employee share options), (v) treatment of tax incentives and government subsidies, (vi) acceptance of different types of ownership of intangibles (i.e., legal, beneficial and economic) and (vii) tax treatment (e.g., withholding obligations) of contributions and balancing payments.

Some comments on the revisions to Chapter VIII of the OECD Guidelines,[70] however, included criticism of the approach based on valuation of participants' contributions as less objective than an approach assessed on participants' costs (which are readily identifiable in accounting records). They additionally pointed out that estimation of (expected) benefits and respective allocation of costs (which may seem more fair) makes the system more complicated for the tax authorities than cost-based allocation (which seems more practical). Another comment emphasized the lack of clarity in the requirements for CCA documentation.

The introduction of CCAs can also require a set of changes to domestic rules on contracts and accounting. Such changes include acceptance of cost recognized by a particular company based on cost sharing agreement (as opposed to traditional price setting) and adjustment of rules on documentary evidence of costs in (tax) accounting. Furthermore, as OBOR countries normally use their official languages for accounting

69. Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, at 214–215.
70. OECD, *Comments Received on Public Discussion Draft BEPS Action 8: Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements (CCAS)* (OECD Publishing 2010), pp.19–20 by Federation of German Industries, p.52 by BUSINESSEUROPE, pp.60–61 by CBI etc.

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and reporting purposes, companies interested in using CCAs will have to bear the expense of translating documentation supporting the arrangements.

2.5 Documentation

Every transfer pricing analysis necessitates comprehensive knowledge of the facts and circumstances of the specific case. If facts and circumstances are not known, a reliable assessment cannot be made. The extraordinary volumes of relevant data that must be looked at usually distinguishes transfer pricing cases from other tax cases, and even minor changes in the fact pattern can have a significant influence on the results of such analysis. Thus, a common understanding of the facts and circumstances of a case is essential. Establishing such knowledge is based on the data collected by the taxpayer to substantiate its tax position – in this context, transfer pricing documentation.

Under the BEPS project, Action 13[71] has aimed to re-examine transfer pricing documentation and has developed rules regarding transfer pricing documentation to enhance transparency for tax administrations, taking into consideration the compliance costs for business. This has resulted in a new three-tier approach consisting of: (i) a master file containing standardized information relevant for all group members, (ii) a local file referring specifically to material transactions of the local taxpayer and (iii) a country-by-country report containing information on income, taxes paid and economic activities of the group.[72] Structurally, this builds on Chapter V of the OECD Guidelines, as well as the EU Code of Conduct on Transfer Pricing Documentation[73] in which the concepts of master file and local file were first introduced. The country-by-country report is, instead, something genuinely new in the transfer pricing field, however, it was used before – in slightly different form – for accounting and reporting purposes for groups in specific sectors (e.g., banking and extractives).[74]

This new BEPS standard, as introduced in the paragraph above, involving a three-tier approach to transfer pricing documentation, is not fully endorsed by the UN Manual as revised in 2017. The UN Manual emphasizes that for developing countries, it must be decided – depending on the specific country situation – whether the implementation is useful and doable,[75] while the Manual still acknowledges that related to the UN standards on transfer pricing, documentation should – to the extent

71. OECD, *Transfer Pricing Documentation and Country-by-Country Reporting – Action 13: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 5 Oct. 2015).
72. OECD, *Action 13 Final Report, supra* n. 71, Chapter C.
73. EU Code of Conduct: Resolution of the Council and of the representatives of the governments of the Member States, meeting within the Council, of 27 June 2006 on a code of conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD), OJ C176 (28 Jul. 2006).
74. European Commission, Country-by-country reporting for specific sectors (banking and extractives) in the EU, available at https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/public-country-country-reporting and https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/transparency-requirements-listed-companies_en.
75. UN, *Practical Manual on Transfer Pricing for Developing Countries, supra* n. 3, Chapter B.1.6.6 and C.2.2.3.1.

possible – be in line with OECD standards.[76] Also, the World Bank Handbook does not make any recommendations to implement specific standards (whether it is the new BEPS standard or that of other institutions), but merely describes various approaches.[77] Nevertheless, as the BEPS project created a minimum standard on transfer pricing documentation, and countries in the Inclusive Framework[78] are committed to implement all minimum standards, it will certainly unleash global effects in the coming years.

