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Recent Reforms on Tax System and Tax Administration IN BRI JURISDICTIONS

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CONTENTS

Belt and Road Initiative Tax Journal
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FEATURE

Contents

China's Tax Reforms in Facilitating Globalization and the Belt and Road Initiative

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Abstract: Since the proposal of the Belt and Road Initiative (BRI) in 2013, the economic and trade cooperation between China and related BRI economies has flourished over the past eight years. The Chinese government has given top priority to improving its doing-business environment to implement the national initiative of "bringing in" and "going abroad", which echoes the BRI economic activities. Being a core part of the doing-business environment, tax reforms and the building of a more growth-friendly tax environment serve as one of the key drivers to further attract foreign investment and encourage domestic enterprises to go abroad. This article starts with the background of China's tax reforms, followed by an in-depth analysis of the corporate income tax and individual income tax reforms, and finally discusses the impacts of China's tax reforms on cross-border investment and trade.

Keywords: The Belt and Road Initiative; Tax reforms; Cross-border; Corporate income tax; Individual income tax

1. Background

It has been more than 40 years since China's reform and opening-up policy was implemented in 1978. Abundant milestones and significant achievements have been made in the past few decades, making China transform into a popular target jurisdiction for foreign direct investment (FDI) and outbound direct investment (ODI). As a strong player in global economic arena, China never stops its progress in reform, especially in the area of taxation.

Why is China so keen on reforming its tax systems?

Globally, the aftermath of COVID-19 pandemic, the trade friction with the United States, and the volatile economic situation together urge China to seek a more open, robust and sustainable growth. In response, China is actively adjusting and transforming its economic structures to cater to the new norm, especially by pursuing a higher level of opening-up to further attract foreign investment. The Foreign Investment Law of the People's

Republic of China that was passed on 15 March 2019 was a milestone, establishing the basic framework and rules of China's new foreign investment mode. Meanwhile, as the initiator of BRI, China is also supporting capital-export to BRI economies and establishing more cooperation with them, which accelerates the pace of its reform in every aspect. Among others, eliminating tax obstacles to cross-border trade and investment and better serving taxpayers are vital to fulfil this national strategy of "bringing in" and "going abroad".

Domestically, China is devoted to nurturing entrepreneurship and innovation as a new pillar to its GDP. Taxpayers, especially start-ups, yearn for not only tax incentives, but also a good tax environment of certainty, consistency, and simplicity. In light of these needs, China has been working on tax legislation to enhance tax certainty, standardizing tax compliance procedures and interpretation of tax rules to ensure consistency, removing most approval/record-filing requirements to simplify its tax administration, and introducing a basket of tax cuts and fee reduction policies to invigorate the domestic economy.

Against this backdrop, China has conducted various tax reforms, with the purpose of creating new heights of high-standard opening-up and optimising the tax environment for both domestic and overseas investors.

2. Major Tax Reforms

Corporate income tax (CIT) and individule income tax (IIT) are two cornerstones of China's tax regime. A series of CIT and IIT reforms have been introduced over recent years to boost cross-border trade and investment.

2.1 CIT Reforms

2.1.1 Optimised tax laws and regulations in relieving cross-border investors' tax burden

The Chinese government has taken several crucial actions to reform tax laws and regulations, making a more friendly environment for both foreign investors to expand investments in China and domestic investors to go abroad.

• Providing Withholding Tax (WHT) deferral treatment for foreign investment

In the past, foreign investors are subject to WHT when receiving dividends, no matter if they remit the cash back or reinvest them in China. In 2017, China introduced the WHT deferral treatment, allowing qualified foreign investors who reinvest in encouraged projects in China using profits that are distributed from Tax Resident Enterprises (TREs) to defer the payment of WHT on dividends. The applicable investment scope was later expanded to all "non-prohibited projects and fields" to encourage foreign investors to retain their capital and expand their investments in China.

• Renewing tax treaties and protocols to echo the Action Plans of Base Erosion and Profit Shifting (BEPS)

In June 2017, China and 66 other jurisdictions signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. Following that, China has signed and renewed several tax treaties (or tax arrangements) and protocols with jurisdictions including Congo, Argentina, Spain, India, Italy, New Zealand, Hong Kong SAR and Macao SAR, to incorporate BEPS measures, such as adding the provisions on tax transparent entities and main purpose test, and modifying the requirements for permanent establishments. The updated tax treaty provisions are more consistent with the international practice and also provide cross-border investors with more tax certainty.

• Refining the foreign tax credit (FTC) policy

Double taxation is always an issue for domestic investors to go abroad. In the past, they could only claim FTC for indirect investment structures within three tiers and the "country/region-basket" FTC calculation approach may create tax leakage for investors with multiple investments in different countries. Starting from 1 January 2017, domestic investors were allowed to choose either "country/region-basket" approach or consolidated credit approach (i.e., no country/region-basket limitation) to calculate their FTC. Meanwhile, the number of the layers qualified for FTC was also extended to five tiers. Such changes help eliminate double taxation more thoroughly and outbound investors find it easier to manage tax burden.

• Exempting overseas income from CIT for qualified enterprises registered in Hainan Free Trade Port (FTP)

Chinese companies are subject to worldwide taxation. So business operation income or dividends arising from overseas investments are usually taxed at the standard rate of 25%. To support the development of Hainan FTP as an investment hub, from year 2020 to 2024, income acquired from new outbound direct investment by tourism, modern service and high-tech enterprises established in Hainan FTP are exempt from CIT. The preferential policy will undoubtedly reduce the tax burden and enhance overall investment return of the eligible "going abroad" enterprises involving in these industries.

2.1.2 Streamlined tax collection and administration in reducing taxpayers' compliance cost

To better implement the afore-mentioned policies, the Chinese government has kept optimising its tax collection and administration system by introducing and deepening the reform of "Streamlined Administration, Delegated Powers, Improved Regulation and Services" in recent years.

• Simplifying tax-related procedures for non-TREs

The Chinese government revamped two key administrative procedures in relation to non-TREs, namely:

(i) cancelling the approval procedures for consolidated CIT filing for non-TREs with establishments or places (E&P) in China, so that eligible non-TREs don't have to get an approval in order to offset gain and loss among different E&Ps; and

(ii) non-TREs can claim tax treaty benefits via the "self-assessment" mechanism, instead of the traditional record-filing. Under this new mechanism, they could self-assess the eligibility for treaty benefit and retain relevant supporting documents for future inspection, if any.

These two measures together relieved the compliance burden of non-TREs and marked another step forward for the Chinese tax administration in moving from ex ante review to ex post monitoring and supervision.

• Giving more flexibility to non-TREs in terms of WHT regime

In the past, non-TREs shall self-report CIT within seven days since the triggering of withholding liability if the withholding agents fail to withhold tax. The timeframe was too rigid for foreign taxpayers who may not be familiar with China's tax system. In October 2017, the State Taxation Administration of China (STA) released a Public Notice to streamline the withholding tax regime. Notably, the seven-day time limit was removed to allow non-TREs to self-report and settle taxes in a more flexible way. Usually no additional levies/penalties would be charged unless the payment missed the deadline imposed by tax bureaus. The new provision, which facilitates non-TREs to fulfil their tax obligations in China and makes it easier to close cross-border transactions, has been welcomed by foreign investors.

• Optimising tax procedures in remitting outward payment

Since 2013, tax authorities have been continually improving their tax procedures in remitting outward payments, changing the administrative focus from pre-remitting approval to post-remitting supervision. Now most items could be remitted with a record-filing and some could even be exempted from the record-filing. To further optimise the business environment for foreign investors and uphold the free movement of capital, the STA launched another batch of reforms, such as expanding the scope of outward payments exempted from the record-filing, reducing the record-filing for repetitive payments, and adding online channels for remittance. With the enhanced exchange of information and digital capability of tax administration, it can be predicted that the tax procedures for outward payments will continue to be streamlined in the future to further ease cross-border trade and investment.

2.1.3 Taxpayer-centred service prioritised by tax authorities

Improving taxpayer services involves showing more respects and protection for taxpayers' legitimate rights, offering taxpayers more guidance and resources to help them fulfil their tax obligations, and enhancing the quality and efficiency of the entire tax system. Taxpayer services have become a priority of Chinese tax authorities because it is widely acknowledged that good governmental service could be a benchmark of doing-business environment and critical to promoting FDI and ODI. Now, the awareness of "taxpayer-centred" service has been embedded in Chinese tax authorities to replace the previous "tax enforcement-oriented" administration.

• Multiple measures to support domestic investors to go further under the BRI

The BRI family is becoming stronger than ever. By June 2021, 140 jurisdictions and 32 international organisations have signed 206 BRI cooperation documents with China.[1] However, differences in culture, history, tax systems, stages of development, etc. among BRI jurisdictions make it hard for Chinese investors to have a full picture of the destination jurisdictions. In addition, concerns over tax uncertainty, potential double taxation and discrimination might discourage investors from going abroad. To tackle this, the STA released the Notice on Further Improving Tax Service in the Construction of BRI in 2017, which introduced multiple measures to create a fertile environment for domestic investors to actively participate in the international economic cooperation. For instance, tax authorities need to innovate taxpayer services by providing tailor-made consulting services to outbound investors. Besides, Chinese tax authorities also published Tax Guidance for Going-Abroad Enterprises, Overseas Investment, and Tax Guides to help domestic investors understand BRI jurisdictions' tax laws and regulations.

• Embracing digitalisation

Worldwide digitalisation is phenomenal in recent years. The Chinese government and tax authorities are quite keen to digitalise its tax collection, administration and service system. In retrospect, the launch of "Internet + Taxation Initiative", the nationwide rolling out of "Golden Tax Project Phase III", the upgrade of the Value-added Tax invoice system, etc. have marked China's achievements in tax transparency, as well as the digital transformation of tax administration system. The above moves have unlocked the potential of big data to benefit not only taxpayers, but also related government bodies themselves over the past few years. For instance, the information sharing among government bodies helps taxpayers avoid repetitive data lodging. The automatic cross-check and analysis of the data and information received from various sources help tax authorities build a robust monitor system for preventing potential tax risks in the cradle. Tax risk analysis supported by big data analytics can also categorise taxpayers into different groups subject to different levels of tax risk management and tax services accordingly, which enhances the accuracy and efficiency of tax administration. In the future, Chinese tax authority will, empowered by big data and driven by the e-invoice reform, keep striving for an upgraded version of digitalised and smart tax administration. It is foreseeable that with the infiltration of digitalisation, taxpayers, including foreign taxpayers, will find it much easier to comply with tax rules.

2.2 IIT Reforms

The IIT reform was undoubtedly one of the most ground-breaking changes in recent years. The newly amended IIT Law was officially passed in August 2018 and began its full enforcement in January 2019. The very first annual IIT reconciliation filing for comprehensive income was successfully completed by the end of June 2020, and the IIT policies will be continuously integrated and improved.

The new IIT Law has established a comprehensive taxation regime by introducing specific additional deductions and anti-tax avoid-

1 CAITEC (2021). *China's Trade and Investment Cooperation under the Belt and Road Initiative 2021*, http://fec.mofcom.gov.cn/article/fwydyl/zgzx/202108/20210803190898.shtml.

ance rules, revising the criteria in determining resident and non-resident status, and transforming the tax collection and administration system. By doing these, it marks a "new era" of China's IIT regime.

2.2.1 First step from schedular taxation towards aggregate taxation

China's IIT regime has adopted the schedular taxation system since the IIT Law was promulgated in 1980. As such system is simple in terms of IIT computation and collection, it could not comprehensively measure the actual capability of taxpayers to pay taxes, particularly after China's decades of rapid economic and social development. Hence, it is not conducive to the fairness of taxation.

Under the new IIT Law, among the nine categories of income, "wages and salaries", "remuneration for personal services", "remuneration for manuscripts" and "royalties" are combined as "comprehensive income" for aggregate tax calculation purpose, marking the first step to a combination of aggregate and schedular taxation system.

The new taxation system calls for and lays the foundation for the establishment of a comprehensive deduction system, which now consists of standard basic deduction, specific deductions, specific additional deductions and other deductions. It features the introduction of specific additional deductions which cover taxpayers' basic livelihood expenditures such as education, medical expenses, housing, and elderly care. Compared with the "one size fits all" deduction model under the old IIT regime, the deductions under the new system vary among regions and families, which reflects different levels of taxpayers' living costs.

These fundamental changes in the IIT regime align the tax burden of taxpayers not only with the income level but also with the actual family burden, thereby implementing the ability-to-pay principle more effectively.

2.2.2 Getting in line with international norms to better support "going abroad" and "bringing in" strategy

Policies for cross-border taxpayers were also revamped in response to the changes in the new IIT Law. The new policies are more in line with international norms and practices, providing stronger support for China's "going abroad" and "bringing in" strategy.

• Classification of resident and non-resident taxpayers with respective tax rules

The new IIT Law clearly defined "resident individuals" and "non-resident individuals" and introduced the "183-day" threshold in determining the tax residency status of individuals without a domicile in China. The new 183-day threshold is aligned with international common practice. It facilitates the literal interconnection between China's domestic law and tax treaties concluded. The respective tax calculation and declaration rules for resident and non-resident taxpayers were set out correspondingly.

• Continued support for "bringing in" overseas individuals

The new IIT policy for non-domiciled individuals is in general helpful to attract and encourage overseas individuals, including those from Hong Kong SAR, Macao SAR and Taiwan region, to work in (the mainland of) China.

IIT relief from worldwide taxation for non-domiciled individuals, widely known as the "five-year rule", was retained and further extended to six years. When adopting the "time-apportionment method" to calculate IIT liability on wages and salaries, the "taxation before allocation" rule was replaced by "allocation before taxation", which helps reduce the actual tax burden of some non-domiciled individuals who hold dual posts in China and abroad. And taxation method such as treating bonus obtained from multi-month working period by non-resident individuals also conduces to the elimination of potential double taxation.

• Increased support for Chinese "going abroad"

With Chinese enterprises accelerating the pace of "going abroad" in recent years, the number of outbound employees has increased rapidly. The number of Chinese individuals with direct employment, investment or business operation abroad is also getting bigger. With the implementation of the new IIT Law, adjustment and supplement were made to IIT policies on foreign income and FTC. Tax administration and taxpayer convenience are enhanced by regulations with more details and clarity.

"Retroactive FTC claim" was introduced to provide resident taxpayers with an opportunity to claim FTC within a period of five years in the case where foreign tax has not been settled and the proof of tax payment is not available by the due date of the annual tax filing for the relevant tax year. Proof of foreign tax payment now covers a wider variety of documentation and record. In addition to tax clearance certificate, tax payment certificate, tax declaration record, foreign tax return/tax payment notice supported by payment record, etc. are all acceptable proofs for FTC claim purpose. These changes give outbound taxpayers more flexibility to make full use of FTC and better manage the overall tax burden.

2.2.3 Transformation of IIT collection and administration system empowered by technology

The new IIT regime requires the transformation of IIT collection and administration system. Among others, smart tax service is one of the key factors to the success of tax processing for significantly large number of individual taxpayers, particularly the annual reconciliation filing of comprehensive income under the new IIT Law.

Advanced information technologies were used to create remote tax service channels, such as mobile phone APPs, to enable hundreds of millions of individuals to claim specific additional deductions, complete tax returns, make payments, apply for tax refunds, and check income tax details online. In particular, the application of big data empowered pre-filling of tax returns. The data of tax withholding on comprehensive income could be pre-filled through the electronic filing system, which made it easier for taxpayers to comply with their tax obligations. In the latest annual tax filing for year 2020, more than 99% of taxpayers filed returns via mobile phone APPs.

3. Achievements So Far

3.1 Impact of CIT Reforms

The above-mentioned CIT reforms in multiple areas have attained fruitful achievements and are conducive to the implementation of the strategy of "bringing in" and "going abroad".

Reforms on tax policies and tax administration are complementary, with the former offering substantive benefits to "going-abroad"

and "bringing-in" investors, and the latter ensuring the implementation of policies, as well as the precise and timely delivery of such tax benefits. These two aspects of reforms have jointly enhanced China's international competitiveness and attraction.

According to the United Nations *World Investment Report 2021*, although FDI flows plunged globally by 35% in 2020 due to the COVID-19 pandemic, the FDI growth in China picked up pace and grew by 6% to US$149 billion.[2]

What's more, official data showed that against the backdrop of a 35% year-on-year decline in global ODI, Chinese domestic investors made direct investment of US$18.61 billion in 58 countries/regions along the Belt and Road in 2020, accounting for 14% of the total ODI in the same period and 0.3% higher than that of the previous year.[3]

The positive FDI and ODI data indicates the effectiveness of the multiple policies tailor-made for BRI. China will definitely continue working with countries/regions along the Belt and Road to improve its tax rules and tax system and promote investment and cooperation.

3.2 Impact of IIT Reforms

IIT reform facilitates the cross-border flow of talents and serves as the new development paradigm. As the core of tax competitiveness, IIT regimes keep evolving and optimising around the globe, aiming to boost employment and economic growth as well as to promote the equity of relevant jurisdiction.

China's IIT reform was a profound reform with far-reaching effects, which signifies a fundamental transformation of the IIT regime. The changes conformed to the global trend and contributed to recent years' tax and fee cut in China, which is of great significance to reduce tax burdens and improve the people's well-being.

Under the new IIT framework, the revamped IIT rules and regulations in relation to cross-border taxpayers provide more clarity, reasonableness and flexibility to both the enterprises and individuals that involve in cross-border investment. The alignment with international norms and practices facilitates China to better participate in international cooperation in taxation. And the technology-driven modernisation of the IIT collection and administration system highly improves the convenience and efficiency for the taxpayers. With continued effort to advance the IIT reform, it would be expected to favour and attract more inbound talents as well as outbound employees and investors.

4. Takeaway

Chinese President Xi Jinping emphasized deepening "reform and opening-up across the board" and promoting "high-quality development of the BRI through joint efforts" in his speech at the Ceremony Marking the Centenary of the Communist Party of China (CPC) on 1 July 2021. Going forward, we believe that the Chinese government will, in accordance with the deployment of the CPC Central Committee and the State Council, launch more tax reforms, aiming to promote fair competition between investors, protect the legitimate rights and interests of taxpayers, and create a business-friendly environment for cross-border investors.

In the meantime, cross-border enterprises and individuals are advised to review their business structures and tax arrangements with an international vision and leverage favourable policies when appropriate, in order to reduce the costs of capital and human resource, increase economic profits, and improve the ability to withstand pressure in the ever-changing marketplace. More and more domestic and foreign investors will be able to board the express train of China's development in the near future.

2 UNCTAD (2021). *World Investment Report 2021*, https://unctad.org/webflyer/world-investment-report-2021.

3 CAITEC (2021). *China's Trade and Investment Cooperation Under the Belt and Road Initiative 2021*, http://fec.mofcom.gov.cn/article/fwydyl/zgzx/202108/20210803190898.shtml.

A Comparative Study on the Annual Reconciliation of IIT Between China and Some Other Jurisdictions

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Abstract: On 30 June 2021, China successfully completed its second annual reconciliation of individual income tax (IIT). The successful implementation of the annual IIT reconciliations in the past two years, with hundreds of millions of natural person taxpayers involved marks a significant milestone in China's ongoing reform of the IIT system, especially regarding the tax collection and administration system for natural persons. Assessing the achievements of China's annual IIT reconciliation requires a comprehensive analysis from various aspects, including concepts for IIT governance, system design and implementation effects. This report with the national reconciliation data as the sample uses descriptive statistics to analyze the effectiveness of China's annual IIT reconciliation practice and the issues. The report also compares the IIT filing data of six jurisdictions, including the United States and Canada, with those of China, to evaluate the effectiveness of China's annual IIT reconciliation from an international perspective. Finally, the report offers several suggestions for further improving the IIT annual reconciliation system in China.

Keywords: Individual income tax; Annual reconciliation; Tax governance; Tax administration

Individual income tax (IIT), as an important part of the direct tax system, has attracted international attention. Jurisdictions around the world are constantly committed to reforming and improving their own IIT systems as well as relevant measures for tax administration and service. This report compares the annual IIT reconciliations in China in the past two years with international practices in an effort to assess its current effectiveness and shortcomings, and provide insightful suggestions to further improve the annual reconciliation system.

1. Overview of the Annual Reconciliation System of IIT in China

The Individual Income Tax Law of the People's Republic of China (hereinafter referred to as "the Individual Income Tax Law") was adopted and put into effect in 1980. The current Individual Income Tax Law, which underwent seven revisions, was promulgated for implementation on 1 January 2019. The individual income tax system stipulated in this law features the integration of the comprehensive and schedular tax systems. With a series of supporting documents being issued subsequently, the annual reconciliation system of IIT was initially established in 2019.

The annual reconciliation system of IIT has the following main characteristics:

First, it specifies the two circumstances where individual income shall be subject to the annual reconciliation. The first circumstance is where the annual tax prepaid is greater than the annual tax payable and the tax refund is claimed, including: (1) where the annual comprehensive income does not exceed RMB60,000 but the individual income tax has been prepaid; (2) where the withholding rate applicable to the income for provision of independent personal services, author's remuneration or royalties is higher than that charged at comprehensive income during the year; (3) when prepaying the tax, the deduction is not declared or not fully deducted regarding standard deductions[1], special deductions[2], special additional deductions[3] and other deductible items determined pursuant to law[4] or donations; (4) where the comprehensive income tax benefits are unclaimed or not fully claimed, etc. The second circumstance is where the annual gross comprehensive income exceeds RMB120,000 and the IIT shortfall exceeds RMB400, including: a taxpayer receives comprehensive income from two or more sources, and the applicable tax rate is increased after all incomes are combined, resulting in the prepaid tax less than the annual tax payable, etc.

Second, the exemption system is well designed. There are three types of circumstances that do not require the annual reconciliation: (1) where taxpayers need to file for makeup tax payment but their annual gross comprehensive income does not exceed RMB120,000; (2) where taxpayers' IIT shortfall does not exceed RMB400 in annual reconciliation; (3) where prepaid tax by taxpayers is the same as the annual tax payable or taxpayers do not claim tax refund.

Third, it clarifies the channels of conducting the annual reconciliation. Taxpayers can choose from several reconciliation methods, such as by themselves or through withholding agents, or intermediaries. In terms of channels, the first choice can be the "eTAX" platform, or one can choose mailing or visiting the taxpayer service hall in person.

Fourth, it stipulates the time for the annual reconciliation. A resident individual, who obtains comprehensive incomes, calculates IIT on an annual basis, and needs to make the annual reconciliation, shall complete the process within the period from 1 March to 30 June of the year following that in which the income was obtained. For a non-resident individual who receives salaries and wages, income for provision of independent personal services, author's remuneration and royalties, where there is a withholding agent, the withholding agent shall withhold and prepay tax on a monthly basis or when the taxable income arises, and the taxpayer does not need to make the annual reconciliation.