The master and local files, according to the BEPS standard, are to provide comprehensive data to a tax administration to conduct a transfer pricing examination, while the country-by-country report is conceived as a risk assessment tool. This is stated not only in the respective BEPS final report,[79] but also in section 5 of the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (Multilateral CAA),[80] as well as in model Competent Authority Agreements to income tax treaties (tax treaties) and tax information exchange agreements as attached to the BEPS Action 13 Final Report. Nevertheless, this clarification should not be misunderstood. While the template is conceived for use in high-level risk assessment regarding transfer pricing and other BEPS-related risks, and tax administrations are not allowed to base adjustments merely on the information received in this specific form, the country-by-country report will certainly have to be available to auditors during a later transfer pricing audit. In addition to these objectives, transfer pricing documentation additionally serves to increase taxpayer awareness and attention to compliance with the arm's length principle.[81]

According to the Action 13 Final Report, the procedure for transmitting the documentation to the tax authorities deviates significantly between the country-by-country report and the master and local files. While the master and local file are directly sent by a local subsidiary of a group to the respective tax authorities, the country-by-country report is sent only by the ultimate parent company of a group to the tax administration of its residence country and is subsequently disseminated to other affected tax administrations via exchange of information mechanisms. Thus, such differences lead to deviations in the date on which documentation is available to tax administrations, as well. While it is up to every single tax administration to define timelines for transmission of the master and local files, the country-by-country report must be submitted within twelve months[82] after the fiscal year of the report, and shared with other authorities within fifteen (eighteen) months.[83]

76. *Ibid.*, Chapter B.1.8.12.
77. Cooper et al., *World Bank Transfer Pricing Handbook, supra* n. 4, at 241–268.
78. As at December 2017, there are 110 countries participating in the inclusive framework on BEPS. *See* http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf. Many of them participating in the OBOR initiative.
79. OECD, *Action 13 Final Report, supra* n. 71, para. 25.
80. OECD, *Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports*, available at http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/cbc-mcaa.pdf.
81. OECD, *Action 13 Final Report, supra* n. 71, Chapter B.
82. *Ibid.*, Article 5, Annex IV (Model legislation related to Country by Country Reporting).
83. OECD, *MCAA on the Exchange of Country-by-Country Reports, supra* n. 80, section 3.

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Transfer pricing documentation regimes are often reinforced with significant penalties. Nevertheless, the new OECD standard does not necessarily foresee penalties and leaves it to the domestic legislature as to whether to implement them or not.[84] In contrast, the EU, which issued a binding directive on country-by-country reporting in 2016,[85] includes the obligation for Member States to foresee penalties, but leaves it open to the Member States to design such rules individually.[86] In any case, when it comes to penalizing groups that are obliged to submit a country-by-country report, it will be difficult to determine penalties that are severe enough to be effective while also not being draconian. At the same time, it is widely acknowledged that – regarding country-by-country reporting – the risk of being negatively rated during a tax administrations risk assessment process and later thoroughly audited will incentivize groups at least as much as penalties to submit accurate data.

Transfer pricing documentation and the country-by-country report as part of it are protected by tax secrecy. The BEPS Action 13 Final Report emphasizes this fact by reiterating confidentiality requirements in Chapter V of the OECD Guidelines, in the model legislation on domestic implementation of country-by-country reporting and in the multilateral competent authority agreement, as well as in the competent authority agreements based on the model tax conventions and model tax information exchange agreements. Nevertheless, certain stakeholders – in particular from civil society[87] and academia – call for publication of country-by-country reports, arguing that only public knowledge of these facts will lead to a push back against overly aggressive taxpayer behaviour. While within the OECD there seem to be no signs to reconsider the confidentiality approach, publication of these reports is more intensely discussed at the level of the EU. In 2016, the Commission proposed to amend the Accounting Directive[88] to oblige groups to publish parts of their country-by-country reports.[89]

OBOR countries have widely deviating transfer pricing frameworks on these topics. Some of them look back on many years of experience in applying transfer

84. OECD, *Action 13 Final Report, supra* n. 71, Article 7, Annex IV (Model legislation related to Country by Country Reporting).
85. EU Exchange of Information Directive 3: EU Council Directive 2015/2376/EU of 8 Dec. 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 332 (2015).
86. EU Exchange of Information Directive 4: Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 146 (2016), Article 25a.
87. *See* e.g., A. Knobel & A. Cobham, *Country-by-Country Reporting: How Restricted Access Exacerbates Global Inequalities in Taxing Rights*, Tax Justice Network (December 2016).
88. EU Accounting Directive: Directive 2013/34/EU of the European Parliament and of the Council of 26 Jun. 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance, OJ L182 (29 Jun 2013).
89. According to this approach, information on the following topics should be published: (i) the nature of the activities, (ii) the number of employees, (iii) total net turnover made, which includes turnover made with third parties, as well as between companies within a group, (iv) the profit made before tax, (v) the amount of income tax due in the country as a reason of the profits made in the current year in that country, (vi) the amount of tax actually paid during that year and (vii) accumulated earnings.