1 Fixed standard deduction is RMB5,000 per month, or RMB60,000 annually.

2 Special deductions include basic pension insurance, basic medical insurance, unemployment insurance and housing provident fund.

3 Special additional deductions include expenses for children's education, expenses for continuing education, medical expenses for serious diseases, mortgage interest, housing rent and expenses for supporting parents.

4 Other deductible items include annuity, commercial health insurance, tax-deferred commercial pension insurance, etc.

2. International Comparison of Annual IIT Reconciliation Practices

In recent years, China has pushed forward the reforms of streamlining administration, delegating powers, improving regulation and upgrading services so as to create a stable, fair, transparent and predictable business environment. Significant progress has been made, with China's ranking reaching the 31st place in *Doing Business 2020*, a report issued by the World Bank Group.[5]

In order to analyze the overall performance of China's annual IIT reconciliation, this report selects the United States[6], Canada[7], Japan[8], Australia[9], Taiwan region of China[10] and Hong Kong SAR of China[11], representing the three continents of America, Asia and Oceania, and draws the following conclusions through data analysis and comparison.

2.1 China's Prepayment System of IIT Comprehensive Income Is Relatively Accurate

Based on the data of the filing rate, the tax refund rate, the makeup payment rate, etc., this report summarizes five indicators. The calculation formulas are shown in Table 1, and part of the calculation results are shown in Table 2.

Table 1: Indicators for international comparison of annual IIT reconciliation

Indicators	Unit	Calculation Formula
Tax Refund Rate	%	Tax refund rate = number of tax refund filers / total number of people participating in the reconciliation and filing
Per Capita Tax Refund Amount	RMB	Per capita tax refund amount = actual tax refund amount / actual number of people receiving tax refund
Makeup Tax Payment Rate	%	Makeup tax payment rate = number of makeup tax payment filers / total number of people participating in the reconciliation and filing
Exempted Makeup Tax Payment Rate	%	Exempted makeup tax payment rate = number of people exempted from makeup tax payment / total number of makeup tax payment filers
Non-Makeup Tax Payment and Non-Tax-Refund Rate	%	Non-makeup tax payment and non-tax-refund rate = number of people who filed for no makeup tax payment or refund / total number of people participating in the reconciliation and filing = 1- tax refund rate - makeup tax payment rate

5 The World Bank Group. *Ease of Doing Business Rankings*, https://www.doingbusiness.org/en/rankings.
6 The filing data of the U.S. come from Internal Revenue Service, https://www.irs.gov/.
7 The filing data of Canada come from Canada Revenue Agency, https://www.canada.ca/.
8 The filing data of Japan come from National Tax Agency, https://www.nta.go.jp/.
9 The filing data of Australia come from Australian Taxation Office, https://www.ato.gov.au/.
10 The filing data of the Taiwan region of China come from the following website, https://www.etax.nat.gov.tw/etwmain/.
11 The filing data of Hong Kong SAR of China come from Inland Revenue Department, https://www.ird.gov.hk/.

Table 2: General performance of annual IIT reconciliation in China

Year	Tax Refund Rate	Per Capita Tax Refund Amount	Makeup Tax Payment Rate (Exempted Tax Payment included)	Exempted Makeup Tax Payment Rate	Non-Makeup Tax Payment and Non-Tax-Refund Rate
2019	45.21%	RMB581.61 (two years on average)	11.83%	8.52%	42.96%
2020	52.09%		12.71%	9.41%	35.20%

Note: The actual makeup tax payment rate in China is 3.31% (11.83% - 8.52%) in the year of 2019; 3.30% (12.71% - 9.41%) in the year of 2020.

Figure 1 shows the average value of the tax refund rate of each jurisdiction in a certain period. The tax refund rates of Australia from 2015 to 2018 were 77.21%, 76.01%, 76.68% and 76.27% respectively, and the four-year average was 76.54%; Canada's tax refund rate in 2019 was 63.84%; the U.S. tax refund rates from 2017 to 2020 were 59.55%, 58.93%, 58.30% and 70.59% respectively, and the four-year average was 61.84%; Japan's tax refund rates from 2015 to 2018 were 57.96%, 58.02%, 58.39% and 58.77% respectively, and the four-year average was 58.29%; China's tax refund rates from 2019 to 2020 were 45.21% and 52.09% respectively, and the two-year average was 48.65%; the average tax refund rate in the Taiwan region of China from 2015 to 2017 was 42.34%, and the average tax refund rate in Hong Kong SAR of China from 2015 to 2019 was 33.11%.

China's average annual tax refund rate for 2019-2020 was 48.65%, approximately 10 percentage points lower than that of the United States and Japan, 6 percentage points higher than the Taiwan region of China, and 15 percentage points higher than Hong Kong SAR of China. Given that the historical tax refund rates in the relevant jurisdictions are on a stable trend, the annual tax refund rate under the current IIT system in China is at a reasonable level from the international perspective, indicating that the design of the prepayment system of IIT in China is relatively accurate and

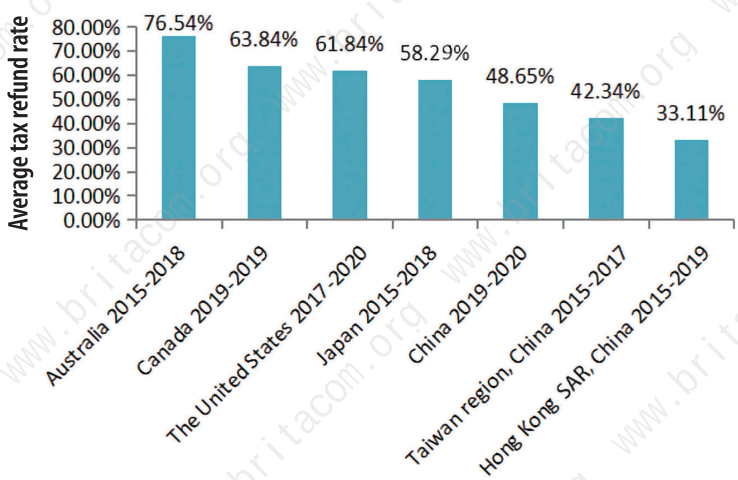

Figure 1. Comparison of the average tax refund rate of annual IIT reconciliation in each jurisdiction

efficient, which could keep the tax refund rate during the annual reconciliation in a reasonable range, while ensuring that tax dues could be fully transferred to the treasury during the withholding stage.

Meanwhile, the non-makeup tax payment and non-tax-refund rate of China is much higher than that in developed countries, showing the efficiency of withholding system from another perspective. In the reconciliation stage, the number of non-makeup tax payment and non-tax-refund accounts for 42.96% and 35.20% respectively of the total number of taxpayers participating in the reconciliation in 2019 and 2020, marking the average of 39.08%, which is much higher than that of 7.26%, the three-year average in Australia, and 9.55% in Canada in 2019.[12] A large number of taxpayers found that their tax withheld is exactly the same with the annual tax due in the reconciliation; therefore, all they need to do is simply to make a confirmation, which has largely alleviated the burden of tax compliance.

2.2 China's Tax Refund Mechanism Highlights the Taxpayer-oriented Concept

The current withholding and reconciliation system effectively prevents the trouble of "paying more in advance and then getting back later", thus enabling most taxpayers to accurately prepay taxes at the withholding and prepayment stage and enjoy the benefits of the reform in advance. The two-year average in 2019 and 2020 of the per capita tax refund was RMB582, much lower than the per capita tax refund in the United States, Canada, Australia, Japan, Hong Kong SAR of China and Taiwan region of China.

According to the data disclosed on the official websites of tax authorities of various jurisdictions (see Figure 2), the per capita tax refund for six consecutive years from 2015 to 2020 in the United States were USD2,954, USD3,044, USD3,186, USD3,280, USD3,261 and USD2,813 respectively; the six-year average per capita tax refund was USD3,090, equivalent to RMB20,902. The per capita tax refund in Australia from 2015 to 2018 were AUD2,543, AUD2,551, AUD2,555 and AUD2,554 respectively, and the four-year average per capita tax refund was AUD2,551, equivalent to RMB12,538. Canada's per capita tax refund is CAD1,848, equivalent to RMB9,873. Japan's per capita tax refund from 2015 to 2018 were JPY86,399, JPY86,546,

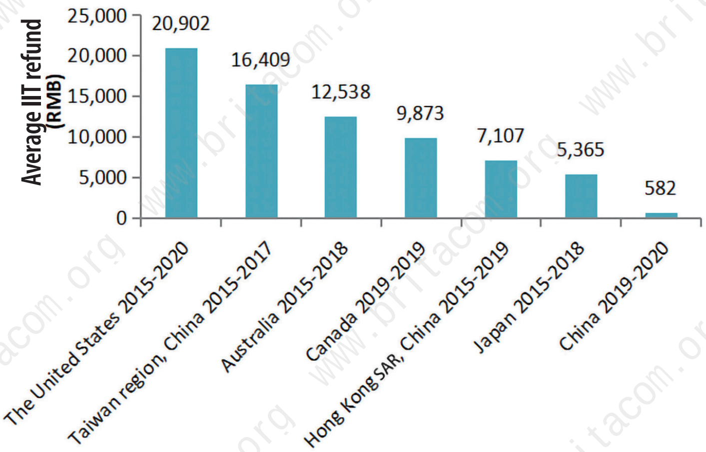

Figure 2. Comparison of the average IIT refund in annual reconciliation in each jurisdiction

12 The United States and Japan did not release the amount of makeup tax payment and tax refund, so only the data in Australia and Canada are compared.

JPY90,231 and JPY89,206 respectively, and the four-year average per capita tax refund was JPY88,096, equivalent to RMB5,365. The per capita tax refund in the Taiwan region of China from 2015 to 2017 were TWD73,437, TWD75,637, and TWD84,460 respectively, and the three-year average per capita tax refund was TWD77,845, equivalent to RMB16,409. The per capita tax refund of Hong Kong SAR of China from 2015 to 2019 were HKD7,642, HKD7,891, HKD7,321, HKD9,144 and HKD8,880 respectively, and the five-year average per capita tax refund was HKD8,176, equivalent to RMB7,107.[13] The per capita tax refund of the above jurisdictions is significantly higher than that of China.

From the perspective of tax system design, some jurisdictions make tax refunds the mainstream annual reconciliation method to improve tax compliance. This is certainly an effective measure, but imprecision in the regime design may result in excessive tax refunds, which take up a large amount of taxpayers' funds and then lead to the impression of onerous tax burden. China adheres to the "people-oriented" development philosophy, and makes every effort during the system design process to maintain the amount and rate of tax refund within a reasonable range, which in turn helps reduce the burden of taxpayers and enhance their sense of gain.

2.3 China's E-filing Rate Is Relatively High

Based on the annual "number of completed e-filings" published by the United States, the U.S. e-filing rate of each year can be calculated. The e-filing rate of the United States in the past six years is shown in Figure 3. Its IIT e-filing rate has gradually increased, from 68.09% in 2015 to 87.50% in 2020, and there is an increase of nearly 15 percentage points in 2020 compared with 2019 (the COVID-19 pandemic is an important factor), and the six-year average e-filing rate is 73.51%.

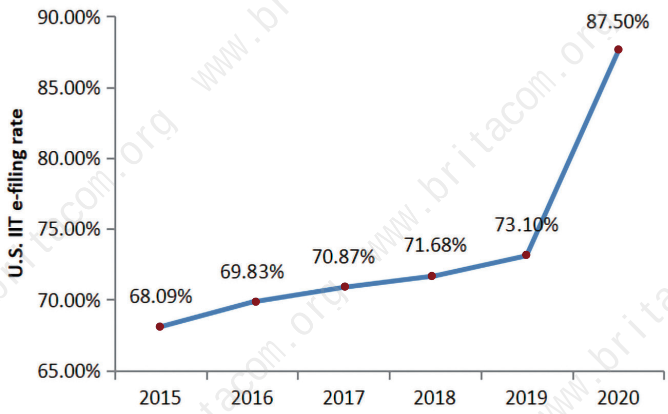

Figure 3. Trend of U.S. IIT e-filing rate

China's e-filing rate is at a relatively high level in the world, and the use of IIT APP in the annual reconciliation is a milestone progress of "Internet Plus Tax Administration". According to the data of annual reconciliations in the past two years, the average rate of e-filing in China is above 95%, more than 20 percentage points higher than that of the U.S. In view of the effectiveness, the promotion of "IIT APP" by tax authorities has achieved good results. Most of the taxpayers use cell phone APPs to complete their tax refunds and makeup tax payment. Tax informatization has played a great role in the IIT collection and administration.

2.4 China's Pre-filling Service Is at a Relatively High Level

The level of pre-filling service of each jurisdiction is assessed from three aspects, i.e., whether income items are pre-filled, pre-filling rate in general and pre-filled data usage rate.

13 Exchange rate used in this paper: USD100=RMB676.44, AUD100=RMB491.49, CAD100=RMB534.25, JPY100=RMB6.09, TWD100=RMB21.08, HKD100=RMB86.93.

Table 3: Comparison of the pre-filling service in annual IIT reconciliation

Jurisdiction		Whether Pre-filled	Pre-filling Rate	Pre-filled Data Usage Rate
United States		Yes	75%	Data not obtained
Canada		Yes	72%	Data not obtained
Japan		Yes	75%	Data not obtained
Australia		Yes	80%	Data not obtained
China	Year of 2019	Yes	62.5%	94.35%
	Year of 2020	Yes	100%	97.95%

Note: Pre-filling rate = number of pre-filled items / total number of income items;
Pre-filled data usage rate = the rate of using the data pre-filled by tax authorities when filing.

Table 3 shows that jurisdictions such as the United States, Canada, Japan and Australia provide pre-filling services. The United States[14] pre-fills 6 out of 8 major income items, with a pre-filling rate of 75%; in Canada[15], incomes are divided into 25 items under 5 categories, of which 18 items are pre-filled, with a pre-filling rate of 72%; Japan[16] presents a total of 19 items of income under 10 categories on the return, of which 2 out of 8 categories of comprehensive income are not pre-filled, with a pre-filling rate of 75%; in Australia[17], incomes are divided into 10 categories, of which 2 categories are not pre-filled, with a pre-filling rate of 80%; in China's 2019 annual reconciliation, salaries and wages, royalties and income for provision of continuous independent personal services under the category of comprehensive income were pre-filled, and the pre-filling rate reached 62.5%; all four types of comprehensive income were pre-filled in 2020, and the pre-filling rate was 100%. The pre-filled data usage rate of China's 2019 and 2020 annual reconciliations reached 94.35% and 97.95% respectively, indicating that the pre-filled items were relatively accurate, and taxpayers have generally benefited from the use of the pre-filling services provided by tax authorities.

2.5 The Processing Rate of Tax Refund in China Is Faster than the Global Average

In the United States[18], it takes 24 hours to 21 days with e-filing (and in some cases, more than 21 days) to deal with tax refund and 6-8 weeks with paper filing; in Canada[19], it takes an average of 2 weeks with e-filing and 8 weeks with paper filing, and the process can take up to 16 weeks if you live outside Canada and submit a non-resident IIT return; in Australia[20], it takes 2 weeks with e-filing and 10 weeks with paper filing. In China, the proportion of e-filing has exceeded 95%, and the corresponding tax

14 https://www.irs.gov/site-index-search?search=W-2&field_pup_historical_1=1&field_pup_ historical=1.
15 https://www.canada.ca/en/revenue-agency/services/forms-publications/tax-packages-years/general-income-tax-benefit-package/5000-g/income-tax-benefit-guide-total-income.html#Line101EmploymentIncome.
16 https://www.nta.go.jp/english/taxes/individual/incometax_2019.htm.
17 https://www.ato.gov.au/Tax-professionals/Prepare-and-lodge/In-detail/Pre-filling-reports.
18 https://www.irs.gov/refunds/tax-season-refund-frequently-asked-questions.
19 https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return /refunds.html.
20 https://www.ato.gov.au/Individuals/Your-tax-return/Check-the-progress-of-your-tax-return/.

Mr. Pascal Sanit-Amans, Director of the CTPA of the OECD highly commended the IIT reform in China

refund processing time is generally 3-14 days, with an average of 11.84 days (shortened to 11.29 days for the 2020 annual reconciliation), which is faster than the average level of the above jurisdictions.

3. Suggestions for Further Improving China's Annual IIT Reconciliation System

The implementation of the annual IIT reconciliations in the past two years in China achieved greater effects than expected. However, there is still much to be done when compared with the requirements of the 14th Five-Year Plan (2021-2025) and the Opinions on Further Deepening the Reform of Tax Collection and Administration released by the Central Government of China. In view of the problems in the annual IIT reconciliation process and drawing on the experience of other jurisdictions worldwide, the following suggestions are proposed for further improvement.

3.1 Improving the Legislation on Tax Administration for Natural Persons

The current Law of the People's Republic of China on the Administration of Tax Collection does not yet contain distinct provisions on tax administration for natural persons. The annual reconciliation requires taxpayers to complete the previous year's reconciliation by 30 June every year, but there are still some taxpayers who postpone the annual reconciliation or even fail to fulfill tax obligations for various reasons; in terms of tax overdue, there are also a small number of taxpayers who owe taxes for a long period of time, yet there is no legal basis for law enforcement. At present, the tax authority can only invoke Article 32 of the Law of the People's Republic of China on the Administration of Tax Collection, which stipulates that "Where a taxpayer fails to pay tax or a withholding agent fails to remit tax within a prescribed time limit, the tax authority shall, in addition to requiring the taxpayer or withholding agent to pay or remit the tax within the prescribed time limit, impose a surcharge for late payment at the rate of 0.05% per day of the amount of tax in arrears, from the date the tax payment is overdue." Starting from 30 June, a surcharge at the rate of 0.05% will be imposed on a daily basis for natural persons with tax in arrears after the annual reconciliation. In terms of law enforcement measures, such as public announcements of tax arrears, administrative penalties, prevention of border exit and enforcement, there are yet no clear legal provisions or penalties, which may easily lead to tax disputes and law enforcement risks. In terms of anti-tax avoidance management of IIT, currently the special tax adjustment mainly targets at enterprises. Although there is a general rule in Article 8 of the Individual Income Tax Law on anti-tax avoidance for IIT purposes, detailed guidance is not available yet. At present, as the Law of the People's Republic of China on the Administration of Tax Collection is under revision, it is suggested that relevant provisions of tax administration for natural persons should be added as soon as possible.

3.2 Improving Tax System and Filing Management

In terms of the tax system, China's IIT rate schedule[21] is designed with relatively narrow brackets and small differentials between brackets for taxable income above RMB300,000[22]. The top level in the schedule targeting taxable income above RMB960,000 applies a nominal tax rate of 45%, which is relatively high compared with that of other jurisdictions. It is suggested that the lower limit of the highest-level bracket be appropriately raised, the highest nominal tax rate be reduced at an appropriate time, the differentials between the bracket of RMB300,000 taxable income and the highest bracket be widened, and the range between the higher and lower limits of the same bracket be increased, so as to reduce the top nominal tax rate and balance the actual tax burden among high-income groups and improve vertical equity.

In terms of tax return design, the United States, Canada and Japan have integrated all incomes of taxpayers into the tax returns regardless of whether the incomes are included in the comprehensive income. In the future, with the continuous development of China's IIT reform, it is suggested that information related to items not included in comprehensive income be added to the annual reconciliation statement.

3.3 Strengthening the Supporting Measures for IIT Collection and Administration in Annual Reconciliation

In the first place, further integrating the information of natural persons. In the future, with the IIT reform being continuously pushed forward, it is necessary to collect and summarize all individual taxable income items as a whole. At present, the collection of IIT data is still relatively dependent on source-based withholding and self-declaration. The lack of third-party data of property income and other information is not conducive to the establishment of an integrated profile of individual income, nor to the refinement of IIT collection and administration. It is recommended to take the opportunity of building the "Golden Tax Project Phase IV"[23] to further improve the intelligent collection of tax and fee information on "each single" natural person.

In the second place, enhancing collection and comparison of information from third parties. In the first annual reconciliation, tax authorities have innovatively introduced the pre-filling service for tax return forms. Salaries and wages, royalties and income for provision of continuous independent personal services can be directly pre-filled in the tax return. As regards income for provision of non-continuous independent personal services and author's remuneration, tax returns can be pre-filed by importing the withholding pre-payment declaration record into the tax return. For the 2020 tax year, all four categories of incomes were directly pre-filled in the

21 Tax rates of IIT for comprehensive income in China are 3%, 10%, 20%, 25%, 30%, 35% and 45%.

22 According to the annual reconciliation data of 2019 and 2020, those with annual taxable income above RMB300,000 accounted for 1.05% of the total number of filers in 2019 and 1.10% in 2020.

23 Golden Tax Project is the information technology project for tax administration in China and now it is under the Phase IV construction.

declaration form, which further facilitated tax filing. As regards items other than income in the return, such as deduction items of commercial health insurance and of tax-deferred commercial pension insurance, and maternity allowance and severance compensation under the category of tax-exempt income, it is recommended to realize data pre-filling as early as possible while enhancing the collection and comparison of information from third parties so as to ease compliance burden.

In conclusion, the new IIT reform implemented in 2018 marks an important step forward in establishing an IIT system which combines the comprehensive and schedular tax systems. It represents the improvement of national governance capacity and governance level, where tax plays a significant role in modernization of national governance. The annual IIT reconciliation system has ensured sufficient data collection from third parties and easy filing, and the e-filing rate and tax refund rate have remained high. The problems have also showed us the direction for further improvement. The annual IIT reconciliation requires taxpayers to include all their incomes in the annual comprehensive income before filing tax returns to tax authorities. It will not be helpful for enhancing the awareness of tax payment and taxpayers' participation, neither will it reflect the principle of tax fairness. Tax authorities have realized deep integration of social governance and comprehensive services by giving full play to modern information technology, innovative publicity services, and big data governance and application, which connect business chains for handling multiple government affairs and enhance collaboration among different government agencies. This fully demonstrates the achievements of the comprehensively deepening reform in tax system. The IIT annual reconciliation practices have proved that the tax reform is moving at a fast and steady pace and has achieved a new breakthrough in tax services and administration.

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Tax Reforms in Indonesia: Road to Stronger Economic Development and Beyond

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Abstract: Tax reform is perceived as an applicable strategy for attracting investment and promoting economic development for its impact on decision-making process carried out by business players and investors. Driven by the vision to boost economic growth, attain escalated national development, and establish a more solid tax landscape, Indonesia opened a new chapter of vast tax system reform during the period of 2018–2021. This paper discusses Indonesia's tax reform on two essential aspects, which are tax policy reform and organisational reform of the tax authority, culminating with the impacts of the reform on business environment and potential investors.

Keywords: Tax reform; Tax policy; Tax administration; Organisational reform; Tax landscape; Business environment

I. Introduction

Economic growth, prevalent prosperity, investment-friendly environment, and long-term fiscal stability are desirable for jurisdictions around the globe. Inevitably, the urgency for tax system to respond to global changes has become more prominent over the past decade, upon the rise of information technology (IT) and digital economy where cross-border mobility of capital, goods and people is increasing, bringing significant challenges for tax system. Reforming the tax system, therefore, is a strategic step to attain economic growth and long-term fiscal stability, as well as to address some challenges arising from the digitalization of the economy.

By definition, tax reform involves changing the tax system structure, which enables a tax regime to come closer to an ideal one. It could reduce tax evasion and avoidance and allow for more efficient and fair tax collection, thus optimising financing of public goods and services.[1] For national revenue purpose, it could make revenue levels more sustainable and promote future independence from foreign aid and natural resource revenue. In addition, re-

1 Rao Sumedh (2014). *Tax Reform*, https://gsdrc.org/topic-guides/tax-reform/concepts/what-is-tax-reform-and-why-does-it-matter/.

forming tax system could improve economic growth and address issues of inequality through redistribution and behaviour change.[2]

Since 2019, apparently tax reform has become something of exigency, following the occurrence of the unprecedented Coronavirus Disease (COVID-19) pandemic. The impacts of the pandemic require governments to implement relevant measures, which heavily relies on tax policies and tax revenue. As reported in 2021, 70 jurisdictions have applied and reformed tax policies as their responses against the economic downfall.[3]

Indonesia has been one of the numerous countries envisioning the evolvement of its tax system to achieve long-term economic stability and growth. The reform of Indonesia's tax system stems from the urgency to keep pace with the changes of international tax landscape and to address the economic challenges in recent times.[4] This paper discusses the most recent changes in Indonesia's tax system in the latest years and its implications to the business environment and cross-border investment.

2. Recent Changes in Indonesia's Tax System

Indonesia's tax landscape has been evolving for achieving a greater tax system and national development purposes. The latest revolutionary evolvement occurred during the period of 2017–2021, where the reform was made on two fundamental aspects, i.e., tax policy and tax administration.

2.1 Reforms in Tax Laws and Tax Policies

The most recent changes in Indonesia's tax law and regulation are actuated through the enactment of the long-awaited Omnibus Laws, Law No.7 of 2021 and Law No. 11 of 2020 (hereinafter referred to as "Omnibus Law"), and the enactment of Law No. 2 of 2020.

The Omnibus Law is the utmost mark of the new chapter of Indonesia's legal system reform. *Black's Law Dictionary*[5] defines an omnibus bill as a single bill covering several diverse or unrelated topics, or a bill that deals with all proposals relating to a particular subject. This omnibus bill is one of several means to streamline overlapping provisions in various laws and improve the ease of doing business in Indonesia. The Omnibus Law contains legislative amendments on provisions concerning income tax, value-added tax (VAT), and general provisions and tax procedures. The legal system reform serves the purpose to promote investment-friendly environment, boost economic growth, provide justice and equality for foreign investors, and encourage voluntary compliance.[6]

Subsequent to the enactment of Omnibus Law on 2 November 2020, Government Regulation No. 9 of 2021 was issued in February 2021, as one of the implementing regulations of the Omnibus Law, dealing with taxation issues under the Omnibus Law. Also in the same month, Indonesia Ministry of Finance (MoF) issued MoF Regulation No. 18 of 2021 to provide implementing rules of the amendments made on Income Tax Law, Value-Added Tax Law and General Provision and Tax Procedures Law.

Besides the Omnibus Law, another mark of the recent tax reform in Indonesia was the enactment of Law No. 2 of 2020 in May 2020, which was previously released in the form of Regulation in Lieu of Law to address the immediate importance of extraordinary measure in response to the pandemic. It contains several changes in tax provisions, such as corporate income tax (CIT)

2 Ibid.

3 OECD (2021). *Tax Policy Reforms 2021: Special Edition on Tax Policy During the COVID-19 Pandemic*, https://www.oecd-ilibrary.org/sites/427d2616-en/1/3/3/index.html?itemId=/content/publication/427d2616-en&_csp_=1ebcf09c255186d32adec934a657a201&itemIGO=oecd&itemContentType=book.

4 Ministry of Finance of Indonesia (2021). *Reformasi Perpajakan Meningkatkan Sistem Perpajakan yang Adil dan Akuntabel*, https://www.kemenkeu.go.id/publikasi/berita/reformasi-perpajakan-meningkatkan-sistem-perpajakan-yang-adil-dan-akuntabel/.

5 Garner A. Bryan (2019). *Black's Law Dictionary*. (11th ed.). Thomson Reuters.

6 Kadek Meytha Dewantari (2020). *UU Ciptaker Disahkan, Simak Perubahannya pada Klaster Perpajakan*, https://www.pajak.go.id/id/artikel/uu-ciptaker-disahkan-simak-perubahannya-pada-klaster-perpajakan.

rate and the collection of VAT on electronic commerce. Law No. 2 of 2020 does not only provide an immediate legal basis for alleviating the economic downfall confronted by taxpayers and for collecting revenue to fund national strategies against the COVID-19 outbreak in short-term period, but also constitutes a crucial milestone for reforming Indonesia's tax system for long-term objectives.

2.1.1 Reforms in income tax

2.1.1.1 The decrease of CIT rate

The decrease of CIT rate is one of the most notable changes in Indonesia's tax system. Before the recent enactment of the Omnibus Law, the CIT rate was 25% according to Law No. 36 of 2008 as the third amendment of Law No. 7 of 1983 concerning income tax.

The change of CIT rate took place in the first half of 2020, when the government of Indonesia was undergoing the immense economic disruption caused by COVID-19 pandemic, by passing Government Regulation in Lieu of Law No. 1 of 2020, which was then enacted as Law No. 2 of 2020. The CIT rate is cut through two stages, from 25% to 22% in tax year 2021, and 20% from 2022 onwards.

The reduction of CIT rate was initially designed to be one of the articles in the Omnibus Law. However, the occurrence of pandemic requires the government to release immediate policies for the continuity of business environment.[7] Thus, the change of CIT rate was included in Law No. 2 of 2020 which was enacted prior to the Omnibus Law.

2.1.1.2 The exclusion of certain types of income from taxable income

After the enactment of Law No. 11 of 2020, several types of income are excluded from taxable income. According to the Omnibus Law, the first exclusion is dividend received from domestic companies. This means that the dividend income would not be taxable on the hands of recipients, thus facilitating investment in domestic companies both for domestic or foreign investors.

Moreover, the change of priorly taxable income into non-taxable income betides on dividend received from foreign companies and other type of foreign sourced-income which are not earned by a permanent establishment outside Indonesia, as long as the foreign dividend and other foreign-sourced income qualify the criteria. The criteria for taxable income exclusion are that the distributed dividend shall be at least 30% of the corporation's total income before tax; the dividend income shall be from foreign companies of which the shares are not publicly traded on Stock Exchange; and the dividend and other foreign income shall be reinvested in Indonesia. This policy, adopted by Indonesia, is aimed at boosting investment in productive sectors, which in turn could promote economic growth and increase the GDP.

2.1.2 Reforms in general provisions and tax procedures

General Provisions and Tax Procedures Law within Indonesia's law system stands as the legal basis which stipulates procedures on the actualisation of Tax Law, including Income Tax Law and Value-Added Tax Law. Some of the provisions and procedures therein are administrative penalties upon overdue tax payment, obligation in relation to annual report, and events or conditions that would induce a tax audit.

The Omnibus Law amends General Provisions and Tax Procedures Law, which has a wider long-term impact on Indonesia's tax landscape and economic development. The amendments embodied in the Omnibus Law are changes in the calculation of the interest penalty and the interest compensation, and the deletion of certain terms in General Provisions and Tax Procedures Law that could give rise to duplicative meanings or multi-interpretation.

Prior to the amendment through Omnibus Law, in the event that taxpayers failed to fulfil tax payment or reporting obligation as stipulated in

7 Ministry of Finance of Indonesia (2020). *Pemerintah Terbitkan PERPUU untuk Tangani Dampak Ekonomi Akibat Covid-19*, https://www.kemenkeu.go.id/publikasi/siaran-pers/siaran-pers-pemerintah-terbitkan-perppu-untuk-tangani-dampak-ekonomi-akibat-covid-19/.

General Provisions and Tax Procedures Law, penalties would be payable in the form of interest. The penalty was calculated at the interest rate of 2% per taxable month. In present times, such flat rate is no longer applied. The interest rate for tax penalty calculation is of the monthly floating rate, which reflects the fair value of economic condition.

These amendments are made to increase voluntary tax compliance in Indonesia. Since the interest rate reflects the dynamics of economic condition, the change will strengthen the fairness principle to taxpayers. This, hopefully, would shift the old paradigm of rigid tax regimes into a cooperative climate between tax authority and taxpayers, thus positively affecting taxpayers' compliance rate.[8]

2.1.3 Reforms in VAT

2.1.3.1 Taxing digital economy: VAT collection on imported digital products

In 2020, Indonesia began to introduce more solid legislative regulation to capture potential indirect tax revenue from digitalisation of the economy, despite the difficulties embedded in digital economy environment, such as the absence of physical presence, the complex nature of transactions carried out in the digital economy[9], and the problem of obtaining reliable data.

The milestone in taxing a fair share of digital economy was the enactment of Law No. 2 of 2020, which contained provisions concerning indirect tax through VAT. This was a vital step in Indonesia's taxation history since there was previously no provision directly regulating VAT collection mechanism in relation to cross-border transactions of goods and services through digital means. Under the new law, such collection is undertaken by overseas sellers, who have officially been appointed as VAT collectors by Indonesian government.

Law No. 2 of 2020 stipulates that VAT on the utilization of intangibles or services provided by overseas sellers and e-commerce platform providers should be collected, paid, and reported either by sellers and providers themselves or by their appointed representatives in Indonesia. If the seller fails to fulfil this obligation, Indonesia will impose sanctions, ranging from administrative sanctions to access termination.

Subsequent to Law No. 2 of 2020, on 15 May 2020, the Ministry of Finance issued Minister Regulation 48/2020 concerning the appointment of VAT collectors and procedures of collecting, paying and reporting VAT. On 25 June 2020, the Directorate General of Taxes (DGT) provided implementing regulations in the form of Director-General Regulation 12/2020, followed by Circular Letter 44/2020 on 30 July 2020 elaborating the procedures in more detail.

As of 6 September 2021, 83 off-shore companies had been appointed as collectors of VAT on imported digital products.[10] Indonesia's endeavor to strengthen VAT collection on imported digital products through a close cooperation between foreign digital-based companies and the Indonesian government is a breakthrough revolution of tax system. In fact, since its implementation in June 2020, the VAT collection on imported digital products has generated a significant amount of tax revenue for Indonesia. During the period from June 2020 to 31 December 2020, the revenue collection was 915.7 billion rupiah.[11] The figure increased significantly between 1 January and 31 August 2021, generating 2.5 trillion

8 Ministry of Communications and Informatics (2020). *Reformasi Perpajakan Upaya Kemudahan Berusaha di Indonesia*, https://www.kominfo.go.id/content/detail/30917/reformasi-perpajakan-upaya-kemudahan-berusaha-di-indonesia/0/berita.

9 Fajersztajn B. & Santos R.T. (2020). *The Challenges of Taxing the Digital Economy*, https://www.internationaltaxreview.com/article/b1ky5z950v9tl6/the-challenges-of-taxing-the-digital-economy.

10 Ministry of Finance of Indonesia (2021). *DJP Aktif Tunjuk Pemungut PPN PMSE*, https://www.kemenkeu.go.id/publikasi/berita/djp-aktif-tunjuk-pemungut-ppn-pmse/.

11 Pangastuti, Triyan (2021). *DJP: Hingga Semester I, Penerimaan PPN dari Perdagangan PMSE Capai Rp 1, 64 Triliun*, https://investor.id/business/255277/djp-hingga-semester-i-penerimaan-ppn-dari-perdagangan-pmse-capai-rp-164-triliun.

rupiah of VAT collection.[12]

The adoption of VAT collection on imported digital goods and services has delivered essential benefits for Indonesia. The most of which are the creation of level playing field between digital-based business and brick-and-mortar business, the significant amount of VAT revenue, and the enhanced aspect within Indonesia's tax system.

2.1.3.2 VAT provisions to facilitate the ease of doing business

One of the main objectives of Indonesia's tax system reform is to facilitate the business carried out by small and medium-sized enterprises (SMEs). The VAT regime is one of the numerous impactful aspects to reform. Among taxpayers doing business, SMEs would be parties being significantly affected by provisions on indirect tax regimes, which include VAT rate and administrative complexity.[13] This is due to the fact that tax compliance cost is relatively higher for SMEs in comparison with big corporations.

The Omnibus Law laid down the changes in VAT regime, which support business environment, particularly affecting SMEs. The amendments on VAT provisions included the exclusion of consignment from the application of VAT regime, whereas priorly it was categorized as taxable transfer of goods; relaxation on the credit mechanism of input tax on VAT, and simplification on tax invoice administration for retail merchants.

2.1.4 Reforms in tax dispute resolution system

Since the effectiveness and reliability of tax dispute mechanism is inter-related with the perception of tax certainty, the reform of tax dispute system stands as one of the most crucial aspects of a tax landscape, which constitutes a foundation for creating a climate of trust between the government and taxpayers. For the purpose of achieving economic growth, tax certainty is a priority, as it is crucial for taxpayers' investment decisions.[14]

The path to providing tax certainty, in terms of transfer pricing, is now on a more promising stage through the enactment of the MoF Regulation No. 22 of 2020 on Implementation Guidelines of Advance Pricing Agreement (APA), on 18 March 2020. This is a milestone in enhancing the tax law certainty in Indonesia, as well as in strengthening the fundamental framework for a more reliable national revenue system.

The new APA regime contains certain provisions to enhance the effectiveness of tax dispute prevention, and therefore offers a more comprehensive basis for tax certainty. The key features are a longer APA coverage period, from previously up to four to five years, roll-back provision, and much more simplified administrative requirement for taxpayers' APA submission. A longer APA period means that certainty will be secured for taxpayers for a longer period. The inclusion of roll-back provision within APA negotiation provides a cost-effective way to obtain certainty over the past fiscal years while preventing the same transfer pricing dispute in the coming fiscal years. Then, importantly, simplified administrative requirement in the process of seeking APA facilitates taxpayers to obtain tax certainty without excessive administrative burden involved.

2.2. Reforms in Tax Administration

Tax administration plays a crucial role in tax system. In order to fulfil its objectives in resource allocation, income distribution, and macro-economic stability and growth, tax administration must function effectively and efficiently.[15] Therefore, besides reforming the legal basis of tax regime in Indonesia, reforming tax

12 Ministry of Finance of Indonesia (2021). *DJP Aktif Tunjuk Pemungut PPN PMSE*, https://www.kemenkeu.go.id/publikasi/berita/djp-aktif-tunjuk-pemungut-ppn-pmse/.

13 Mach Petr (2018). VAT Rates and Their Impact on Business and Tax Revenue. 12 *European Research Studies Journal*, pp. 145. https://www.ersj.eu/dmdocuments/2018_XXI_1_13.pdf.

14 IMF/OECD (2019). *2019 Progress Report on Tax Certainty*, https://www.oecd.org/tax/tax-policy/imf-oecd-2019-progress-report-on-tax-certainty.pdf. pp.6.

15 Tanzi, Vito & Pellechio, Anthony J (1995). *The Reform of Tax Administration*, https://www.elibrary.imf.org/view/journals/001/1995/022/article-A001-en.xml.

administration is also placed as a priority.

The reform in tax administration involves multi-dimension changes, such as tax organisation, business process, database and administrative system, and human resource management.[16] In Indonesia, the reform in tax administration aims to optimize the function of tax revenue collection through establishing an organisation with efficient and effective performance, reliable integrity, and high qualification.

One of the most significant changes in tax administration is the tax units, of which main functions are to monitor, supervise, and audit taxpayers' compliance, especially tax payment and tax reporting. In 2020, Minister of Finance Regulation No. 184 of 2020 was enacted, which became the game-changer, transforming tax office organisation and business process. Not only the units and human resources are substantially built up, their main focus, strategies, and working conduct are also adjusted.

Furthermore, as the information technology evolves, the government of Indonesia adopts IT and data analytics within its tax administration. The first milestone in this respect was the enactment of President Decree No. 40 of 2018, which commenced the reconstruction of tax information system. Subsequently, innovation in tax data analytics was set out in 2019, when Compliance Risk Management (CRM) entered into development phase. Now the CRM program has already been utilised for optimising tax revenue collection and tackling tax avoidance and evasion.

3. Impacts of Indonesia's Tax Reforms on Business Environment and Investment

The tax reform of Indonesia affects the business and investment environment that could be foreseen as beneficial opportunities for both domestic and foreign investors. Importantly, the reform engraves two-sided evolution. It is a growing supportive climate for doing business, which abides hand in hand with enhanced law enforcement within tax regimes.

From the perspective of investors, facilities and ease available after tax landscape changed could be seen as potential benefits in achieving business objectives. The momentum of Indonesia's tax reform could be an encouragement to invest in Indonesia's productive sectors. During the planning phase, corporation could select what kind of business activities to carry out and what sectors to invest, by taking into account relevant tax provisions. This is in line with the notion that planning is actually the core function of organisation management.[17] Examples of important consideration in doing business and investing in Indonesia are the decrease of CIT rate, which alleviates tax burden of corporations, and the utilisation of dividend as non-taxable income in the event of reinvestment in Indonesia's productive sectors. Another noteworthy point is that in the purpose of securing tax certainty, taxpayers could prevent transfer pricing disputes in a cost-efficient way through APA mechanism.

Nevertheless, business players still need to maintain their tax compliance. Since Indonesia has been reforming both tax law and tax administration, the conduct of tax administration and the law-enforcement aspect would be more intensive and narrowed. Therefore, taxpayers should preclude the possibility of inefficiency resulting from tax penalties by maintaining their compliance levels and improving their understanding of tax provisions.

From the government's point of view, tax reform is perceived as a momentum to build stronger cooperation between tax authority and taxpayers. Indonesia's tax system is evolving to be more reliable, fairer, and well-established. Despite some room left for improvement, this is indeed a road to stronger economic and social development.

16 Ministry of Finance of Indonesia (2021). *Ditjen Pajak Jelaskan Reformasi Perpajakan*, https://www.kemenkeu.go.id/publikasi/berita/dirjen-pajak-jelaskan-reformasi-perpajakan/.

17 L. Jeseviciute-Ufartiene (2014). Importance of Planning in Management Developing Organization, 2 *Journal of Advanced Management Science* 3, pp.177.

Tax Incentives: Tax Revenue versus GDP in Malaysia

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Abstract: Malaysia has a set of "blessed advantages" over other members of ASEAN in terms of fiscal incentives, environmental perspectives and established infrastructures. MNEs are welcome to invest in Malaysia as they could generate substantial income at the expense of significant tax benefits, compared with local companies. The proceeds of business can be diversified into venture capitals and private equities, earning sustainable investment returns and large capital gains upon realisation. Despite tax forgone, Malaysia continues furthering tax incentives to attract FDI.

Keywords: Tax cuts; Tax incentives; Tax administration; Tax Revenue; FDI; GDP

1. Introduction

Malaysia is within the axis of the Belt and Road Initiative (BRI), with adequate capacity to support Asia's regional link and economic integration to Africa and Europe, via land and maritime networks connecting the Indian Ocean and the Pacific Ocean. It is also rich in natural resources, with established infrastructures and continuous investments in human capital. However, tax remains a point of differentiation between countries in ASEAN, in promoting FDI and MNEs to locate their regional or global operations.

Malaysia has experienced several phases of income tax reforms since it became independent in 1957. Tax policy has shifted from high to low tax regime with various tax deductions and gradual reduction in tax rates, which intended to advance social goals and economic growth. Tax administration has long embarked into ICT (Information and Communication Technology) with continuous advancement of technology, to keep pace with digital transformation and to facilitate many tasks in managing and improving tax compliance. Major reforms in the 1990s focused on tax rate, tax deductions and different types of tax. Fiscal policy in the 2000s mainly concentrated on self-and-current-year-based assessment. Recent tax reforms aim to address issues arising from borderless, e-commerce and digital economy, and further liberal tax incentive policies to account for equity and growth objectives.

This article examines the tax regime and effects of corporate tax reforms and tax incentives in Malaysia. Relevant analysis is not conclusive and further studies are necessary for more insights.

2. Tax Regime

2.1 Tax Cuts

In Malaysia, the tax system has reformed from high to low tax regime, to encourage employment, saving and investment, and to spur economic growth and productivity. Low tax regime is intended to increase the spending power of consumers and enhance aggregate demand.

The scope of income taxation has long shifted from worldwide to a territorial basis, then income repatriated back to Malaysia is also exempted. Severance Taxation, Excess Profit Tax and Development Tax were removed from the tax system in the 1980s and 1990s. Corporate Statutory Tax Rate (STR) was at flat rate 40% (1970s), which gradually reduced to 35% (1980s), then to 30% (1990s) and now at 17%, or 24% for enterprises with larger capital and higher profit.

Tax scope and tax rate for Capital Gains Tax (CGT) are below the practice of other members of ASEAN. Disposal of land property and disposal of interest or rights over land property is subject to CGT and termed Real Property Gains Tax (RPGT). No CGT is based on the realisation of other assets. The RPGT is calculated according to asset holding period, despite the size of capital gains. The rate is 30% for disposals of real property made within three years as of the date of acquisition, and 20%, 15% and 10% for disposals in the fourth, fifth and sixth year/thereafter, after the acquisition respectively. For companies incorporated outside Malaysia, the rate is 30% for disposals made within five years and 10% thereafter. Recurrent quit rent and assessment is very minimal, and there is no such gift/wealth/surtax, as in some member countries of ASEAN.

Stamp duties are imposed on the instruments of transfers such as sale/purchase and loan agreements, where rates are lower than those in many countries. Remission of stamp duties and exemption orders are applicable to a range of instruments to support the transactions of property market and specific economic activities.

2.2 Tax Incentives

The ASEAN Economic Community (AEC) did not incorporate taxation in any of the regional market and production base agendas, so member countries continue using tax incentives in attracting FDI. In general, tax incentive in terms of tax holiday is between 5 and 20 years.

As FDI has been the cornerstone of any pro-growth fiscal policy, Malaysia's 2020 budget furthered existing tax incentives and introduced new incentives to create more opportunities for prospective investments. Tax incentives are granted to companies investing in promoted sectors for a period of 5 to 10 years, in the form of tax exemption such as the Pioneer Status. Alternatives are tax credit varying between 60% and 100% of the capital investment, and Investment Tax Allowance (ITA) which is cost-based measure.

A 10-year tax exemption is being instituted for investors from multinational companies in the electronics and electrical industry, particularly investors in selected knowledge-based services, dealing with high-end technology, manufacturing or value-added industries.