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pricing rules, while others introduced respective law only quite recently.[90] Accordingly, the capacities of tax administrations vary broadly, as well. Rules on transfer pricing documentation will have to consider such variations and tailor-made approaches will be necessary. Nevertheless, a clear trend towards the implementation of transfer pricing documentation regimes could be observed over the last decade which further accelerated after the release of the BEPS Action 13 Final Report.[91] In addition, it must be recognized that international commitments to different standards deviate between countries (some being OECD, some G20, some Inclusive Framework members), and policies will have to take this into account.

Implementation of country-by-country reporting requires a network of exchange of information rules. Typically, such provisions are implemented through a country's tax treaty network or accession to the Multilateral Convention on Mutual Assistance in Tax Matters. Where such network does not exist (which is still the case for some of the countries participating in OBOR), implementation will have only limited effects, as country-by-country reports of foreign groups will not be transmitted to those countries.

Furthermore, not all OBOR countries' tax administrations are capable of processing transfer pricing documentation provided in English, even though this will be the language of most of the data obtained. Thus, this will lead in the short term to the necessity for taxpayers to provide (costly) translations.

2.6 Advance Pricing Arrangements

An APA is defined as:

> an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables, an appropriate adjustment thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations.[92]

An APA can be concluded unilaterally, bilaterally or multilaterally, as questions on transfer pricing issues can occur between a taxpayer and the tax administration of its residence country, as well as between tax administrations of different

90. Cooper et al., *World Bank Transfer Pricing Handbook, supra* n. 4, Chapter 6. *See also* e.g., EY Transfer Pricing Surveys (latest publication -http://www.ey.com/gl/en/services/tax/ey-2016-transfer pricing-survey-series), Deloitte Global Transfer Pricing Country Guides (latest publication – https://www2.deloitte.com/us/en/pages/tax/articles/global-transfer pricing-country-guide.html).
91. *See* e.g., KPMG, *BEPS Action 13 Country Implementation Summary*, https://home.kpmg.com/content/dam/kpmg/xx/pdf/2017/04/tnf-beps-action-13-april24-2017.pdf. On implementation of country-by-country reporting, *see* OECD, *Country-Specific Information on Country-by-Country Reporting Implementation*, http://www.oecd.org/tax/automatic-exchange/country-specific-information-on-country-by-country-reporting-implementation.htm.
92. OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 2, para. 4.123.

jurisdictions.[93] The legal basis for unilateral APAs can be found in the respective domestic tax law, either in transfer pricing law, in specific law on APAs or in general procedural rules. The legal basis for bilateral or multilateral APAs can be found in international treaties such as tax treaties, where provisions implementing Article 25 of OECD or UN Models on the mutual agreement procedure (MAP) usually serve as the basis for such agreements. While some countries consider international treaty provisions on MAPs alone as a sufficient basis for a bilateral or multilateral APA, others require specific domestic implementations.

An APA must be based on the arm's length principle. Regardless of whether an APA is concluded unilaterally, bilaterally or multilaterally, its purpose should be to find a common interpretation of the arm's length principle in a specific situation, rather than to arbitrarily define tax burdens for involved taxpayers. An APA is not a civil law contract, but an instrument of public law. Tax administrations will lack the authority to autonomously reduce or increase a taxpayer's tax burden, and they will certainly be bound by the rule of law to apply their country's transfer pricing law, including the arm's length principle. Nevertheless, it is only rarely the case that a jurisdiction will use favourable and unilateral APAs that go beyond the arm's length principle as an incentive to attract businesses.

Not all OBOR countries provide for the possibility of an APA.[94] The main reasons for being reluctant to introduce APAs can be grouped into three categories, namely: (i) a lack of transfer pricing experience and knowledge, (ii) a lack of capacity and (iii) a lack of trust in such cooperative procedure. Where countries have only recently introduced transfer pricing law or have just started to enforce such rules, they usually need to gain experience before starting an APA programme in order to minimize the risk of locking in transfer pricing positions that are either not in line with international standards and/or are harmful for their country. Some countries that have already gained know-how and experience in the field of transfer pricing still have not implemented APA programmes because of their limited personal capacity in this area and their will to use such limited capacity primarily for tax audits, as only this function promises revenue generating effects. Finally, countries might be reluctant to introduce APA programmes because they do not trust in the specific APA procedure, where taxpayers are typically intensively involved in establishing the assessment of a case and results might depend on the agreement of a taxpayer.