Additionally, the recent budget improves tax incentive design to encourage industries into digital economy with new technology, re-training of the local workforce, and the development of new electronics and electrical subsectors. Incentives are also available for businesses to implement automation into their practices. A set of stimulus packages for foreign companies in the manufacturing sector seeking to relocate to Malaysia, which are available up to 31 December 2021, are listed as follows:

- The 2015 principal hub incentive is extended for another five years, with numerous additional measures introduced, to mitigate the economic impact caused by the pandemic.

- Incentives in terms of preferential corporate income tax (CIT) rate of zero to 10% for a period of up to 10 years, according to the following categories:

– Companies relocating operations to Malaysia and making new investments in the manufacturing sector and selected service sectors, in particular sectors adapting Revolution 4.0 and digitalisation technology, with investment that contributes to a significant multiplier effect;

– Global Trading Centre tax incentives to attract companies to establish their regional trading hubs in Malaysia; and

– Companies manufacturing pharmaceutical products including vaccines.

In line with the aim to place Malaysia at the forefront destination for high value-added services, these companies must prove significant contributions to the following services:

- Provide technology-based solutions;
- Provide technology and infrastructure for cloud computing;
- Engage in research and development activities;
- Develop medical devices testing laboratories and clinical trials; and
- Any service or manufacturing related service determined by the Minister of Finance.

Tax exemption in the Budget 2021 is extended until 2022 for the following categories:

- Investor companies that commercialize research and development (R&D) findings of public/private research institutions, including the commercialization of non-resource based R&D findings.
- Investor companies dealing with promoted sectors in the economic zones, and business located in the investment corridors.[1]

Companies in the Federal Territory of Labuan may be exempt, or taxed at only 3%, or make an irrecoverable selection to be taxed under the standard income tax rate to be entitled for double taxation relief. Recent reforms are in line with the Base Erosion and Profit Shifting (BEPS) Action 5 initiatives to encourage the usage of the minimum standards for taxation matters. The key changes to the Labuan new regime include Labuan entity's scope of business activity, preference for tax charged, type of exemption and substance requirement.

2.3 Tax Administration

Reform in tax administration is necessary to enhance the efficiency and effectiveness of tax operations. Administrative reforms include advancement in technology and dynamic strategies, as an indirect role to compensate for some revenue forgone due to tax cuts and tax incentives.

Increasing service demand is tackled using various electronic communication channels and secured internet services. Investors are able to comply with tax obligations anytime and anywhere using computers and smart devices to access online facilities for registering, filing and payment. Taxpayers are able to comply with tax obligations and obtain tax information online because the tax system gateway provides an access to the global system which is connected to a secured interface.

3. Analysis and Insights

Literature studies have highlighted the mixed effects of tax cuts and tax incentives, depending on how reforms are designed and implemented. This section analyses the effects of corporate tax reforms based on the interpretation of data gathered.

3.1 Tax Cuts

Tax makes up about 70% of the Federal revenue, with corporate tax as the major component. Revenue loss due to continuous tax cut policy may distort Government coffers to fund various operational and development expenditures. The self-assessment and "pay-as-you-earn" collection systems have partially balanced the revenue loss due to tax cut. Reform in the tax system from preceding assessment in

1 East Economic Region (ECER), Iskandar Malaysia (IM) and the Sabah Development Corridor (SDC).

the early 2000s to current year basis saw an increase in tax revenue, as taxes were collected on earnings and business profits concurrently. Post compared with pre current year basis of assessment increases corporate tax as share of GDP by 0.02 percentage point.

Reform in the tax system by shifting from formal to self-assessment expedites tax bills and the payment of tax. Post compared with pre Self-Assessment-System increases Corporate Tax as share of GDP by 0.01 percentage point.

Effective Tax Rate (ETR) is used to measure the actual tax burden as companies benefit with a range of standard tax reliefs/deductions and tax incentives. Corporate ETR is much lower than the current STR (17% and 24%), which is about half the size of the STR in the 1980s. The ETR for companies that were granted tax incentives is between 0% and 15%. Trend in the corporate tax in relation to GDP implies buoyancy. However, tax cuts distort the "corporate tax in-tandem-growth to GDP". Line chart in Table 1 is an overview of the downward trend in the corporate tax as the share of GDP, implying the slowdown trend of corporate tax growth. The structural shift story implies that tax cuts and tax incentives significantly distort corporate tax revenue in the long run.

3.2 FDI and Tax Incentives

FDI has been the cornerstone of pro-growth fiscal policy. Tax incentives remain as the preferred approach to attracting FDI, which may be unnecessary in low tax regime country. As shown in Table 2, FDI net inflow growth contributed to more than 10% foreign equity in Malaysia's companies until 2017, mainly from Hong Kong SAR of China, mainland of China and Singapore. Then FDI declined due to lower investment in the mining and quarrying sector. FDIs remain at the low level amid uncertain economic recovery of the COVID-19 pandemic. The overall decrease in FDI net inflow was pulled by lower equity and investment shares and higher loans extended to affiliates abroad.

Tax incentives led to the economic growth to a certain extent. Nevertheless, incentives may not attract additional investments and significantly constrict corporate tax base in the long run. As in Figure 1, FDI net inflow slowdown and corporate tax growth is below GDP growth level, as in Table 2. The FDI net inflow as share of GDP fell from 3.84% to less than 1% from 2016 to 2020. The corporate tax as share of GDP decreased from 6.39% to 4.45% from 2013 to 2020. Trend in macro ratios implies that tax incentives play a partial role in attracting FDI, and the mechanism of eroding corporate tax base is of particular concern in dampening government fund.

Table 1: Line chart for personal tax and corporate tax in absolute value and tax as share of GDP nominal in percentage point

Year Period	Personal Tax (PIT value)	Corporate tax (Corp value)	GDP nom (GDP value)	PIT/GDP (%)	Corp/GDP (%)
1980-2020					
1980-1984					
1985-1989					
1990-1994					
1995-1999					
2000-2004					
2005-2009					
2010-2014					
2015-2020					

Table 2: Trend in corporate tax and FDI net inflow in relation to GDP

Year	Percentage ratio	
	Corporate tax : GDP	Net FDI : GDP
2013	6.39%	3.75%
2014	6.32%	3.19%
2015	6.13%	3.40%
2016	5.37%	3.84%
2017	5.29%	3.11%
2018	5.15%	2.25%
2019	4.98%	2.27%
2020	4.45%	0.98%
2013-2020		

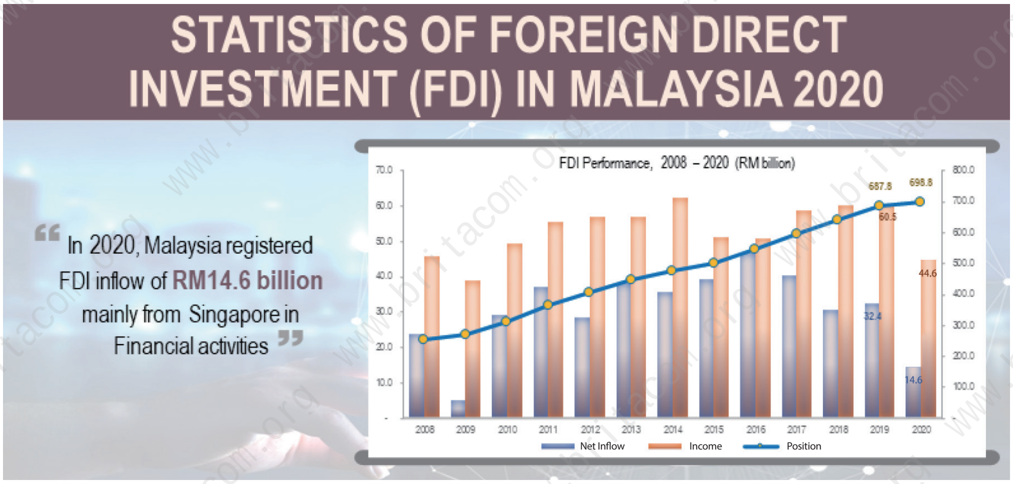

Figure 1. Trend in FDI from 2008 to 2020

Note: The line in the table represents accumulative FDI, and the blue bars indicate net inflow and orange bars imply income generated.

Source: Department of Statistic, Malaysia, https://www.dosm.gov.my/v1/index.php?r=column/cthemeByCat&cat=322&bul_id=WjJ6NU94Z3haUHEzcUxMaEdVbVVBQT09&menu_id=azJjRWpYL0VBYU90TVhpclByWjdMQT09.

ETR diverges from STR mainly due to tax incentives that vary across enterprises, depending on different set of incentives according to preferred economic activities. Table 3 and Table 4 display the percentage ratio of tax to business in foreign and local companies to reflect relative tax benefits resulting from tax incentives.

Over two decades of tax cut policy and tax incentive package, foreign companies remain at 5% of the corporate tax base compared with 95% local companies. In relation to numbers, income generated by foreign companies is substantial (between 25% and 35% of the total sales), compared with the proportion of taxes paid (between 14% and 19% of the total corporate tax). The difference in percentage ratio between income and tax paid reflects the effect of tax cuts and tax incentives in eroding tax base.

Table 4 displays taxable income and tax payable as share of sales, in foreign companies compared with local ones. The trend in foreign-tax-ratios which is lower than local-tax-ratios shows that foreign companies benefited from tax incentives more than locals.

The proportion of sales in foreign companies that subject to tax is between 3.67% and 5.20%, compared with locals (between 6.66% and 8.50%). Furthermore, tax as share of sales is between 0.84% and 1.25% in foreign companies, while it is between 1.43% and 2.01% in local companies. The gap in tax charged ranging from 0.59% to 0.76% indicates that foreign companies benefited from tax incentives more than locals, implying an inequitable tax treatment.

Table 3: Foreign companies: numbers, sales and tax (in percentage proportion to local companies)

Year	Number of foreign companies	Turnover or sales	Tax charged
2001	6.04	35.54	19.14
2005	5.26	30.08	15.32
2010	5.16	25.44	14.13
2015	5.05	25.59	15.93
2016	5.04	26.13	16.86
2017	5.13	26.40	16.62
2018	5.28	26.60	17.15
2019	5.27	27.84	17.95

Table 4: Foreign versus local companies: taxable income and tax in proportion to sales

Year	Foreign companies		Local companies		Gap in tax charged ratio
	Taxable income: sales	Tax: sales	Taxable income: sales	Tax: sales	
2001	3.67	0.84	6.66	1.43	0.59
2005	4.29	0.87	8.48	1.46	0.59
2010	4.57	1.00	8.23	1.69	0.69
2015	5.12	1.25	8.45	2.01	0.76
2016	5.20	1.23	8.29	1.92	0.69
2017	5.18	1.20	8.50	1.90	0.70
2018	5.11	1.18	8.10	1.83	0.65
2019	4.83	1.13	7.78	1.76	0.63

3.3 Benefits of Capital Investment

"Property Market Overview, Buying Guides, Rental Yields and Advice" highlights the competitive property investment features of Malaysia, in relation to other ASEAN members. Malaysia stood at 3.72%, 4.0% and 5.0% level, with regard to Gross Rental yield per annum, Buy to Let Rating and Effective Capital Gains Tax, respectively.

Statistics indicate that many investors purchased premises as second homes, or buildings and lands to let out for rental as incidental revenue to business. Others confidentially buy appreciating assets such as shares, bonds and real property to sell at profit. Around 80% of property disposals were kept for at least six years with profits up to three digit millions.

3.4 Reform in Tax Administration

The future direction would be to embrace technological advancement and develop human capital competency. The employment of data lake with data analytic tools has significantly enhanced tax compliance program and non-compliance operation. Keeping pace with digital communication channels and providing various online services may ease tax compliance and facilitate tax administration to meet increasing service demand.

Consumer electronic usage mainly on e-filing, stamping, tax information, payment and application for credits indicate a high response rate. The number of electronic usage increased from a single digit million in 2010 to more than 70 million in 2020. Filing of corporate tax form stood at 100% electronic. Nonetheless, stamp duty service has achieved more than 90% electronic, and 85% of tax payment was made electronically as in the third quarter of 2021.

As the flexible global access is available on the online services, foreign investors may comply with tax obligations anywhere anytime. Reforms in tax administration have collectively increased tax efficiency and effectiveness into output and outcome, which compensates a partial revenue loss in a low tax regime environment.

3.5 Established Non-Fiscal Incentives

Many studies have emphasized the important role of non-fiscal incentives in constructing attractive model for investors, both foreign and domestic. Comprehensive cost benefit analysis at the micro and macro levels, as well as objective survey studies is yet to be conducted for this purpose. Model must account for both equity and economic growth objectives, as well as pertinent considerations by investors that include: market sentiment and opportunities; supporting industries and access to raw materials; administrative cost of doing business; availability of excellent infrastructures/telecommunication-financial services; trainable workforce and liberation on the recruitment of skilled workforce; as well as good governance.

4. Concluding Remarks

Malaysia prefers tax cuts and tax incentives to non-fiscal incentives in promoting business activities and attracting FDI. Tax incentives through FDI play a partial role in ripple effect on the country's economy, with limitation to further enticing the trade of MNEs. The gap in tax benefit between foreign and local companies implies inequitable tax treatment and raises concern over the issues of inequality and non-neutrality of the corporate tax system.

Local characteristics of tax effects are consistent with other studies that indicate taxes on economic growth are non-linear. High tax regime discourages economic activities, while extensive tax cuts slow down economic growth in the long run, and regular specific tax preferences could affect the allocation of economic resource.

Long-term reforms in tax cuts and tax incentives have led to structural shift in the downward trend of corporate structure as share of GDP. Incentives in attracting investors by the mechanism of eroding corporate tax base as the main tax component are dampening government fund to meet prudent budget spending, eventually increasing budget deficit. Stimulus package comprising of tax incentives must be designed effectively to revert to corporate tax growth in tandem with GDP.

Reforms in tax system and tax administration into a large-scale technology innovation and IT application have collectively contributed to some increase in output and outcome. Hence, revenue loss has been partially balanced by administrative enhancement. Nonetheless, continuous tax cuts and greater granting of tax incentives will further erode tax base.

As for foreign companies, non-fiscal incentives may play an important role in investors' decision, as evidenced by the slowdown and low level of FDI net inflow, despite lucrative tax incentives package. Nevertheless, the extensive tax benefits provided for foreign companies are attractive enough for them to make investment decision.

As for Malaysia, it is necessary to conduct a comprehensive cost-benefit-analysis study to construct a non-fiscal investment model to balance the investors' tax benefits against revenue forgone.

Major Changes in Tax System and Administration on Cross-border Trade and Investment in Myanmar

Thiri Aung

Abstract: This article presents the efforts of Myanmar Internal Revenue Department to change the tax system from an office assessment system (OAS) to a self-assessment system (SAS) to achieve a fair and efficient tax system and to improve taxpayers' compliance through the impact of tax reform on cross-border trade and investment.

Keywords: Tax system; Tax administration; Tax reform; Tax incentives; Cross-border trade; Investment

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1. Introduction

Strategically located between China and India, Myanmar is one of the ASEAN (Association of Southeast Asian Nations) countries in South-East Asia. Rich in natural resources, the country has a population of about 54 million with an average age of 28. Compared with other countries in the region, the minimum wages in Myanmar are significantly lower to attract foreign investment.

The government of Myanmar is initiating several structural reforms with great momentum to improve the living standards of Myanmar nationals and to promote cross-border trade. The Internal Revenue Department (IRD) has also been undertaking actions to advance tax reforms since the 2011/2012 fiscal year, and has successfully implemented the first phase of the reform program. Based on the success achieved and lessons learnt, the second phase of the reform program from the 2017/2018 fiscal year to the 2021/2022 fiscal year has been developed and implemented.

2. Background of the Latest Tax Reform in Myanmar

The Myanmar Sustainable Development Plan (MSDP, 2018-2030) is intended for the long-term development with "the vision of a peaceful, prosperous and democratic country". The MSDP is organized with three pillars: (1) peace and stability, (2) prosperity and partnership, and (3) people and plant. The five goals are:

(1) Peace, national reconciliation, security and good governance;

(2) Economic stability and strengthened macro-economic management;

(3) Job creation and private sector-led growth;

(4) Human resources and social de-

velopment for the 21st century society; and

(5) Natural resources and the environment for the posterity of the nation.

Among these goals, Goal (2) is planned for fiscal, monetary and exchange rate policies. The IRD under the Ministry of Planning and Finance is carrying out strategy 2.3 in Goal (2), which is "to increase domestic resource mobilization through a fair, efficient and transparent tax system". The current tax-to-GDP ratio is nearly 7%, the lowest among ASEAN countries. The objective of the government is collecting high tax revenue for the causes of social welfare, economic development and poverty elimination.

3. Major Changes in Tax System and Administration

The IRD is currently undertaking a significant tax reform program with major changes in tax system and administration, including structural, strategic and technological changes.

3.1 Structural Change of IRD

With the effective execution of the transformation program since the 2011/2012 fiscal year, the IRD under the Ministry of Planning and Finance has managed to restructure the headquarters into different functional lines.

The IRD has transformed from a tax-based into a function-based organization. The IRD categorized taxpayers as large taxpayers, medium taxpayers, small taxpayers, and offices have been established accordingly (Large Taxpayer Office, Medium Taxpayer Office (1,2,3,4,5), Small Taxpayer Office).

As a pilot project of tax reform program, Large Taxpayer Office (LTO) was established in 2014 and started self-assessment system on 1 April 2015 with about 450 largest taxpayer companies in Myanmar, and now it is convenient to collect tax. Based on the success of LTO, Medium Taxpayer Office (1) and Medium Taxpayer office (2) have utilized self-assessment system since 1 April 2016 and 1 October 2020. The IRD is practicing the self-assessment system (SAS) in other Medium Taxpayer Offices (3) (4) (5) in Yangon and Mandalay.

Under the SAS, taxpayers are obliged to calculate the amount of tax due using tax returns, file tax returns and pay taxes timely, and keep books and records. The SAS has smoothed tax collection activities.

The LTO was established to introduce international good practices in tax administration, to focus on major contributors to tax revenue, to be a model office for IRD that orients and implements tax reform program. The LTO is the first reform project, the first office practicing SAS, and the first office using function-based system.

The IRD has also been making changes for legislative framework: enacting of *Specific* Goods Tax law and Tax Administration Procedure Law (2019), drafting new Income Tax Law, introducing Value-Added Tax, and enhancing transparency in planning, reporting and monitoring system and boosting effectiveness in internal audits to increase transparency and accountability.

Under the management of reform, the IRD implemented the following:

- Developing governance framework;
- Setting up Tax Reform Program Steering Committee;
- Setting up Tax Reform Directorate; and
- Submitting project reports on progress.

3.2 Strategic Change of IRD

Before the change in 2011 tax administration was characterized by low capacity, low taxpayer compliance, and outdated tax policies, laws as well as procedures. Thus, IRD sets a vision to be "a modern organization that acts with integrity and is recognized internationally as a highly effective tax administration". The IRD also sets a new mission —"to make taxpayers willingly pay tax as good citizens by delivering quality service in order to maximize revenue for the well-being of the people". The goals of tax administration reform are to increase tax-to-GDP ratio and transform to modern tax administration.

In order to collect revenue without any gap and to stabilize the financial situation of the government, tax reform activities were undertaken through the following four targets:

- Maximizing revenue;
- Broadening tax base;

• Improving and maintaining compliance; and

• Modernizing tax administration.

Activities that are underway according to strategic change program are:

• Human resource change;

• Tax policy change;

• Legal change;

• Information and communication technology change; and

• Administrative change.

According to human resources capacity building program, training for township revenue officials and special training for tax officials as well as tax auditing training have been carried out annually to explain tax change program and develop staff.

Approaches to service and enforcement are as follows:

• Establishing Taxpayer Service Units;

• Educating taxpayers on self-assessment;

• Carrying out tax audit and collecting taxpayers' information; and

• Organizing programs to assist in capacity building, technical and legal support and disputes resolution processes.

Measures to develop the staff are as follows:

• Explaining tax reform program and organizing discussions;

• Providing trainings and seeking technical assistance to raise the capacity of staff;

• Taking technical advice from international advisors to enable LTO and MTO (1) offices to work on the processes effectively; and

• Finding approaches to provide the staff with better facilities.

3.3 Technological Change of IRD

The IRD has been trying to change the system which maximizes the use of information technology in place of the traditional paper-based system. The IRD has prioritized providing adequate computers to all staff nationwide and has launched online payment platforms for making e-payment of tax using the Myanmar Payment Union's (MPU) Corporate Debit Card since 2015, mobile payment connecting with the related banks for the taxpayers getting TIN (Taxpayer Identification Number) since 2018, and tax payment by m-banking and e-banking since January 2020.

In order to streamline tax processes and procedures, the IRD has developed the Integrated Tax Administration System (ITAS) since 2017/2018 fiscal year and has already carried out building a data center and upgrading its official website. With the aim of providing efficient tax processes and procedures by modern technology, the IRD assumes that the ITAS will be operated in key sites for taxation (Headquarters, Yangon and Mandalay) in 2022.

The IRD utilizes technology to:

• Change to the system which maximizes the use of information technology (IT) in place of the paper-based system;

• Prioritize to provide adequate computers to all staff in IRD nationwide; and

• Purchase a mini data center and combine with ITAS to provide tax services.

From the perspective of cross-border investors, major changes in tax measures implemented by the IRD have made tax-paying easier and more economical, and reduced the time to comply. Moreover, online filing system and mobile payment system have been utilized to overcome the impact of COVID-19 and ensure the certainty of tax payment and tax planning. To encourage the compliance of taxpayers, the IRD is implementing taxpayer education, taxpayer services and e-filing systems. Tax offices are practicing transparency in tax assessment and tax auditing.

4. Cross-border Trade and Investment

Income generated from cross-border trade has become one of the main sources of income in Myanmar. According to the 2019 World Bank Census,[1] export to China market accounted for 31.78% of the total, followed by

1 World Bank (2019). *World Integrated Trade Solution,* https://wits.worldbank.org/countrysnapshot/en/MMR.

Thailand 17.99%, Japan 7.93%, the United States 4.61%, and Germany 3.54%. Moreover, China is also a top import partner of Myanmar by the rate of 34.64%, followed by Singapore 18.22%, Thailand 11.80%, Malaysia 5.08%, and Indonesia 4.87% respectively.

4.1 Export/ Import

Oil and natural gas lead Myanmar's exports. Other major exports include vegetables, wood, fish, clothing, rubber and fruits. The chief products imported were mineral fuels including oil, electrical machinery and equipment, base metals and manufactures. Non-electric machinery and transport equipment are the major import products.

According to trade report (2020/2021),[2] the value of total export in 2020/2021 fiscal year (October-January) is US$5,233.39 million, including normal trade US$2,978.58 million and cross-border trade US$2,254.81 million. Similarly, the value of total import was US$5,874.32 million with normal trade of US$4,721.97 million and cross-border trade of US$1,152.35 million respectively.

4.2 Trade Balance

As shown in Table 1, Myanmar's trade balance was apparently leading to a negative value of a trade deficit starting from 2014/2015 to next five consecutive years, so all financial transfers, investments and other financial components should be taken into account. The export data of re-export and import covers draw-back items.

Table 1: Value of foreign trade

Unit: million US$

Year	Export	Import	Balance of Trade
2005/2006	3,558.0	1,984.4	(+) 1,573.6
2010/2011	8,861.0	6,412.7	(+) 2,448.3
2014/2015	12,523.7	16,632.6	(-) 4,108.9
2015/2016	11,136.9	16,577.9	(-) 5,441.0
2016/2017	11,951.6	17,211.1	(-) 5,259.5
2017/2018	14,850.7	18,687.0	(-) 3,836.3
2018 (Apr.-Sep.)	8,832.2	9,859.3	(-) 1,027.1

Source: Customs Department, Myanmar.

4.3 Trade-to-GDP Ratio

The trade-to-GDP ratio is used to measure the importance of international transactions relative to domestic transactions. Total trade is the sum of exports and imports of goods and services measured as a share of GDP. As shown in Figure 1, in 2011, the trade-to-GDP ratio recorded 0.20% and increased continuously until 2018. Statistics suggest that the ratio fell to 52.04% in 2019, however, it bounced up a year later.

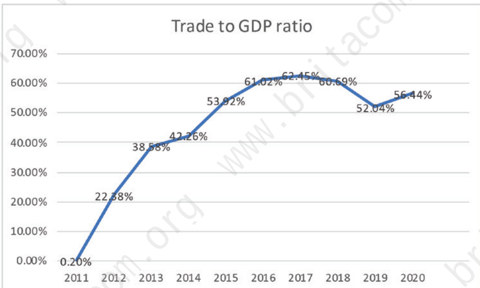


Figure 1. Trade-to-GDP ratio in Myanmar
Source: World Bank. https://www.macrotrends.net/countries/MMR/myanmar/trade-gdp-ratio.

2 Trade Report (2020-2021, Oct-Jan), Ministry of Planning and Finance, https://www.csostat.gov.mm/InformationAndReport/TradeReport.

5. Taxation for Cross-border Trade and Investment

Investors could enjoy income tax exemption and commercial tax exemption in accordance with Myanmar Investment Law (2016) and Myanmar Special Economic Zone Law (2014). The investments covered in investment-promoted sectors should be granted income tax exemption if it is applied to the Investment Commission. Investment-promoted sectors have been prescribed by Myanmar Investment Commission (MIC).

5.1 Tax Incentives

Tax incentives generally aim at encouraging domestic and foreign investments. The Myanmar Investment Law (MIL) and Special Economic Zone (SEZ) Law provide tax incentives. The MIL stipulates profit-based tax holidays ranging between 3 and 7 years depending on the location of investment and other tax incentives. After termination of the tax exemption period, tax of reinvested profits are completely exempted. Moreover, firms may deduct R&D expenses and make use of an accelerated depreciation at a rate of 1.5 times of the standard rate.

The SEZ law, enacted in 2014, targets export-oriented firms. Initial tax holidays range between 5 and 7 years. Subsequently, 50 percent of profits are exempt for another 5 years, increasing the effective benefit substantially. In addition, foreign investors have to pay income tax on their income at the rates applicable to the citizens residing within Myanmar.

5.2 Income Tax

If companies make investment in Myanmar, their net profit would be taxed at 22% under the Income Tax Law. A company is defined pursuant to the Myanmar Companies Act or any other existing law. The income tax rate for individual persons is progressive from 0% to 25%.

5.3 Withholding Tax for Non-resident Foreigners

According to Notification No. 47/2018, non-resident foreigners will be subject to withholding tax as follows: withholding tax for non-resident foreigners must be assumed as a final tax assessment of their income tax (see Table 2).

Table 2: Withholding tax rate

Income Classification	Withholding Tax Rate
Interest payment	15%
Royalties for the use of licenses, trademarks, patent rights etc.	15%
Payment by Union Organization, Union Ministries, Naypyitaw Council, Region/State Governments, State Enterprises and Development Committees for purchase of goods, work performed or supply of services within the country under a tender, an auction, a bid, a contract, an agreement or any other modes	2.5%
Payment by Public-Private Partnership (PPP), Partnership, Joint ventures, Companies, Body of persons, Organization or Association established under the existing laws, Co-operative Societies and Foreign companies or enterprises for purchase of goods, work performed and supply of services under a contract, an agreement or any other modes	2.5%

5.4 Commercial Tax

The commercial tax shall be imposed at a standard rate of 5% on the sale proceeds if the goods are produced and sold in the country or on the landed value if the goods are imported or on the sale proceeds for carrying out importing goods and reselling and trading them in the country. But the exempted goods are described in the yearly enacted Union Taxation Law. The commercial tax shall be charged at 8% on electricity and 5% on crude oil for exporting abroad and the commercial tax shall be charged at 0% on the sale proceeds for the export of all other goods, except the above-mentioned two goods.

The commercial tax paid at the time of purchase or production of goods may be set off from the commercial tax due for the export of goods in accordance with the regulations. With regard to the exported goods, if the commercial tax due for the export is less than the commercial tax paid at the time of purchase or production, a refund may be demanded. However, goods bought in the country and taken abroad for personal use shall not apply.

5.5 Specific Goods Tax

For specific goods imported into Myanmar, manufactured in Myanmar or exported abroad, specific goods tax shall be charged at the rates defined under Union Taxation Law 2021. Specific goods tax shall not be charged on the export of specific goods other than logs and different types of timber.

5.6 COVID-19 Economic Relief Plan (CERP) and Taxation

COVID-19 caused fiscal challenges and increased public debts. Due to the effects of COVID-19 pandemic, Myanmar's public health and economy have both worsened. The government implemented CERP as a short-term response plan to mitigate the immediate impact of COVID-19 on households and businesses.

Corporate income tax (quarterly payment) and commercial tax (monthly payment) of Cutting, Making and Packing (CMP), Hotel and Tourism and SMEs for 2019/2020 fiscal year were deferred up to 31 January 2021, while 2% advance income tax for exports was exempted till 30 April 2021. Other tax reliefs, such as non-refundable tax credits and deductions, have been allowed. Tax revenue declined slightly due to economic slowdown and the impact of policy responses such as tax deferrals and exemptions.

In order to resuscitate the businesses and stimulate investments that are delayed due to the COVID-19 outbreak, the income tax shall be imposed at 22% instead of 25% previously on the total net profit of the company in the Union Taxation Law 2021. The commercial tax shall be charged at 3% on the receipt of the hotel and tourism services instead of the standard commercial tax rate of 5%.

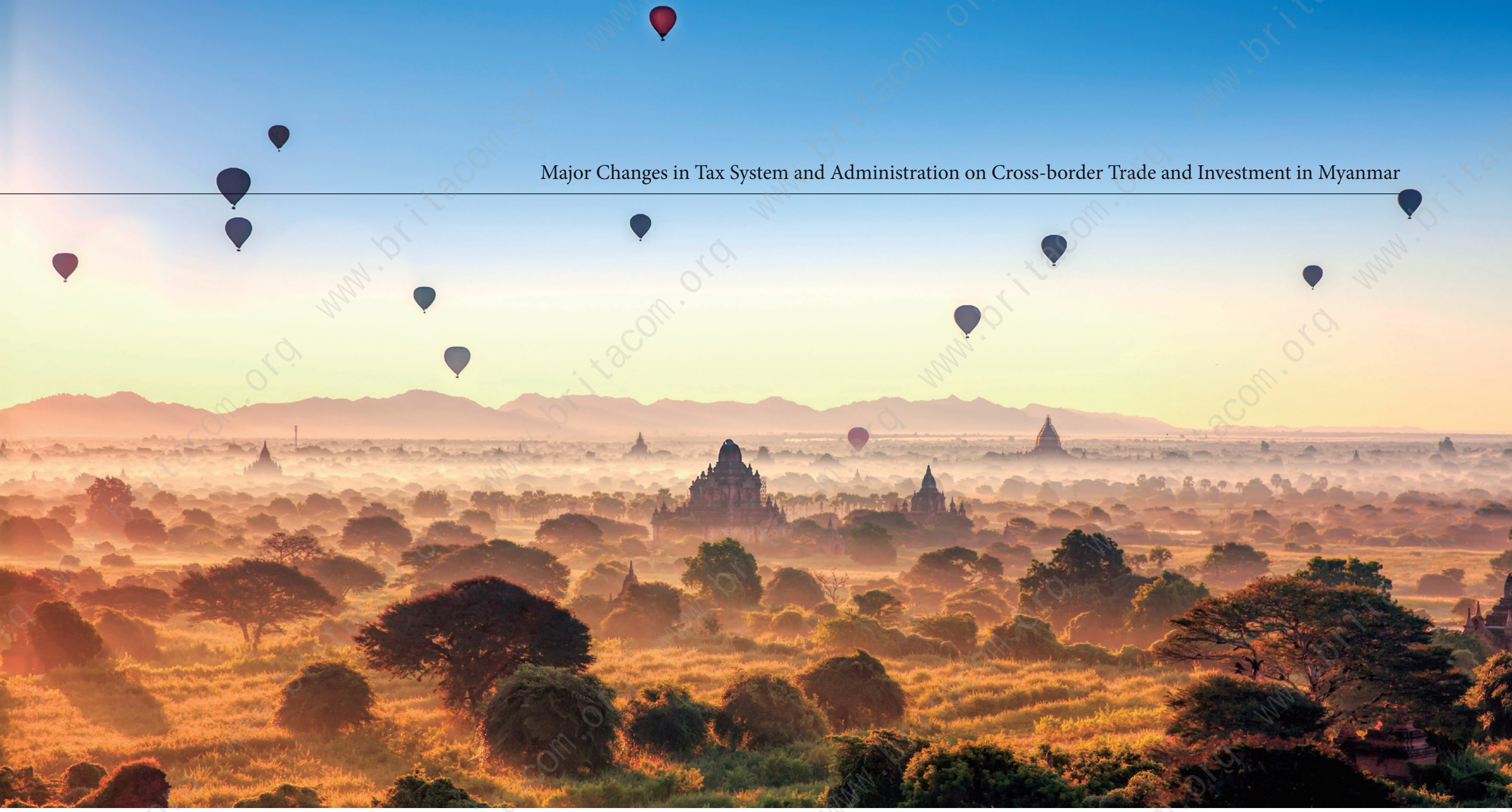
6. Suggestions and Recommendations to MNEs

Administrative tax reform of the IRD has shown significant improvements in the efficiency and effectiveness of tax collection, making the payment and tax compliance procedure simpler and reducing compliance cost for investors. Among them the apparent outcomes for the investors are:

- With the introduction of SAS system, the administration procedures including assessment are transparent, certain and simplified;
- Taxpayers' services are improved;
- Tax payment and filing can be made online;
- The rights of taxpayers and tax offices are balanced; and
- Measures are taken to combat corruption as zero corruption happens in SAS offices.

On the other hand, the lower corporate tax rates relate to the higher investment and larger economic growth. The income tax break for enterprises granted by the government intends to reduce tax burdens and improve new investments, work effort, skill acquisitions and entrepreneurial incentives.

Additionally, there are three main special projects that have been implemented in Myanmar to attract foreign direct investment, namely, Dawei Special Economic Zone in the southern



Taninthayi region with Thai investors, Kyaukphyu Economic and Technology Zone in the western Rakhine state with investment from China, and Thilawa Special Economic Zone near Yangon with assistance from Japan. The aims of SEZs include increasing trade balance, employment, and investment.

7. Concluding Remarks

As a member of the World Trade Organization (WTO), Myanmar facilitates the exports of goods manufactured domestically. As part of the ASEAN Free Trade Area (AFTA), Myanmar participates in all intra-ASEAN trade agreements as well as trade agreements with Japan, China, India, Korea, Australia, and New Zealand and is a member of Regional Comprehensive Economic Partnership (RCEP) agreement.

Myanmar is strategically located near major Indian Ocean shipping lanes. Its geographical location is critical for the Belt and Road Initiative (BRI). The BRI seeks to improve integration, increase trade and stimulate economic growth. We suggest that jurisdictions along the Belt and Road provide tax incentives to attract foreign investment and boost startups and employment, such as income tax and other tax exemptions depending on job creation, trade tax reductions for value-added products related to agriculture, and custom duties and commercial tax relief for imported goods. Cost-based tax incentives (e.g. tax deductions and credits) should be considered other than profit-based tax incentives (e.g. tax holidays). The IRD has been implementing SAS to create a fair and efficient taxation system for all taxpayers.

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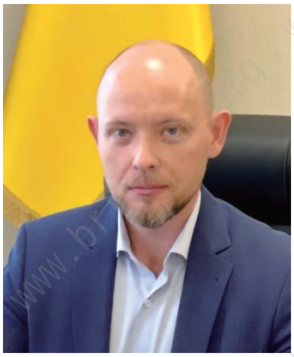
An Analysis of Tax Reform Measures and Trends in Ukraine

Anatoliy Aleksandrov



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Abstract: This article introduces general insights into the Ukrainian tax reforms made during 2020 and 2021, covering major tax legislation changes such as implementation of the BEPS Action Plan, interstate exchange of fiscal information, taxation of investment projects and economic security. It also underlines that up-to-date contactless IT-solutions and the adoption of international standards are top priorities of the future tax agenda.

Keywords: Tax reform; BEPS; Automatic exchange of information; CFC; Taxation of investment activities; Economic security; Intelligence-led policing

1. Introduction

The COVID-19 pandemic has created new challenges and opportunities for the development of Ukraine's economy, forcing it to quickly adapt to new realities and rules of the game. The tax system is one of the areas of Ukraine's economy that has undergone significant transformations. Coronavirus has become a catalyst for many recent tax trends in the world, and Ukraine has not stayed away.

The main purpose of the latest tax reforms was to create favorable conditions and incentives for honest work of the state and business on a partnership basis. That is why the reforms of the tax system of Ukraine involved the legislative mechanisms for regulating tax administration and were aimed at combating the tax "shadow".

Within the inclusive framework of the BEPS Action Plan, Ukraine officially announced its intention to introduce the International Standard for Automatic Exchange of Information on Financial Accounts for Tax Purposes in 2021, to be implemented in 2023. In the nearest future, Ukrainian fiscals and their foreign counterparts will have all the information about business transactions or income in any jurisdiction, including both legal entities and individuals.

Furthermore, legislative changes have introduced control mechanisms for controlled foreign companies (CFCs), and defined their terminology, as well as rules of taxation of CFC profits (CFC rules), which will come into force in 2022.

This article also highlights legislative initiatives in taxation of investment activities, which provides temporary tax privileges for taxpayers engaged in the implementation of an investment project.

Additionally, the article focuses on recent changes on law enforcement activity in economic area, in particular, establishing a new state authority, the Bureau of Economic Security of Ukraine (BES), instead of the Tax Police, which will use modern analytical tools (intelligence-led policing) for preventing and combating tax and economic crimes.

2. The Implementation of BEPS and CRS in Ukraine

Back in 2020, Ukrainian legislation was amended to ensure the implementation of 8 items out of the 15 BEPS Action Plans. Such changes are due to Ukraine's need to join a single multilateral mechanism to combat aggressive tax planning, which aims to artificially reduce the tax base and shift taxable profits to low tax jurisdictions.

On 30 August 2021, Ukraine officially announced its intention to introduce CRS for tax purposes in 2023.

This powerful new tool, already used in more than 100 jurisdictions, will help Ukraine generate additional tax revenue by identifying tax evasion cases and help increase tax compliance. Ukraine plans to make the first exchange of information in September 2023 for the reporting year 2022. In the coming year or two, the State Fiscal Service of Ukraine and its foreign counterparts will have all the information about business transactions or income in any jurisdiction, including both legal entities and individuals.

3. Exchange of Information and CFC Legislation

An important element of Ukraine's financial relations with other countries is the exchange of tax information on the basis of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and the relevant conventions (agreements) on the avoidance of double taxation.

There are generally three types of exchange of information, namely, on request, automatically, and spontaneously.

The Tax Code of Ukraine (TCU), for example, starting from 2021 provides the automatic exchange of tax and financial information with other countries in the context of the report of an international group of companies submitted within the TP (Transfer Pricing).

One of the steps in implementing the BEPS rules is to develop effective control mechanisms for CFCs.

To date, Ukraine has adopted the Law of Ukraine "On Amendments to the Tax Code of Ukraine to Improve Tax Administration, Eliminate Technical and Logical Inconsistencies in Tax Legislation", which regulates the legal institution of the CFC. Taxation under the new rules came into effect at the beginning of 2021. However, this idea was not supported by many experts who considered it premature.

The Law "On Amendments to the Tax Code of Ukraine and Other Laws of Ukraine on Ensuring the Collection of Data and Information Required for Declaring Certain Objects of Taxation" postponed the application of the CFC rules until 1 January 2022.

The above law introduces a new terminology, in particular defining the CFC as any legal entity registered in a foreign jurisdiction under the control of a resident of Ukraine. This also includes entities without the status of legal entities (trusts, funds, etc.).

The CFC rules will come into force on 1 January 2022. Accordingly, the first CFC report will need to be submitted in 2023 based on the results of 2022.

4. Investment Area

Legislative initiatives also involved the taxation of investment projects. The Verkhovna Rada of Ukraine was adopted, and the President of Ukraine signed the Law of 2 March 2021 № 1293-IX "On Amendments to the Tax Code of Ukraine on the Peculiarities of Taxation of Economic Entities that Implement Investment Projects with Significant Investments in Ukraine".

According to this Law, by 1 January 2035, importation of new equipment and components by a taxpayer- an investor with significant investments for the implementation of a project or of a special investment agreement- into Ukraine are temporarily exempt from VAT.

Investors who are parties to a special investment agreement concluded in accordance with the Law "On State Support of Investment Projects with Significant Investments" are also exempt from corporate income tax, provided that this profit is received as a result of such an agreement.

5. Law Enforcement in Economic Area

In 2021, the vector of law enforcement activities in the field of economic security has changed.

On 25 March 2021, the Law of Ukraine of 28 January 2021, № 1150-IX "On the Bureau of Economic Security of Ukraine" came into force. The BES will become the new single state authority responsible for combating economic crimes. The BES will receive the relevant powers of the Security Service of Ukraine and Tax Police of the State Fiscal Service of Ukraine, which will soon be eliminated.

Today, economic crime is getting more complex and rampant than ever before in the light of global processes. It has become the top priority for law enforcement activities to prepare for the growing complexity of the criminal environment and reduce its social impact.

The traditional model of law enforcement can't cope with the rapid changes that have expanded the possibilities of modern crime. In today's risk environment, the state and society view law enforcement as a source of risk management.

The BES will soon be the authority with the main function of doing analytics. Big data analytics, artificial intelligence, data mining and intelligence-led policing will be the key instruments used by the detectives of the BES in their daily work.

It is important that the above law on the BES creates institutional conditions for the protection of both economic processes and economic entities from the pressure of law enforcement agencies.

All this will eliminate duplication of law enforcement and control functions and reduce the number of government agencies that investigate economic and financial crimes.

Therefore, the creation of the analytically-oriented state authority such as the BES, ensuring the state's economic security and minimizing pressure on taxpayers, would be fully in line with the EU agenda chosen by Ukraine.

6. Future Agenda

Despite the fact that the impact of the COVID-19 pandemic on Ukraine's economy has been significant like in many other countries, Ukraine's government has taken efforts on protecting the national economy from recession and at the same time on improving business environment in order to attract new investments. Since the tax system is crucial for the sustainability of every national economy, there is still a lot of work to be done at the state level in this regard. The main tasks of Ukraine's government, to be included into the tax agenda for the nearest future, are improvement of public services delivered to taxpayers by introducing up-to-date contactless IT-solutions to businesses, and to adopt international standards and good practices aimed at preventing and combatting economic crimes, including e-commerce crimes.

On the Road Towards a Competitive Tax System: Hungarian Perspective

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Abstract: Following the 2008 economic crisis, Hungary introduced a series of growth-oriented tax changes. These changes were rooted in the "taxation and growth" literature of the 2000s. Measures included large cuts in direct taxes on labour and profits, consumption tax increases and significant measures to combat the shadow economy. At the same time, the priority of international tax policy discussions shifted more towards equity concerns, which led to a new OECD initiative on a global minimum corporate income tax (GloBE). The compromise proposal leaves a limited space for tax policy measures aiming to neutralize distortions associated with corporate income tax and to promote capital accumulation and productivity, but some room will remain.

Keywords: Taxation and growth; Corporate income tax; Global minimum tax; GloBE

1. Recommendations of the "Taxation and Growth" Literature

The relation between tax policy and economic growth was investigated by a broad theoretical and empirical literature. OECD (2010) and Mirrlees, et al. (2011) provide an excellent summary of the main findings of that research.

The literature found that not only the level of taxation but also the composition of the tax mix has a significant effect on growth. Corporate income tax (CIT) has been found the most detrimental to growth. Personal income tax (PIT) and taxes on consumption followed, while property taxes and taxes on negative externalities have been considered as the least harmful means of revenue collection.

Several recommendations were formulated on the ideal design of taxes as well. As a general recommendation, the literature calls for a broad base—low rate approach and decreases in marginal tax rates. On the other hand, certain well-designed tax incentives, especially on research and development (R&D), may have their merits. Tax policy goals are not supposed to be directly reflected by the details of every single tax but by the tax system as a whole. Consequently, incentives shall be provided only where appropriate.

CIT has been found to be distortive by design. CIT distorts economic decisions by disincentivising the reinvestment of profits, distorting financing decisions towards debt and taxing nominal returns, thereby including inflation. Several recommendations were made to diminish these drawbacks. A comprehensive business income tax (CBIT) would disallow the deduction of interests, thus diminishing the debt-equity bias. Allowance for Corporate Equity (ACE) systems on the other hand also address the same problem by providing a deductibility for a "normal" return on corporate equity. The latter approach simultaneously eliminates the inflation bias and the disincentive to invest into normal-return projects. Finally, cash-flow tax systems provide immediate deduction for any equity-financed expenses, including investment. As the value of immediate expensing is equal to the present value of the future taxes on the investment's normal return (calculated with the investors' individual discount rate), this approach is also suitable to neutralise the above-mentioned distortions.

In PIT, the literature aims to find an optimum between growth and equity considerations. While a certain level of progressivity can be justified on the latter, it is recommended to take into account the elasticity of taxable income while designing the tax schedule. Average tax rates shall be low for groups weakly attached to the labour market (i.e., unqualified persons, secondary earners, young and elderly persons). Marginal tax rates shall be reduced where the intensive reaction dominates (typically the higher end of the income distribution). Studies prefer taxation at the individual level as family taxation increases the average tax rate for secondary earners, thus disincentivising labour market entry. The taxation of capital income at individual level shall seek for neutrality across investment vehicles. Taxing capital income on the individual level is generally preferred over taxing corporations. However, solutions to diminish the income taxes' disincentive effect on savings — such as preferential tax rates on capital income, rate-of-return allowances or expenditure taxation — are also welcome.