Unfortunately, there are currently not many publicly available data on existing programmes, many countries do not even publish their administrative guidance and there is scarcely any case law available. Such lack of transparency increases the risk

93. For guidance of these topics, *see* OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 2, paras. 4.129 & 4.130; UN, *Practical Manual on Transfer Pricing for Developing Countries*, *supra* n. 3, Chapter 3.10; Cooper et al., *World Bank Transfer Pricing Handbook*, *supra* n. 4, Chapter 7.

94. The APA policy of specific countries can be found in the Transfer Pricing Surveys published annually by major firms such as EY, https://www.ey.com/gl/en/services/tax/ey-2016-transfer-pricing-survey-series; KPMG, https://home.kpmg.com/xx/en/home/insights/2013/04/kpmg-global-transfer-pricing-review.html; PwC, https://www.pwc.com/gx/en/services/tax/publications/international-transfer-pricing.html; Deloitte, https://www2.deloitte.com/us/en/pages/tax/articles/global-transfer-pricing-country-guide.html.

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that APAs will not be in line with international standards, will be inconsistent with the treatment of other cases or will even be considered as providing preferential taxation in specific cases.

Regarding issues related to APAs, generally, every transfer pricing case should be resolved based on the same set of rules. As such, there should be no distinction between an APA case and any other case, although an APA case is resolved in advance of the concerned transactions while other cases are often handled years later during a tax audit. This earlier resolution can be financially favourable for a tax administration; if during APA negotiations the tax liability of a taxpayer turns out to be higher than according to the taxpayer's initial approach, this will – looking at the time value of money – increase tax revenue for the tax administration. Additionally, the quality of data to which a tax administration has access in an APA procedure is often better than during an audit, and thus allows for a more accurate assessment. For businesses, an APA increases certainty, allowing for more accurate planning. Businesses must plan their undertakings as accurately as possible for internal and external reasons. Internally, a company must know how much resources are available in order to be able to make sound management decisions. Externally, a company must provide a clear picture of its financial situation in order to attract new investors[95] or to satisfy demands of its creditors. Uncertainty counteracts these demands, and thus companies are likely to be interested in the certainty regarding their tax liabilities as provided by APAs.

During negotiations for an APA, the tax administration can obtain in-depth insights into the taxpayer's organization and strategies, allowing the administration to learn and increase its knowledge. APA negotiations are typically held in an open and cooperative atmosphere where the tax administration is working closely with the taxpayer. As the taxpayer initiates an APA procedure, its willingness to share information on the concerned transactions will typically be higher than during an audit procedure. The fact that on the side of the taxpayer the same persons who designed the transfer pricing system of the respective transactions will negotiate the APA, will further improve the quality of information at hand vis-à-vis audits of past transactions. These insights will allow tax administrations personnel to learn more about the thinking of taxpayers, a knowledge that can be used later in different areas of work (e.g., risk analysis, auditing).

Nevertheless, asymmetries in the skill and training level between a tax administration and taxpayers or between different tax administrations can influence outcomes negatively. An APA is the result of a process of negotiations. If the APA is unilateral, these are conducted between a tax administration and a taxpayer; or if the APA is bilateral or multilateral, they are conducted between more than one tax administrations with the involvement of a taxpayer. If there are significant discrepancies between the resources of stakeholders, this will likely influence the outcomes favouring the

95. In particular regarding projects with an extraordinary investment volume, such certainty is essential for investor relations. In the past, agreements similar to APAs were even lifted to the level of states treaties in order to comfort investors (e.g., Intergovernmental Agreement on the Nabucco Pipeline Project where agreement was found that profits should be shared according to the length of the pipeline in a specific country).

resource-rich parties. If, for example, one party can rely on the expertise of an economist who is specialized specifically in transfer pricing, while the other party cannot rely on such a person, there is a risk that facts in favour of the latter party's position will be overlooked. Asymmetries (as described above) will also occur in other situations, such as audits and MAPs, and are therefore not an exclusive problem of APA negotiations. However, the cooperative character of an APA procedure could certainly give rise to potentially negative effects.