Value-added tax (VAT) is usually considered as the most neutral tax by design. Preferential rates still may cause some distortions, while they are usually not considered as an efficient tool for redistribution purposes. Consequently, many studies argue for a single-rate VAT system. A further advantage of consumption taxes is that they are usually levied at destination; thereby exports are unaffected by the domestic tax rates while imports bear the same tax burden as domestic production.

In small open economies, the effect of growth-oriented tax reforms is also enhanced by their effect on foreign investment. However, they can also contribute to growth in closed economies by supporting capital accumulation, innovation and investment in human capital.

2. Hungarian Tax Policy Objectives in the 2010s

The 2008 crisis found Hungary in a vulnerable position. During the 2000s, growth rates lagged behind its regional peers. Low labour force participation, high redistribution rate and government deficits, external imbalances, high inflation and an increasing amount of foreign exchange (FX) loans undermined the competitiveness of the economy. Following the crisis, the country had to introduce growth-oriented reforms to break out of that vicious circle. These included a series of growth-oriented changes in the tax system broadly based on the insights summarised above.

While the budget has been stabilized, tax revenue to GDP ratio was kept below its pre-crisis level. The focus of taxation was gradually shifted from income taxes to consumption taxes. Policy measures included subsequent tax rate cuts in direct taxes, consumption tax hikes, the introduction of new consumption taxes and increasing the effectiveness of tax collection by simplifying the tax system and combatting the shadow economy (see Figure 1).

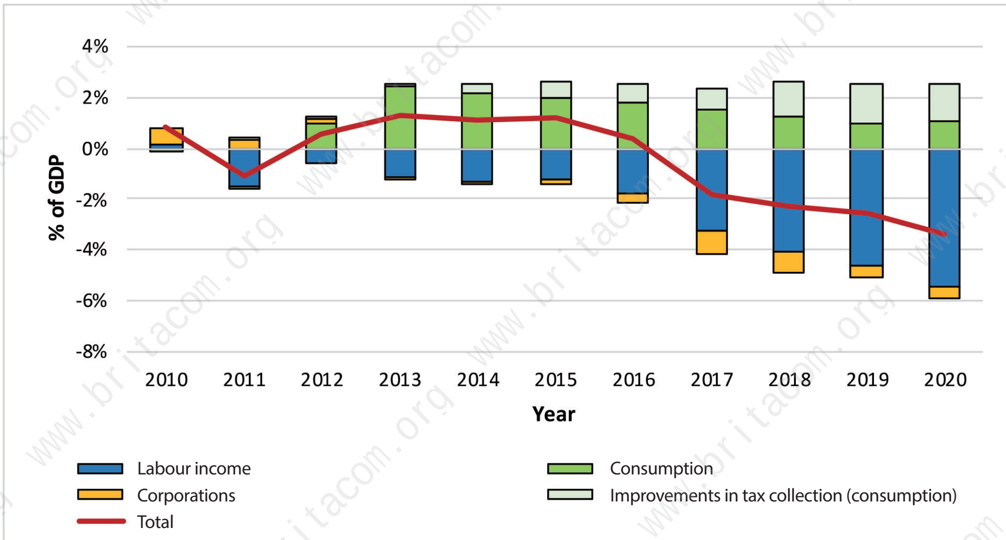

Figure 1. Revenue effect of Hungarian tax policy measures cumulated since 2010

2.1 Labour Tax

The tax policy regarded the reduction of labour taxes as the first priority, thus Hungary applies a flat rate PIT system since 2011. As a general rule, social security contributions (SSCs) paid by employers and employees are also flat.

The government cut the previously high labour tax wedge in several consecutive steps. In 2016, the Permanent Consultation Forum between the Government of Hungary and the private sector representatives concluded an agreement on a six-step labour tax cutting program. As a result, the minimum wage increased by 45% while payroll taxes were decreased from 28.5% to 17% between 2017 and 2020. In the following years, the tax rate is to be further reduced to 13% in two steps. As a result of these tax cuts, the Hungarian tax wedge decreased to a level similar to that of its regional peers.

Fostering the employment of the most vulnerable groups on the labour market was also an important goal. The tax system provides targeted allowances in employers' taxes in order to increase the demand for such workers. The targeted groups include those employed in elementary occupations, the new entrants, the long-term unemployed or inactive, mothers returning from childcare and those with disabilities. Besides this, all forms of work activity carried out by retired persons were exempted from social security contributions.

Another important policy priority of the Hungarian PIT system is to support families. The flat tax system introduced in 2011 already included a family tax allowance, and the amount of family tax allowances and rebates increased substantially in the following years.

In order to simplify the tax system, similar taxes and contributions on labour income have been merged. Previously there were 11 different taxes and contributions levied on personal income on the employer and employee level. As of 2021, the number was already reduced to 4 and it will be down to 3 (PIT, employee's SSC and employer's social contribution tax) in 2022. As previously there were some differences between the bases, the mergers resulted in real simplification.

2.2 Corporate Income Tax

Reducing the tax burden on companies was also a priority. The general CIT rate was decreased in two steps. In 2010, the 20% profit tax rate was decreased to 19% (by abolishing a 4% "solidarity tax" on profits and increasing the statutory CIT rate from 16% to 19%) and a lower tax bracket 10% for incomes below HUF500 million (EUR1.5 million) was also introduced. With that ceiling, almost every SME had to pay the lower rate only. As of 2017, the progressive regime was replaced by a flat rate of 9%, which is the lowest CIT burden in the EU.

Aiming to further encourage investments, the tax policy also made steps to bring the tax base closer to the cash-flow tax approach. A long-standing investment incentive in the Hungarian tax system has been the development reserve, which is a special form of accelerated depreciation. Under this regime, companies may constitute a reserve for future investments, which is deductible from the tax base. If the investment is made (within four years), no tax shall be paid on the release of the reserve; however the company may not charge depreciation on that investment (practically the reserve turns into immediate expensing). By 2021, any limitations on the amount of development reserve have been abolished.

Further measures were also taken to improve the competitiveness of CIT, including the introduction of group taxation, the reinforcement of investment incentives provided in less developed regions and the simplification of the advance payment mechanism.

As of 2013, two simplified tax regimes were introduced: a cash-flow tax regime for SMEs and a lump sum tax for the self-employed.

2.3 Consumption Tax

Direct tax cuts were generally financed by spending cuts, consumption tax hikes and improved tax compliance. Measures aimed at combatting the shadow economy have focused on the collection of consumption taxes.

The consolidation period started with consumption tax hikes. General VAT rate was increased to 27% in 2012 and excise duties also went up. Some special consumption-type taxes on certain services were also introduced (e.g., a financial transaction duty, a telecommunication tax and an insurance premium tax). However, given the high general rate, pressure has been mounting to apply reduced VAT rate for certain services and products strongly affected by the grey economy. Due to favourable economic conditions in recent years and the progress achieved against tax evasion, some targeted reductions of the VAT rate to 5% or 18% became possible for certain products and services, such as raw meat, fresh milk, restaurant meals and housing constructions.

Online cash registers were introduced in 2014, followed by the introduction of the Electronic Public Road Trade Control System in 2015. In 2016, a POS terminal installation program was launched to encourage electronic payments. Online data reporting on invoices became mandatory as of 1 July 2018, first only on transactions between taxable persons, but its coverage has been expanded in two further steps from July 2020 to January 2021. As a result of these measures, the amount of uncollected VAT as a share of the theoretical tax liability decreased from 22%—23% to around 8%—9%.

To sum up, tax policy reforms introduced in Hungary since the 2008 crisis generally aimed to increase the competitiveness by improving the structure of the tax system and the design of the single tax.

3. A Shift in the Priorities of Global Tax Policy Discussions Since the 2008 Crisis

During the decades preceding the crisis, inequalities in developed economies increased significantly. The process was fuelled by several factors including the global reallocation of blue-collar jobs, skill-biased technological change and growth-oriented economic policies restricting the redistributive role of tax and benefit policies. The 2008 economic downturn combined with that long-standing process resulted in increasing political tensions. It was also recognised that above a certain limit, inequalities may also undermine the fundamentals of economic growth by restricting social mobility and hindering human capital accumulation.

These processes led to a shift in the priorities of international economic policy discussions, including tax policy recommendations. Along with the growth-equity trade-off, the emphasis on equity concerns increased. New economic policy recommendations of international organisations focused on "inclusive growth", shifting the focus towards the distributional effects of the policy measures. The international decreasing trend of top marginal income tax rates slowed down (or even halted).

The changing train of thought also affected the way of thinking about corporate taxation. Although CIT is not a well-designed tool for taxing the rich, it certainly contributes to the redistribution of income as high-income individuals tend to rely on capital incomes to a larger extent. Instead of searching for the ideal design of the tax base, aggressive tax planning techniques of large multinational companies came into the focus of international tax policy debates. As an indisputable merit, OECD's Base Erosion and Profit Shifting (BEPS) project developed several recommendations to curb unfair tax competition by limiting the room for artificial profit shifting agreements. Later on, voices arguing for the need to step up against tax competition in general got stronger, which might have brought measures to attract investment into the debate as well. In 2019, OECD launched its work to develop a new tool against "race to the bottom": the global minimum tax.

4. Towards a Global Minimum Tax

The OECD has proposed a two-pillar solution to address the remaining BEPS issues and the issue of digital taxation. It has become a principle (political compromise) for the two proposals that they form a package and can only be adopted together. Decision-making on the OECD's two-pillar proposal came within reach in 2021, following the strong position by the US administration, and technical discussions are actively taking place on the details of the rules.

The first pillar aims to ensure fair taxation of large companies with high profits by redistributing corporate tax bases based on the place of consumption. While our present international tax system is linked to physical presence, the proposal would tax part of the profits of large profitable companies in the country of users, by amending the so-called nexus rules and creating a new right to tax. The proposal would give the State in which customers are located more taxing rights than at present.

The second pillar introduces a global minimum corporate tax (the "GloBE" proposal), which penalises companies that are subject to too low effective tax rates. The most important rule of the GloBE proposal is the Income Inclusion Rule (IIR) together with the Undertaxed Payment Rule (UTPR) that acts as a backstop. Quite similar to CFC rules and the US Global Intangible Low-Taxed Income (GILTI), the IIR triggers the inclusion of low-taxed income at the level of the shareholder where the income of an entity or permanent establishment is taxed at an effective rate below the minimum tax rate. The UTPR is a secondary rule which is applied in the payer's jurisdiction by associated enterprises when the parent is not subject to the IIR. Finally, the Subject-to-Tax rule (STTR) complements these GloBE rules. It is based on the denial of treaty benefits for certain deductible intra-group payments made to jurisdictions where those payments are subject to no or low rates of nominal taxation. The global minimum tax proposal is of great importance for Hungary, mainly because of the low corporate tax rate and the significant number of foreign investors.

5. Room to Manoeuvre

The technical details of the regulation are formulated by conflicting views. While some countries thought that the aim of the minimum tax is to avoid the race to the bottom and to exclude any form of tax competition, others — including Hungary — have been of the view that the legislation shall focus on artificial profit shifting structures and countries should be given the right to make their sovereign decisions on their tax system and on the taxation of genuine activities. The latest version of the compromise proposal leaves a limited space for tax policy measures, but some room will remain.

Basically, the proposal clearly sets a minimum effective level of taxation based on accounting profits, without recognising any tax incentives. It may be problematic from the subsidiary jurisdictions' point of view that the determination of minimum tax base will rely on the ultimate parents' accounting standards. Consequently, subsidiaries' jurisdictions could exclude the emergence of any extra tax liability by aligning their taxation and accounting systems with that of the parent jurisdictions. However, that seems impossible in a jurisdiction where multiple investors are present.

On the other hand, the new rules will apply mainly to companies with revenue above EUR750 million, so that the taxation of smaller businesses will be less affected. Furthermore, it is currently envisaged that it will be possible to collect the difference up to the minimum level with a separate domestic top-up tax, which will allow subsidiaries' jurisdictions to collect extra tax liabilities stemming from technical differences for themselves.

Some room will remain to implement design options proposed by the taxation and growth literature, but only to a limited extent. On the basis of the documents prepared for decision by the OECD, there will be an exemption for real economic activity (substance carve-out). The exemption will be based on the carrying value of tangible assets and payroll. The carve-out may leave some room for Allowance for Corporate Equity systems, but only to an extent limited by the amount of tangible assets.

The proposals will also address mismatches due to timing differences in tax bases. Although these will be generally limited in time, some specific differences, including depreciation, are expected to be recognised without time limits. That may also leave some room for certain tax base techniques bringing the tax base closer to the cash-flow tax approach, but a pure cash-flow tax base could probably not fit well with the global minimum tax base.

While there is no explicit exemption on R&D tax credits, certain specific tax incentives will be recognised as Qualified Refundable Tax Credits which will be treated preferentially. That may also leave room to reformulate the current incentives.

From a Hungarian point of view, it is also important that the proposed legislation contains a relatively broad definition of covered taxes. Besides CIT, that definition covers some other taxes on companies, which will significantly increase the effective tax rates for the bulk of companies operating in Hungary.

On 8 October 2021, the major features of the international reform proposal on the minimum tax affecting Multinational Enterprises have been agreed upon by 136 countries and jurisdictions. It was argued that "the minimum tax agreement did not seek to eliminate tax competition, but put multilaterally agreed limitations on it".[1] The agreement was hailed as "a major victory for effective and balanced multilateralism".[2] Hungary has in the end agreed to the proposal after many months of heated debate. However, the work is still ongoing as many details are still to be hammered out. Protecting legitimate real investment promotion potential of developing countries remains an important priority for us. It would be beneficial if the final design reflected insights from as large a part of the international community as possible. After all, the OECD stands for "fostering prosperity, equality, opportunity and well-being for all"[3] and the Inclusive Framework format suggests that these values should be enjoyed by every country at the table.

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[2] Mirrlees J., et al. (2011). *Tax by Design*. Oxford University Press.

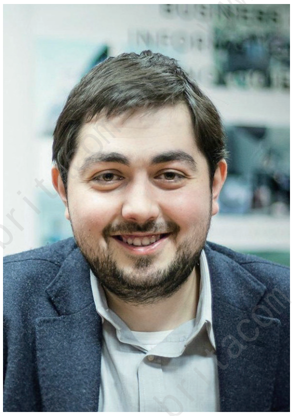
1 OECD (2021). *International Community Strikes a Ground-Breaking Tax Deal for the Digital Age*, https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm.

2 Ibid.

3 https://www.oecd.org/about/.

Reforming VAT Refund System in Georgia

Dachi Kinkladze



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Abstract: This article is trying to share experience of Georgia in reforming its VAT refund system by highlighting key elements in the process of the reform as well as demonstrating key features in the operation of profound VAT system. The article also discusses the implication of the reform for economic growth and promotion of cross-border trade and investment.

Keywords: Automated VAT refund; Automated risk management system; Tax reform

1. Background

Georgia has for decades positioned itself as a relatively low tax burden country with a very simple tax structure and streamlined regulations for businesses. Therefore, the reforms concerning tax policy and tax administration are mainly driven to improve services, ease compliance, attract foreign direct investment (FDI) and boost economic growth.

When talking about tax reform that can affect economic development, the role of well-functioning VAT refund system is unquestionable. It is also internationally recognized that adequacy of VAT refund system is one of the prerequisites when assessing efficiency of tax administration.[1]

Furthermore, VAT refund system contributes significantly to promotion of cross-border trade and investment as well as economic growth by increasing cash flow for businesses. The latter is especially true for companies who conduct export and/or make substantial investments, as they are ones who accumulate a larger number of VAT credits. It is believed that VAT refund system has significant impact on overall competitiveness, productivity, and capital formation of one country.[2]

In Georgia, cash VAT refund has been problematic for decades. While tax-

1 See Tax Administration Diagnostic Assessment Tool (TADAT).

2 Mario Pessoa, Andrew Okello, Artur Swistak, et al. (2021). *How to Manage Value-Added Tax Refunds*, https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2021/05/10/How-to-Manage-Value-Added-Tax-Refunds-50357.

payers were entitled to use its excess VAT credits to offset other tax liabilities, the request of VAT refund was connected to significant compliance costs for taxpayers, as extensive documentation was required as well as refund claims used to trigger full-scale audits. No risk-based approach to evaluating and/or auditing VAT refund claims was in place. Therefore, it was logical that taxpayers were too reluctant to even apply for a refund.

The above practice was known to significantly discourage business climate. Companies, who used to generate a large number of VAT credits, were deprived possibility to have access to their substantial finance (as VAT credits could not be fully offset against current tax liabilities).

Besides, the existence of a large stock of VAT credits remains a significant fiscal risk for the government. It is generally recognized that "improperly functioning VAT refund practices can have profound implications for fiscal policy and management, including inaccurate deficit measurement, spending overruns, poor budget credibility, impaired treasury operations, and arrears accumulation".[3]

In addition, the practice, where taxpayer could offset their VAT credits against other tax liabilities without any check or audit, represented significant risk for tax fraud and revenue leakage.

2. Path to Automated VAT Refunds

Georgia Revenue Service (GRS) started reforming existed VAT refund system with close cooperation with technical assistances of International Monetary Fund. The first step was assessment of operated system as well as stock of VAT credit as a basis for future strategy to be followed.

To illustrate the shortcomings concerning VAT refund system, it's worth mentioning that the stock of VAT credit grew to GEL1.6 billion (about US$0.5 billion) over time.[4] TADAT assessment, conducted in 2016, highlighted VAT refund system as a weakness of Georgian tax administration, stating, "Fundamental flaws in design and operation of the refund system undermine the integrity of VAT"[5]. The amount of refunds issued to the taxpayers (which included not only VAT but also all other taxes) during 2016 was close to only GEL174 million.

From 2019, GRS introduced an automated VAT refund system, which subjected VAT returns to automated risk-based verification process. Preferential treatment was given to low-risk returns. Low-risk declarations were allocated on so-called "Green Card". This allowed taxpayers to either request excess credit VAT amount to be transferred to their bank accounts by clicking a payment button or leave the amount to offset tax arrears. Although taxpayers used to have full right to transfer the amount from "Green Card" to their own bank accounts automatically, some taxpayers still preferred to keep the money on the "Green Card".

Despite the need for further progress as well as reluctance by taxpayers, significant progress in the operation of VAT refund system was evident. Automatically approved VAT credits equaled to GEL320 million, as well as overall approved VAT credits equaled to GEL573 million during 2019.[6] Furthermore, TADAT assessment conducted in 2020 highlighted VAT refund as a strength of Georgian tax administration, this time stating, "Good practice for VAT refund claims established over the last year, with automatic payment soon to be introduced".[7]

3 Ibid.

4 Ibid.

5 Lucilla McLaughlin, Vincent de Paul Koukpaizan, et al. (2016). *Georgia: TADAT Performance Assessment Report*, https://www.tadat.org/assets/files/Georgia_Final_PAR_2016.pdf.

6 *2020 Annual Report of the Georgia Revenue Service of the Ministry of Finance*, https://rs.ge/Media/Default/Docs/GRS%20Annual%20Report%202020_ENG.pdf.

7 Korstiaan Kool, Jimena Acedo, et al. (2021). *Georgia: TADAT Performance Assessment Report*, https://www.tadat.org/assets/files/Georgia_Final_PAR_2020.pdf.

The number of automatically approved VAT returns and credits continued to increase in 2020, which has exceeded 90%.[8]

Having noticed that taxpayers in significant cases used not to request, by clicking the button, their amount from "Green Card", which can be explained by their previous negative experience in case of cash refunds in Georgia, tax administrations initiated changes in the law. According to these changes, tax administrations became entitled to refund VAT credits without any request/involvement directly to a taxpayer's bank account. Therefore, from November 2020, the system became fully automated. As a result of constant improvements in 2020, Georgian tax administration approved/paid more than GEL1 billion refund, out of which more than GEL900 million was automatically approved.[9]

In addition, intensification and fully automatization of VAT refund system, in November 2020, served as business support measures during COVID-19 pandemic, by increasing cash flow for taxpayers.

3. Automated Risk Management System

Automatic risk management system is vital for successful VAT refund system. Therefore, due attention and resources were allocated to create the system, which made it possible to evaluate taxpayers and VAT returns based on certain risk criteria and to act to mitigate risk revealed. The system includes several modules, which assess risks based on taxpayers' compliance history, registration/activity period, etc. There is also validation risk module, cross-matching VAT returns with other data sources existed in GRS database. The fact that GRS is a joint tax and customs administration as well as Georgia has mandatory e-invoicing system makes this matching process more effective.

Besides identifying errors/omissions in VAT returns, the aim of the validation module is also to increase taxpayers' compliance. Based on risks revealed through validation module, taxpayers are being contacted and offered to correct errors or clarify some issues. The fact that only 3% of VAT returns identified by validation module were subject to tax audit in 2020,[10] demonstrates that proper communication can significantly mitigate existing errors and risks as well as save substantial resources.

4. Conclusion

Well-functioning VAT refund system is an essential element to improve tax administration efficiency, reduce fiscal risks and increase cash flow for businesses, especially for investors and those involved in cross-border trade, and has a profound impact on overall business climate.

In the case of Georgia, successful reform of VAT refund system lies in the following pillars:

Strategy — It is essential to assess starting points, existing situation, allocation of necessary financial and human resources, and the aim to reach.

Legislation — As mentioned above, Georgia made all substantial changes in tax law, which allowed it to consider VAT returns as "refund request" and transfer amount to taxpayers' bank accounts without any direct request/intervention from taxpayers' side.

Systems and Structures — There should be effective automated risk management system allowing automatic risk screening of tax returns, followed by dedicated structures. GRS enacted automated risk management system while making changes in its operational structure. The

8 Mario Pessoa, Andrew Okello, Artur Swistak, et al. (2021). *How to Manage Value-Added Tax Refunds*, https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2021/05/10/How-to-Manage-Value-Added-Tax-Refunds-50357.

9 *2020 Annual Report of the Georgia Revenue Service of the Ministry of Finance*, https://rs.ge/Media/Default/Docs/GRS%20Annual%20Report%202020_ENG.pdf.

10 OECD (2021). *Tax Administration 2021: Comparative Information on OECD and other Advanced and Emerging Economies*, https://doi.org/10.1787/cef472b9-en. pp.71.

changes include creation of dedicated unit to ensure risk-based audits when VAT returns are deemed to be "highly risky" as well as dedicated unit to contact taxpayers, when it is believed that final decision of issuing refund requires validation of particular parameters.

Digitalization — It is obvious that in order to enact VAT refund system in line with best practice, it is vital for tax administrations to have a certain degree of maturity concerning digitalization and IT systems. An automated risk management system should be built on available data sources for effective cross-matching and analysis to ensure smooth operation of refund system as well as prevention of any fraudulent schemes.