Offering the opportunity to conclude an APA may increase the attractiveness of a certain jurisdiction for businesses. Business decisions regarding where to locate activities are complex and take into account various aspects. Tax is one of these aspects and in this realm, it is not only the statutory tax rate that companies are considering. In any case, tax certainty and – in particular – a reliable and well-functioning tax administration can positively influence a company's decision to invest in a country, and the availability of an APA can signal this reliability. Accordingly, the BEPS Action 14 Final Report recommends the introduction of (bilateral) APA programmes[96] in its best practices, and a recent joint report from the OECD and IMF on tax certainty refers to APAs as a practical tool for enhancing tax certainty.[97]

Nevertheless, APAs can lead tax administrations to focus scarce resources on compliant rather than non-compliant taxpayers, thus 'squeezing the wrong end'. Tax administrations with very narrow personnel resources may have to wind down their audit attempts in order to be able to run an APA programme, resulting in an overall decrease in collected taxes. At the beginning of a tax administration's work in the field of transfer pricing, personal resources are typically very scarce. If only a very small group of skilled employees is available, the proper allocation of such capacity is extremely critical. Often this group will work in an audit programme first, as this promises countable monetary results while at the same time is a strong signal to the business community. Moreover, audits that are based on prudent risk assessment allow for a focus on taxpayers that are unlikely to be compliant, while taxpayers that reveal their transfer pricing system voluntarily are more likely to be compliant anyway. Thus, introducing an APA programme at an early stage could effort with drawing skilled auditors and result in an unreasonable allocation of scarce resources.

Unilateral APAs are particularly vulnerable to being used in unintended ways. First, the close cooperation between tax administration and taxpayers could lay the groundwork for corruption. The facts that only a small number of tax administration employees will have the skills to verify the integrity of an APA and a domestic appeal procedure is usually ruled out in an APA can further leverage this risk. Second, the broad range of possible interpretations of the arm's length principle could tempt tax administrations to use APAs as a tool for (harmful) tax competition. Especially in European and OECD countries, this opportunity was seen as problematic and counter-measures have been considered already. In the EU, relevant cross-border APAs had to

96. OECD, *Making Dispute Resolution Mechanisms More Effective – Action 14: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 5 Oct. 2015), at 28.
97. IMF/OECD, *Tax Certainty: IMF/OECD Report for the G20 Finance Ministers* (Mar. 2017), available at http://www.oecd.org/tax/g20-report-on-tax-certainty.htm.

be exchanged spontaneously[98] and from 2017, must be exchanged automatically,[99] at the level of the OECD, the BEPS Action 5 Final Report[100] established a new minimum standard on the mandatory exchange of APAs.

Many of the risks mentioned in above can be mitigated through increased transparency. Risks that are rooted in the one-sidedness of unilateral APAs are minimized if all interested jurisdictions are informed at an early stage, and if later APAs are exchanged[101] between the jurisdictions involved in the transactions. Taxpayers are then not able to take different approaches,[102] and thus the risks of unwanted double non-taxation and other forms of misuse are reduced. At the same time, the risk of double taxation is reduced as well, if jurisdictions openly share their opinions. Further transparency will facilitate the closing of the gap in asymmetric situations, this is particularly true when APAs are published and can therefore be studied by anyone who is interested.

3 CONCLUSION AND PROPOSALS

This chapter has analysed various transfer pricing topics that can generate relevant issues in OBOR countries. In general, one of the very first aims is to put on equal footing the understanding of transfer pricing rules among OBOR countries in order to build a bridge between jurisdictions with transfer pricing rules and those without.

Moreover, it would be reasonable to focus further actions on the development and promotion in OBOR countries of two key aspects, namely the improvement of guidance and the dissemination of experience among the various stakeholders. The first part could potentially take place through the implementation of a commonly agreed set of guidelines among OBOR countries. The second part, instead, could take the form of tailoring existing training programmes to the local environments of the target countries. In this context, both international organizations and academic institutions should consider both offering consultations on the development of specific guidelines and training of local tax officers. Additionally, OBOR countries might also consider the establishment of an international forum (e.g., in a similar setting as the EU JTPF) of experts from both governmental institutions and private practice that regularly meets and analyses various pre-defined transfer pricing topics, in order to produce guidance that, although not legally binding, could constitute a useful practical tool to solve specific issues.

98. EU Savings Directive: Council Directive 2011/16/EU of 15 Feb. 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L64/1, Article 9.
99. EU Exchange of Information Directive 3, *supra* n. 85.
100. OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 5 Oct. 2015).
101. Automatic exchange of APAs is obligatory from 2017 onwards according to the Directive on Administrative Assistance (*supra* n. 98) and is part of the new BEPS minimum standard (*supra* n. 72).
102. OECD, *Transfer Pricing Guidelines* (2010), para. 4.129 favours information of the other jurisdiction in cases of unilateral APAs; the Action 5 Final Report foresees a sophisticated system of exchange of rulings.

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