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[1] Lucilla McLaughlin, Vincent de Paul Koukpaizan, et al. (2016). *Georgia: TADAT Performance Assessment Report*, https://www.tadat.org/assets/files/Georgia_Final_PAR_2016.pdf.

[2] Korstiaan Kool, Jimena Acedo, et al. (2021). *Georgia: TADAT Performance Assessment Report*, https://www.tadat.org/assets/files/Georgia_Final_PAR_2020.pdf.

[3] Mario Pessoa, Andrew Okello, Artur Swistak, et al. (2021). *How to Manage Value-Added Tax Refunds*, https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2021/05/10/How-to-Manage-Value-Added-Tax-Refunds-50357.

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Changes of Withholding Tax in Poland in 2019-2021: Impact on Foreign Investments

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Abstract: This study focuses on the taxation of foreign investments in Poland in terms of withholding tax. Over the past three years, there have been significant changes in the way they are taxed, as a result of which the relief at source mechanism has been replaced by the pay and refund mechanism. Despite the urgent need to implement this reform, the application of the new mechanism was repeatedly suspended due to its inconvenience for entrepreneurs. Enterprises that are able to obtain all the necessary information from their contractors will be able to benefit more easily from preferential taxation contained in the EU law or in tax treaties on double taxation avoidance (DTT). On the other hand, companies that have a weaker market position may face difficulties in obtaining information from the recipient of the payment, so they de facto will have to credit the recipients of their payments.

Keywords: Withholding tax; Tax reform; Pay and refund mechanism; Foreign investments

1. Introduction

Efficient withholding tax (hereinafter referred to as "WHT") collection is very important for the effective functioning of the state and the attractiveness of the tax system for foreign investors. In practice, the specific WHT tax rate is relevant to taxpayers, and the simplicity of the tax system is taken into account.

So far, taxpayers (WHT taxpayers as well) could enjoy tax preferences at the time of paying dividend and similar benefits (known as "relief" at source mechanism). As a consequence, possible control of the correctness of the settlements could be carried out only post factum.

2019 was the last year before organizational chaos brought by the COVID-19 pandemic. At the same time, in 2021 Poland introduced the revolutionary reform in the taxation of profits distribution of Poland-based companies. Starting in July 2019, the company paying a dividend is obliged to pay withholding tax at the rate of 19% (20% for royalties and interests). Technically, this kind of duty existed before, but "the devil is in the details". Before going into details, it is worth mentioning some of the reasons for changes of the WHT collection.

1.1 Reform Background

The Ministry of Finance's analysis of the implementation of the relief at source mechanism and tax audits' results showed that there were many cases of abuses in this issue.[1] Specific reasons for the replacement of the relief at source by the new pay and refund mechanism are:

(1) Growing and expanding globalization;

(2) Mobility of passive incomes (dividends, royalties and interests); and

(3) Beneficial owner vs. correct WHT rate.

According to the Polish National Tax Administration's statistics in 2017, due to incorrect beneficial owner's origin, the National Tax Administration (*Krajowa Administracja Skarbowa* in Polish) uder-collected around PLN104,2 million.[2] Poland's specific interest in the new WHT mechanism is a result of the economy's characteristics. One of the most dominant reasons for economic growth in this country is the great scale of foreign direct investments (FDIs), which translates into a high level of passive income transferred abroad. In 2016, FDI investors incomes amounted to PLN79 billion, dividend income was PLN36 billion, and interests income was PLN9 billion.[3]

1.2 Tax Acts Regulating Various WHT Exemptions and Reliefs

Poland has signed around 90 bilateral tax treaties on double taxation avoidance (hereinafter referred to as DTT).[4] Under these treaties, the WHT rate varies from 0% to 10% for interests and from 0% to 15% for dividends (e.g., Poland-China Treaty operates at a WHT rate of 10%).[5] The maximum WHT level is the result of limits provided by the Organisation for Economic Co-operation and Development (OECD) model tax convention. According to the convention, the limits for WHT rate on dividends vary from 5% in the case of affiliated entities to 15% in other cases, but for interests, the maximum level is the only one limit up to 10%.

For investors residing in the European Union countries, there is a possibility of applying EU acts on that issue. These acts are Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states (hereinafter referred to as "Royalties and Interests Directive") and Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (hereinafter referred to as " Parent-Subsidiary Directive").

According to both directives, there is an exemption of taxation at the source of such passive incomes and for dividends, and there is also an exemption on taxable income in the beneficial owner's country. This means that interests on loans are taxed once in the borrower's country and dividends are not taxed at all once meeting EU Directives' conditions, so investing within European Union is more attractive than in third countries.

2. Changes in WHT Applicable in 2019-2021

2.1 New Mechanism "Pay and Refund"

The obligation to collect tax according to the standard rate was introduced if the amount

1 Sejm.gov.pl. *Motives of Changes in the Personal Income Tax Act, the Corporate Income Tax Act, the Tax Ordinance Act and Some Other Acts*, https://www.sejm.gov.pl/sejm8.nsf/druk.xsp?nr=2860, p. 155.

2 1 euro = PLN4.6.

3 Polish Central Bank. *FDI in Poland*, http://www.nbp.pl/publikacje/zib/zib_2016_n.pdf.

4 Ministry of Finance of Poland. *List of Treaties*, https://www.podatki.gov.pl/podatkowa-wspolpraca-miedzynarodowa/wykaz-umow-o-unikaniu-podwojnego-opodatkowania/.

5 Article 10-11, *Poland-China Convention on Double Taxation Avoidance*, https://www.podatki.gov.pl/media/1528/chiny-konwencja-tekst-polski.pdf.

of payment is over 2 million PLN to the same taxpayer in a calendar year. It does not matter that the Polish national law, EU law, or international agreement provides for the right not to collect tax, apply an exemption, or a reduced tax rate.

This means that if the sum of payments of a given entity (payer) to another entity (taxpayer) does not exceed PLN2 million in a given year, the payer may still (already at the moment of making the payment) not collect the tax; apply an exemption or a reduced tax rate when legal requirements are met.

However, also in such a case, the same changes were introduced. The payer, with due diligence, verifies the conditions of not collecting the tax, applying an exemption or a tax rate other than the "basic" rate, which results from Poland's Personal Income Tax/Corporate Income Act.

2.2 Beneficial Owner Issue Concerning Dividends Payments

In the provisions of the CIT Act regarding the taxation of dividends, as well as in the provisions of the Parent-Subsidiary Directive, there is no explicit requirement for the recipient to receive the dividend (in case of interests and royalties there is such an obligation) as the beneficial owner (hereinafter referred to as "BO") of the receivables. Nevertheless, in practice, tax authorities often require verification of the recipient of the dividend from the perspective of meeting this criterion.

Such a criterion may result from the provisions of the DTT (e.g., the DTT concluded with Germany, Italy, France, and the Netherlands), which provide for preferential taxation or even exemption of dividends, provided that the recipient of the dividend retains the status of the beneficial owner.

Following the provisions of the CIT Act, such a criterion can be indirectly deduced from the provisions on the pay and refund mechanism, because the provisions of Article 28b of the CIT Act do not differentiate the overpayment refund procedures and the scope of the necessary documents depending on the type of payment covered by the WHT, but they only apply to payments exceeding the limit of PLN2 million.

2.3 The Cases of Non-binding of the New Mechanism

2.3.1 Payer's declaration-special tax forms

At the same time, exemptions or the rate from DTT may apply even more than the above-mentioned amount. The condition is the submission of a WH-OSC tax form (in the field of CIT) or WH-OSP tax form (in the field of PIT).

In this declaration, the taxpayer should inform that:

(1) He has the documents required by the provisions of the tax law to apply the tax rate or the tax exemption or non-collection resulting from specific provisions or agreements on the avoidance of double taxation; and

(2) After carrying out the verification with due diligence, he does not have the knowledge to justify the assumption that there are circumstances that exclude the possibility of applying the tax rate or exemption or not collecting the tax, resulting from special provisions or agreements on the avoidance of double taxation.

The declaration shall be submitted on the day of payment at the latest. In the case of subsequent payments, the above-mentioned tax is effective until the end of the second month following the month in which the declaration was made. In addition, the payer, until the 7th day after this period, submits a declaration confirming the fulfilment of the above-mentioned premises. If he does not submit it, he is obliged to pay tax with interest for late payment.

Under Polish Accounting Act,[6] the declaration may be signed only by the head of the entity. If several persons meet the criterion of

6 Cf. Article 3 sec. 1, p. 6 of the Polish Accounting Act, https://sip.lex.pl/akty-prawne/dzu-dziennik-ustaw/rachunkowosc-16796295/art-3.

the entity's manager/head, all of them submit declarations. The attorney cannot do this.

The obligation to collect discount tax and interest on certain bonds also exempts the statement made by the issuer of these bonds that he conducted due diligence in informing its related entities about the conditions of the exemption about these affiliated entities.

The submission of the declaration is one of the necessary conditions for applying the exemptions referred to in the tax laws.[7] The issuer submits them only electronically according to a pre-defined template available on the official website.

This kind of mechanism may be applied to all types of WHT exemption, regardless of their legal basis (national/EU/DTT).

2.3.2 Head of the tax office's binding opinion on the application of the WHT exemption

This is the second possibility of being exempt from pay and refund obligations. This may be applied only if the WHT exemption is provided by EU law.

With regard to some categories of income exempt from taxation, taxpayers and remitters of CIT may apply to the competent tax authority for opinions on the application of the method of reduction and exemption at the source.

The head of the tax office issues the opinion on the application of the exemption without undue delay, no later than six months of the receipt of the application by the office.

The head of the tax office may refuse to issue an opinion in the following cases:

(1) The conditions for the exemptions are not met;

(2) There are reasonable doubts concerning the accuracy of the documentation enclosed to the application or of the statement of the taxpayer on being the BO of the amount payable;

(3) There is a reasonable presumption that a decision might be issued under Article 119a of the Tax Ordinance (General Anti-Avoidance Rule — GAAR), or the decision applying the measures that restrict the tax treaty benefits or the decision using Special Anti-Avoidance Rule(SAAR) under Article 22c of the Act on CIT; and

(4) There is a reasonable presumption that the taxpayer does not run actual business activity in the country of his tax residency.

2.4 Tax Reimbursement of WHT

2.4.1 Tax refund for payments not exceeding PLN2 million

No changes have been made. This means that e.g., if the remitter withholds tax on a dividend not exceeding PLN2 million (because the remitter did not have a certificate of residence at hand or had no certainty on whether the conditions were met in the particular case), the rules remain unchanged. Therefore, the taxpayer may apply for determining that tax had been overpaid, under the rules in the Tax Ordinance (*wniosek o stwierdzenie nadpłaty podatku* in Polish).[8]

2.4.2 Tax refund for payments exceeding PLN2 million

If the remitter withholds tax on the amount exceeding PLN2 million, the taxpayer may apply for the reimbursement of the difference between the amount withheld and the amount due, subject to the applicable preference (the right to exemption or a reduced tax rate).

In order to do that, the taxpayer should submit a tax reimbursement application: WH-WCZ (regarding CIT) or WH-WPZ (regarding PIT). If the remitter does not reduce the amount payable by the tax due and instead performs a procedure called "grossing up" (covers the amount of tax from its own funds), only the remitter is entitled to file the tax refund if there

7 Article 17(1) (50c) of the Act on Corporate Income Tax – Act on CIT, and Article 21(1) (130c) of the Act on Personal Income Tax – Act on PIT.

8 Article 75 of the Tax Ordinance, https://sip.lex.pl/akty-prawne/dzu-dziennik-ustaw/ordynacja-podatkowa-16799056/art-75.

is a reason to file it. The remitter should then submit an application for tax reimbursement using the WH-WCP (regarding CIT) or WH-WPP (regarding PIT) forms.

The application for a tax refund shall be accompanied by documentation that allows determining its legitimacy. Such documents include in particular:

(1) Certificate of tax residence of the taxpayer;

(2) Documents on bank transfers or other documents that indicate the method of settling or transferring amounts to which the duty to pay tax was related;

(3) Documents on the obligation to pay the amount payable;

(4) Statement of the taxpayer on meeting individual conditions; and

(5) Documents indicating contractual arrangements due to which the remitter paid the tax using the remitter's own funds and bore the economic burden of that tax (in case the application is submitted by the remitter).

2.5 Freezing of Regulations and Draft Changes from 2022

In effect, the provisions introducing the new mechanism were suspended until the end of 2021. The suspension is carried out under the ordinance of the Minister of Finance. In practice, the new provisions regarding this mechanism never came into force, as they have been repeatedly suspended every six months at the last moment since the beginning of 2019.[9]

However, the suspension of legal force does not apply to provisions obliging taxpayers to exercise due diligence (analysis) in verifying the correctness of the application of the exemption or the preferential WHT rate and to qualify the recipient of receivables as the BO based on the amended (extended) definition (including requiring such entity to conduct actual economic activity).

The draft[10] of the new regulations provides for further changes to the WHT collection mechanism for payments exceeding PLN2 million per year. Currently, the WHT pay and refund mechanism has been suspended until 2022. The Ministry of Finance has proposed that the new collection mechanism should apply if the following conditions are jointly met:

1) The payment will be classified as passive (i.e., dividends, interest, license fees); and

2) The payment will be made with respect to related entities.

This means that, in particular, payments for certain intangible services will no longer fall within the scope of the new mechanism, similar to interest or royalties paid to unrelated parties.

Payments qualified as passive or exceeding PLN2 million per year to related entities will be able to benefit from reduced rates or exemptions at source, provided that:

(1) A ruling (binding opinion) on the application of reduced rates/exemptions will be obtained; or

(2) A certification process will be carried out by the taxpayer, which will be concluded with the submission of a designated statement.

Furthermore, according to the draft bill, the taxpayer will be obliged to collect the tax if the total amount of receivables paid in one tax year to one taxpayer exceeds PLN2 million. Additionally, transactions without justified economic reasons will not be classified as passive payments (e.g., a payment will be artificially classified as a service).

The draft act also extends the scope of the binding ruling (opinion) on the application of the WHT exemption to passive payments benefiting from a reduced tax rate or exemption under double taxation agreements (so far, it only covers payments benefiting from exemptions under the relevant EU directives).[11]

9 Cf. *Minister's of Finance Ordinances*, https://isap.sejm.gov.pl/isap.nsf/DocDetails.xsp?id=WDU20180002545.

10 Sejm.gov.pl. *Act of October 1, 2021 Amending the Act on Personal Income Tax, the Act on Corporate Income Tax and Some Other Acts*, http://orka.sejm.gov.pl/opinie9.nsf/nazwa/1532_u/$file/1532_u.pdf.

11 A. Oktawiec, P. Wielgoławski & D. Widemajer. *Key Changes for International Investors*, https://studio.pwc.pl/aktualnosci/english/insights/polish-deal-key-changes-for-international-investors.

Another modification is the change in the definition of a BO. As it stands, one of the conditions for being considered as a beneficial owner assumes constituting an entity that "*is not an intermediary, representative, trustee or other entity legally or factually obliged to transfer all or part of the receivables to another entity*".[12] The amendment proposes deleting the words "legally or factually".

3. The Impact of a New WHT Mechanism on Foreign Investments in Poland

The described tax changes impose additional obligations on entities that make various payments abroad. For capital-related entities, there are additional transaction costs; while for entities that are completely independent of each other, obtaining the documents needed to apply for the tax exemption is a significant problem (just imagine the relation between a Polish company and Facebook or an international investment bank). What might happen is that a foreign counterparty has a stronger market position and will not want to share any information about itself. As a result, the taxpayer will have to cover the tax amount out of his own sources and submit an application for its return, which will undoubtedly worsen his financial liquidity.

There is another temptation for the recipient if the contract provides for a gross-up clauses whereby the recipient receives the payment in full without deducting WHT. In this case, the taxpayer gets as much as he wants, but may have a limited willingness to deal with local (Polish) difficulties. If the Polish taxpayer wants to recover the tax himself that he has incurred economically, he may face another burden — the time administrative one. It is also possible to imagine that the tax office will refuse the tax refund due to certain circumstances.

In view of the above, contracts with foreign suppliers should be analysed as follows:

(1) Whether there are grossing-up clauses;
(2) What payments are related to; and
(3) What taxes are included.

Importantly, the mere presence of such a clause in the contract does not prejudge anything. In practice, grossing-up clauses may be created on the basis of a tax system other than Polish and their application to taxes in force in Poland, despite the sincere willingness of the drafters of the agreement, will not be easy.

The Polish tax administration has received a powerful ex-ante control tool, which means that the taxpayer is obliged to check whether the conditions of preferential taxation have been met. The taxpayer who violates the provisions of the tax law shall bear fiscal and financial liabilities.

Such a mechanism transfers the bureaucratic burden from the tax authorities to the taxpayer. Due to the professional nature of the economic activity, it is an acceptable behaviour of the legislator. Furthermore, intervention by the Polish lawmaker is justified by the statistics mentioned at the beginning of that elaboration on the scale of tax frauds.

12 Sejm.gov.pl. *Act of October 1, 2021 Amending the Act on Personal Income Tax, the Act on Corporate Income Tax and Some Other Acts*, http://orka.sejm.gov.pl/opinie9.nsf/nazwa/1532_u/$file/1532_u.pdf, p. 2.

Meeting the Challenges of Taxing Multinational Enterprises in New Zealand

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International Revenue Strategy
New Zealand Inland Revenue

Abstract: There have been significant concerns globally regarding the under-taxation of multinational enterprises (MNEs). New Zealand has considerably relied on MNEs in terms of income tax collection. Consequently a full range of measures to combat base erosion and profit shifting (BEPS) by MNEs have been implemented, guided by the products emanating from the OECD's BEPS Action Plan. These law changes have been buttressed by the New Zealand tax administration through undertaking a robust intelligence-led tax compliance programme targeting high risk sectors and issues involving MNEs. Inevitably there have been some trade-offs in taking this approach, but New Zealand regards the desired behavioural shifts by MNEs as a direct result of this substantial work on BEPS, with little material impact on the level of foreign direct investment.

Keywords: MNEs; BEPS; Compliance; Foreign investment

1. Background

The New Zealand Government strives to build a productive and inclusive economy, while supporting a sustainable revenue base to fund improvements to the well-being of New Zealanders and their families. This means it is important for everyone to pay their fair share of tax in New Zealand. There has been significant global concern in recent years over the under-taxation of multinational enterprises (MNEs), and especially digital MNEs. This under-taxation has been mostly caused by deficiencies in international tax rules which have not kept up with modern business developments.

The under-taxation of MNEs impacts the sustainability of Government revenues and the fairness of the tax system. It also distorts investment in favour of MNEs which pay lower worldwide income tax compared with other enterprises. This article canvases the major changes in the New Zealand tax system over the last three years targeting MNEs, including not only legislative measures but also administrative practices to buttress the law changes enacted.

2. Major Changes in the New Zealand Tax System for MNEs

New Zealand is a small open economy and competes for capital with the rest of the world. This means that the Government wants New Zealand to be an attractive place for non-residents to invest and do business. However, a fair share of tax is also necessary so New Zealand's rules for taxing MNEs must attempt to balance these competing objectives.

New Zealand has enacted several measures in recent years to improve our ability to tax multinationals. Many of these are in response to the OECD's BEPS project which arose out of significant global media and political concern about evidence suggesting that some multinationals paid little or no tax anywhere in the world. This problem is referred to as base erosion and profit shifting or BEPS. Such tax planning strategies exploit gaps and mismatches in countries' domestic tax rules and tax treaties to minimise tax.

The OECD/G20 BEPS Action Plan (BEPS Actions) was finalised in October 2015. The Action Plan consisted of 15 reports that contained recommendations to counter BEPS activities in three key areas:

- More robust tax laws;
- International agreements and co-operation; and
- Improving transparency and exchange of information.

The Taxation Act 2018 (Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 No.16, Public Act Contents — New Zealand Legislation) was enacted to counter the BEPS activities of MNEs in New Zealand. The measures in this Act prevent MNEs from using:

- Artificially high interest rates on loans from related parties to shift profits out of New Zealand;
- Hybrid mismatch arrangements that exploit differences between countries' tax rules to achieve an advantageous tax position;
- Artificial arrangements to avoid having a taxable presence (a permanent establishment) in New Zealand;
- Related-party transactions (transfer pricing) to shift profits into offshore group members in a manner that does not reflect the actual economic activities undertaken in New Zealand and offshore; and
- Certain tactics to stymie a New Zealand Inland Revenue (NZIR) review or audit, such as withholding relevant information that is held by an offshore group member.

In addition, New Zealand signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting or MLI on 7 June 2017, which amends most of New Zealand's bilateral double taxation agreements (DTAs) to prevent them from being used to facilitate BEPS activities. These measures (together with New Zealand's existing law) address all of the major BEPS issues identified by the OECD.

These measures are only the latest in a series that New Zealand has undertaken to strengthen our laws for taxing multinationals. Other measures include:

- Applying goods and services tax (GST) to cross-border services — including e-books, music, videos and software purchased from overseas websites;
- Introducing legislation to apply GST to the cross-border supply of low value goods to New Zealand customers;
- Strengthening non-resident withholding tax rules (to ensure non-residents cannot claim interest deductions without also being required to withhold tax on that interest within a reasonable period);
- Limiting the use of look-through companies as conduit vehicles for investment by non-residents (to prevent them from being used to arbitrage New Zealand and foreign tax laws);
- Clarifying that New Zealand's general anti-avoidance rule overrides DTAs; and
- Improving exchange of information between tax authorities, in particular by implementing the OECD's exchange of summaries of cross-border rulings and country-by-country reporting initiatives under which tax authorities exchange cer-

tain information on large MNEs.

3. Major Changes in New Zealand Tax Administration of MNEs

In 2019, NZIR launched its latest Compliance Focus Document for Multinational Enterprises (MNE CFD). The MNE CFD outlined NZIR's refreshed compliance approach and highlighted its commitment to taxpayers. NZIR's objective is to collect the "right amount of tax at the right time through the right channels". NZIR's commitment to all taxpayers is that it will prioritise its efforts and focus mainly on prevention. In doing so, NZIR will be pragmatic and proportionate in reaching solutions to problems.

NZIR's international tax strategy aligns with its customer-centric compliance model which outlines the principles of how it should interact with taxpayers. The MNE CFD recognised explicitly New Zealand's new anti-BEPS measures and encouraged MNEs to change behaviour to ensure compliance, including restructuring their financial arrangements if necessary. To ensure this outcome, a strong focus on MNEs is necessary.

NZIR has progressively increased its coverage of MNEs from a compliance perspective. Each year, NZIR reviews all foreign-owned MNEs with an annual turnover in excess of NZ$30 million. These MNEs are required to submit a Basic Compliance Package (BCP) every year. The BCP comprises a group structure, financial statements and tax reconciliations. Foreign-owned MNEs are also required to complete an annual international questionnaire (IQ) which is designed to collect key information about financing arrangements and transfer pricing issues. In addition, based on the amount of tax they pay, the top 60 corporate taxpayer groups (which include many MNEs) receive even closer attention through one-on-one account management.

The intelligence derived from the information collected via the BCP and IQ processes informs NZIR's strategic and operational risk assessments relating to these businesses in New Zealand. This intelligence is combined with information from other sources (notably country-by-country reports, summaries of tax rulings provided by New Zealand's tax treaty partners, as well as information received from the NZ Customs Service and the Overseas Investment Office) and is run through NZIR's risk rules' engine. Depending on the assigned rating, an MNE may undergo further in-depth examination (including risk reviews and audits). This enables NZIR to give MNEs greater certainty and means that appropriate interventions are made to facilitate their compliance in a timely fashion with tax law in New Zealand.

NZIR has endorsed the Forum on Tax Administration's concept of "enhanced relationships" based on risk management and a fair, open and responsive administration. NZIR endeavours to nurture relationships with taxpayers and their advisors, and create an environment that welcomes full and frank dialogue. As part of its right from the start approach, NZIR's objective is to head off any non-compliance before it occurs by not only close monitoring, but also through advance pricing agreements (APAs) and the provision of practical guidance to allow MNEs to better self-manage their international tax risks. APAs lock in compliant outcomes by agreeing on the criteria for transfer prices in advance of transactions occurring. They can eliminate the need for costly post-lodgement reviews and audits. They are not only a faster and clearer route to multilateral tax certainty, but also give the wider community more confidence in the compliance of MNEs.

NZIR has also used all the intelligence gathered on MNEs to identify those groups that are most impacted by the anti-BEPS measures and develop an International Monitoring Framework (IMF) to actively track them. New Zealand's IMF has enabled NZIR to understand the effectiveness of these legislative measures, in particular whether the much-anticipated behavioural changes are taking place with MNEs adjusting supply chains and the locations of intangibles, as well as revising financing arrangements and contracting practices.

NZIR has supplemented its regular review methodology for MNEs with a series of compliance campaigns since 2019. These campaigns target major sectors and specific tax risks. The intent of the campaigns has been to ask for information and clarification of changes in MNE tax affairs for compliance review purposes, as well as giving NZIR a clearer view of the impact of anti-BEPS measures on MNE behaviour. These compliance campaigns have so far covered wholesalers/distributors, MNEs returning losses, intellectual property/royalties and financing arrangements. A further campaign is addressing the risk that the benefits of COVID-19 wage subsidies paid to foreign-owned MNEs may have been shifted to offshore related parties through inappropriate transfer pricing policies, and campaigns are also scheduled to address international tax risks arising for MNEs in the manufacturing and service sectors. Through these campaigns, NZIR has specifically reviewed over 50% of foreign-owned MNEs with annual turnovers in excess of NZ$30 million.

4. Impact of Tax Reform on Cross-Border Trade and Investment

New Zealand has a general broad-base low rate (BBLR) tax framework, which aims to minimise distortions and promote economic efficiency. A robust company tax rate is an important component of this framework. The company tax rate should apply to both residents and non-residents who derive income from New Zealand sources. It should not favour some taxpayers or some types of economic activity. For government spending initiatives, the tax revenue that is lost from an inability to tax MNEs appropriately needs to be made up from other sources. As a result, a higher tax burden on other sectors of the economy comes with real economic costs. The anti-BEPS measures were adopted to protect New Zealand's BBLR tax base from these distortions and ensure a more appropriate level of tax is paid by all taxpayers on their economic activities in New Zealand.

It was recognised that BEPS practices reduce national income while doing little or nothing to reduce the overall pre-tax cost of capital to New Zealand or increase the overall level of investment. Such behaviour of MNEs distorts the allocation of investment by favouring foreign investors who set out to game the system through aggressive tax planning practices. It was considered that the anti-BEPS measures would improve the equity and fairness of New Zealand's tax system. Multinationals engaging in BEPS activities were able to structure their affairs to receive unintended tax benefits placing them at a competitive advantage over more compliant multinationals or domestic companies. As a result, these more compliant multinationals and domestic companies end up suffering greater tax burdens. The anti-BEPS measures therefore ensure that the tax burden is shared more equally among taxpayers.

In proposing legislative changes, New Zealand applies the generic tax policy process (GTPP) which includes a framework for assessing key policy elements and trade-offs of proposals. This framework is consistent with the New Zealand Government's vision for the tax and social policy system, and is captured by the following criteria:

- Efficiency of compliance — compliance costs for taxpayers should be minimised as far as possible;
- Efficiency of administration — administrative costs for NZIR should be minimised as far as possible;
- Neutrality — the tax system should bias economic decisions as little as possible;
- Fairness and equity — similar taxpayers in similar circumstances should be treated in a similar way; and
- Sustainability — the potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to risks involved.

In relation to the regulatory proposal for the anti-BEPS measures, it was accepted that it would be difficult to achieve positive sustainability, neutrality, and fairness impacts without some increase in compliance costs and so there are some trade-offs that were, and continue to be, considered. Through public consultation under the GTPP, stakeholders were fully engaged, making extensive submissions which have led to minimisation of associated compliance costs as much as possible without sacrificing the benefits of the package. New Zealand also undertook these anti-BEPS measures, in line with a number of like-minded countries throughout the OECD. Given this, it was considered that any impacts on foreign direct investment into New Zealand would not be material and the implementation of these measures remained in New Zealand's best economic interests. It was also seen as unlikely that foreign companies would remove their existing personnel from New Zealand as a result of the proposals. Most of the affected foreign companies are dependent on having personnel in New Zealand to arrange their sales and, without personnel on the ground, they would not be able to serve their profitable New Zealand markets. It was also thought unlikely that foreign companies would cease to operate in New Zealand altogether.

5. Conclusion

The tax collected from MNEs operating in New Zealand is a very significant contributor to the country's total annual tax revenue. The anti-BEPS measures that New Zealand has implemented, together with NZIR's refreshed compliance approach for MNEs, are designed to protect the New Zealand tax base and ensure MNEs pay their fair share.

Prior to the implementation of the anti-BEPS measures, New Zealand had some of the strongest tax base protection rules in the world. New Zealand has implemented the great majority of the recommendations made in the BEPS Action Plan, further strengthening the country's tax laws to protect against base erosion and profit shifting by MNEs. Action taken has included ensuring New Zealand transfer pricing laws reflect world's best practice, implementing country-by-country reporting, adopting a range of new tax treaty rules through the MLI, and introducing new measures to prevent aggressive tax structuring through hybrid/branch mismatches and related-party financing arrangements. These measures (together with pre-existing laws) address all of the major BEPS issues identified by the OECD.

NZIR is already seeing the desired behavioural shifts by MNEs from these anti-BEPS measures. In general, MNEs have become far more aware of their reputations and how aggressive tax positions can tarnish their brands. New Zealand now looks forward to the finalisation of the OECD-led solution for the digital economy, the remaining piece of work required to fully address the taxation of MNEs internationally.

Tax Policies Supporting Growth and Sustainable and Equitable Development in Post-COVID Economic Recovery Period

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Abstract: As the pandemic begins to ease in some places, the support made available to individuals and businesses should be gradually phased out and replaced by spending to encourage economic growth and employment. While businesses and individuals are recovering from the problems caused by the pandemic, revenue from corporate and individual income taxes may be reduced. Additional tax revenues can however be gained from improved taxation of the digital economy and the opportunities to identify undisclosed income sources arising from agreements for the exchange of tax information.

Jurisdictions must modernise tax administration to improve taxpayer compliance and reduce the size of the informal and shadow economies. Modernisation and digitalisation of tax administration can significantly improve tax collection. Using the dialogue process under BRITACOM, the

BRI jurisdictions can benefit from the experience of other developing jurisdictions and receive technical support to improve tax administration and collection.

Tax incentives could be used to encourage businesses to invest in the digital and green energy sectors. These incentives should be specifically framed and targeted to achieve the maximum effect and monitored to ensure that they continue to achieve the required goals.

Keywords: Tax policy; Tax incentives; Tax administration; Environmental taxes; Developing jurisdictions; BRI

1. Introduction

1.1 Fiscal Challenges from the Pandemic

The economic crisis resulting from the COVID-19 pandemic has been a setback to progress towards basic development goals. Many jurisdictions were not on target to achieve the Sustainable Development Goals (SDGs)[1] by 2030 even before the pandemic. Current research shows that the economies of low income developing jurisdictions are falling further behind following the recession caused by the pandemic, while upper income jurisdictions are on the path to economic recovery.

The IMF estimates that an amount of around US$200 billion is needed to step up the spending response to the pandemic. This is calculated to be US$180 billion as the direct response, while a further US$20 billion is needed to rebuild or maintain external buffers. The IMF paper also estimates that an additional US$250 billion in investment spending would accelerate convergence with advanced economies. Further, the paper estimates that if risks identified in an adverse scenario actually materialize, this requires a further US$100 billion in spending.[2]

Low and lower middle income jurisdictions therefore have to tap a number of sources to find the massive amounts of funding needed. Development assistance will be forthcoming from advanced economies, and from China[3] and some other jurisdictions that have achieved remarkable economic growth in recent years. However, the bulk of such funds must be generated through domestic revenue mobilization (DRM) and from private investment.

1.2 Balance between Revenue Needs, Fiscal Prudence and Reviving the Economy

Developing jurisdictions have important policy choices to make in relation to resuming long-term growth and generating more tax revenue. While increased DRM is essential, measures must also be taken to support greater mobilization of private investment capital both from within and outside developing jurisdictions. More progress can be made in many jurisdictions if broad domestic reforms are introduced. Further, most low income developing jurisdictions will also need support from the international community. The reform agenda required from developing jurisdictions must give priority to encouraging economic growth; strengthening domestic resource mobilization; promoting more efficient public spending; and improving the climate for private investment.[4]

Many lower income developing jurisdic-

1 The 2030 Agenda for Sustainable Development was adopted by all UN member countries in 2015. The 17 Sustainable Development Goals are a call to promote prosperity, build economic growth and address a range of social needs, while tackling climate change and environmental protection.

2 IMF (2021). *Macroeconomic Developments and Prospects in Low-Income Countries—2021*, https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/03/30/Macroeconomic-Developments-and-Prospects-In-Low-Income-Countries-2021-50312.

3 World Bank (2021). *China Overview*, https://www.worldbank.org/en/country/china/overview#1.

4 IMF (2021). *A Post-Pandemic Assessment of the Sustainable Development Goals*, https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2021/04/27/A-Post-Pandemic-Assessment-of-the-Sustainable-Development-Goals-460076.

tions and emerging market economies have a low tax-to-GDP ratio. By making appropriate policy changes and collecting more tax revenue, these jurisdictions can increase government resources over time. Increases in domestic tax revenue can only be introduced when a jurisdiction's economy is entering a solid period of post-pandemic economic recovery.

2. Tax Policy during the Crisis

2.1 Support Packages

Fiscal packages introduced during the crisis have included loan guarantees, job retention schemes, direct transfers, expanded access to benefits and tax measures. Many of the tax measures have aimed to reduce unemployment; help companies over a temporary inability to pay suppliers or creditors; and prevent business closure or bankruptcy.

Jurisdictions have also introduced tax measures to support households, combined with direct transfers and expanded access to social benefits which have often played a greater role. Many of the tax measures introduced in the first period of the crisis have been extended and better targeted.[5]

2.2 Recovery-oriented Measures

As lockdowns have eased, governments have begun to introduce recovery-oriented tax measures, including corporate tax incentives for investment and reduced VAT rates targeted at sectors that were worse affected. Many of the jurisdictions in the Asia-Pacific region for example have begun to introduce more stimulus-oriented tax measures.

As jurisdictions begin the period of economic recovery, they could improve the targeting of emergency relief and implement recovery-oriented tax measures. The extent of the recovery is varying greatly among jurisdictions, sectors and households, owing to differences in the pace of vaccinations and to the relative economic position before the crisis began. Low income households, women and young people have borne higher economic costs, so policies will need to support these groups and create incentives for their employment and re-training. The most vulnerable individuals and weakest industrial sectors must continue to be supported as further revenue-raising measures are introduced. Some industrial sectors hardest hit by the pandemic, e.g., tourism, will need further support and should not be disadvantaged by the revenue-raising measures.

To improve public finances, an increasing number of jurisdictions have introduced or announced new tax increases. Some of these represent a continuation of earlier trends, such as increases in fuel excise duties and carbon taxes; and jurisdictions have also introduced tax increases on high income earners, including increases in the highest individual income tax rates. Jurisdictions could consider making individual tax rates more progressive, so that those who can afford to pay the taxes are the ones bearing their fair share of the burden.

3. Tax Policy Recommendations for the Recovery

3.1 Overview

Some tax measures to stimulate economic recovery should be temporary and targeted at the areas where equity requirements and fiscal multipliers are highest. Jurisdictions may need to set clear end-dates for these measures. The stimulus measures should be targeted at areas where they are most likely to generate additional consumption and investment.

Priority should also be given to measures supporting labour market recovery and business re-capitalisation. Temporary and targeted reductions in employer social security contributions could be useful for this purpose. Tax measures to support business re-capitalisation could include temporary schemes such as an exemption for

5 OECD(2021). *Tax Policy Reforms 2021,* https://www.oecd-ilibrary.org/taxation/tax-policy-reforms-2021_427d2616-en.

profits retained in a capital reserve aimed at rebuilding equity. These schemes could be capped and targeted at small and medium enterprises (SMEs) with provisions to prevent abuse.

Tax stimulus measures introduced to help the recovery should be aligned with longer-term environmental and social objectives, such as targeted support for green technologies and greater carbon pricing efforts. After the crisis there will be an opportunity for jurisdictions to undertake a more comprehensive re-assessment of their tax and spending policies and their fiscal framework. This should take account of ongoing structural trends, including climate change, rising inequalities, digitalisation and demographic factors.

While revenue raising measures are essential, it will also be important to ensure that the conditions are right to encourage further mobilization of private capital. This does not mean that more tax incentives are necessary; rather, better administration, reductions in compliance costs and more certainty are likely to improve the conditions for both domestic and foreign private investment.

3.2 Taxation of Digital Services

3.2.1 The broad challenges

Unilateral approaches to taxing foreign digital services include VAT/GST changes to tax digital users as customers; imposition of income tax on foreign digital companies as suppliers; or imposing withholding tax on payments. Another possibility is a tax on digital access or toll tax imposed on the digital companies as customers.

Income within the scope of the unilateral digital service taxes (DSTs) varies greatly from one jurisdiction to another. The scope of a unilateral DST often covers digital services such as sale of data derived from the users; revenue from advertising; activities of intermediaries; and sale of digital content.

An important issue is whether the tax falls within the scope of a tax treaty. This can be a problem because some DSTs are presumptive taxes based on a percentage of turnover. Additional work on the treaty aspect is thus a matter that should be considered going forward.

3.2.2 Issues for developing jurisdictions

One issue for developing jurisdictions introducing a digital service tax is the identification and registration of taxpayers. Simplified registration regimes are therefore being introduced to lower compliance costs. The tax administration needs to identify the level of online traffic and the number of users, which requires the commitment of more resources. The domestic law must define the scope of the tax including the items to be covered, and there must be a way of defining the amount of digital service revenues subject to the tax.

Multinational enterprises (MNEs) are already challenging amounts due, using the relevant double tax treaties. Developing jurisdictions must overcome the challenge of treaty disputes.

3.2.3 OECD/G20 initiative

Jurisdictions are moving towards a consensus-based global solution to taxation of the digital economy under the guidance of the OECD/G20 initiative. The Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, colloquially known as BEPS 2.0, was signed on 8 July 2021.[6] The measures set out in the Statement were endorsed by the G20 leaders at their summit on 30 October 2021.

Pillar One is intended to achieve a fairer distribution of profits and taxing rights among jurisdictions in relation to the largest MNEs. Some taxing rights over MNEs will be re-allocated from their home jurisdictions to the market jurisdictions where they have business operations and earn profits, even if they do not have a physical presence there.

6 OECD (2021). *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy*, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.

Pillar One would apply to MNEs whose global turnover is more than EUR20 billion and with profitability above 10% (measured as profit before tax divided by revenue). Under the agreement, 25% of the profit above the 10% threshold is to be allocated to the market jurisdictions. The turnover threshold is later to be reduced to EUR10 billion, provided there is successful implementation of the provisions. A review is to take place seven years after the agreement comes into force.

The "nexus" rule will permit the allocation of an amount (Amount A) to a market jurisdiction if an MNE obtains at least EUR1 million in revenue from the market jurisdiction. For jurisdictions whose GDP is lower than EUR40 billion the nexus is to be set at EUR250,000. Dispute prevention and resolution mechanisms are to be put in place to avoid double taxation for Amount A. Extractives and regulated financial services are excluded from the Pillar One provisions.

Pillar Two provides for a global minimum corporate tax at a rate of 15%. The minimum tax is to be applicable to MNEs with revenue above EUR750 million. An Income Inclusion Rule (IIR) will operate to impose a top-up tax on the parent entity in relation to the low taxed income of a constituent entity of the MNEs. An Undertaxed Payment Rule (UTPR) will deny a tax deduction or require an equivalent adjustment where the low tax income of a constituent entity is not subject to tax under the IIR. A treaty-based Subject to Tax Rule (STTR) would permit source jurisdictions to impose some source taxation on certain related party payments that are subject to tax below a minimum rate. The interaction between the new rules and the US global intangible low taxed income (GILTI) legislation is still to be worked out in detail.

A multilateral convention to give effect to the agreed reforms is to be signed by jurisdictions during 2022, with effective implementation in 2023. The convention will allow implementation of the new taxing right under Pillar One and will include provisions for the suspension and removal of existing unilateral Digital Service Taxes and similar unilateral measures. Model rules to bring Pillar Two into domestic legislation will be developed during 2022, to be effective in 2023.

A global solution would avoid the problems arising from unilateral measures and would therefore avoid the risks of tax uncertainty, double taxation and possible retaliatory measures. The interests of developing jurisdictions have been raised through participation in the Inclusive Framework on base erosion and profit shifting (BEPS). The international consensus solution needs to be implemented in a way that is easy to administer and consistent with current internationally accepted rules and principles including neutrality and efficiency.

Under an agreement with the US, some European jurisdictions including the UK, France and Italy will withdraw their unilateral digital service taxes when the OECD proposals on Pillar One take effect. In the interim period before the OECD proposals take effect, a tax credit will be available to taxpayers if the amount of digital service tax in a period exceeds the amount that would have been payable under the Pillar One proposals if they were in force. The US has agreed to drop its proposed trade actions in relation to the unilateral digital service taxes until the end of the interim period.

3.2.4 UN Model Treaty — proposed Article 12B

A new Article 12B, relating to income from automated digital services, has been approved for inclusion in the UN Model Tax Convention. Under Article 12B the source state is given the right to tax income from automated digital services where it arises. The maximum rate applicable is to be determined by negotiation between the contracting states. Under paragraph 3 the beneficial owner of the income could choose to be taxed on qualified net profits from automated digital services at the domestic rate of tax in the source state. The definition of qualified profits for this purpose is 30% of the amount resulting from applying the taxpayer's profitability ratio to the gross annual revenue from automated digital services in the source state. The definition of automated digital services includes services provided through the internet or electronic networks where there is minimal human involvement by the service provider.

Withholding tax is important for developing jurisdictions because it is cheap to administer; and is less subjective to abuse than profit-based taxation.

3.3 Measures to Combat Base Erosion and Profit Shifting

In relation to international tax issues, developing jurisdictions should reduce opportunities for base erosion and profit shifting. Corporate tax avoidance can only be effectively combated through international cooperation. Tax avoidance strategies of MNEs give rise to a significant loss of revenue for developing jurisdictions when the MNEs engage in base erosion and profit shifting through the use of low tax jurisdictions, transfer mis-pricing and other strategies.

The aggregated MNE country-by-country reporting recommended in the OECD's report on Action 13 of the BEPS Action Plan has revealed more information to suggest that corporate tax planning strategies are leading a mis-alignment between the location of reported profits and the jurisdictions where the economic activities are carried out.

Statistics indicate that high and middle income jurisdictions account for a higher share of employees (32% and 37% of total employees) and tangible assets (35% and 23% of total tangible assets) than of profits (28% and 18% respectively)[7]. In jurisdictions where the corporate income tax rate is zero, the revenue earned per employee is generally higher. In the case of investment hubs the reporting by MNEs showed a high share of their profits in these jurisdictions (25%) compared with only 4% of employees and 11% of tangible assets. The main activity of the multinationals in the investment hubs is given as holding shares or other equity instruments, which could be a risk factor indicating tax planning arrangements. On the other hand, some investment hubs do play an important role in mobilizing private investment capital; the goal in policy reforms should be to preserve these benefits while seeking to reduce the potential for investment hubs to be used to avoid or evade taxes.

Developing jurisdictions can therefore benefit by committing to the minimum standards on countering harmful tax practices; countering tax treaty abuse; the three-tier transfer pricing documentation (local file, master file and country-by-country reporting) and improving dispute resolution mechanisms. Many developing jurisdictions have signed the multilateral instrument (MLI) to implement tax treaty related BEPS measures in their own bilateral tax treaties, speeding up the process of modernising their tax treaties to combat profit shifting.

3.4 Excise Taxes

Excise taxes can raise tax revenue while encouraging behaviour that is in line with sustainability, health and other public policy goals. The tax revenue collected from excise taxes has been rising during the past decade, especially in the least developed countries (LDCs). Fuel duty can encourage the reduction of carbon emissions and raise considerable government revenue. Other excise duties that can raise substantial revenue are financial transaction taxes, such as stamp duty and an electronic money transfer levy. Some jurisdictions have imposed excise duties on telecommunications services.

Significant revenue can be raised from excise taxes on tobacco and alcohol, and in recent years taxes on sugary beverages have been introduced to promote public health and also raise further revenue. Currently 74 jurisdictions have introduced a tax on sugar-sweetened beverages. However, there is a need to carefully consider policy goals, market realities and the administrative capacity of jurisdictions in placing further

7 IMF (2021). *A Post-Pandemic Assessment of the Sustainable Development Goals*, https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2021/04/27/A-Post-Pandemic-Assessment-of-the-Sustainable-Development-Goals-460076.

reliance on excise revenues.

3.5 Environmental Taxation

3.5.1 General

It is now broadly accepted that jurisdictions need to build greener economies to achieve a more sustainable and inclusive recovery. Climate change is already leading to rising poverty, the spread of disease and food insecurity in low income jurisdictions. The IMF has estimated that a policy mix introducing carbon taxes and incentives for green investment could increase global GDP by around 0.7% in the next 15 years, creating around 12 million additional jobs by 2027.[8] Increases in green investment resulting from a favourable investment climate could lead to more earnings for businesses and higher tax collections.

Taxation plays an important role in environmental protection. On one hand, taxation can be used as an incentive for environment-friendly behaviours. For example, corrective taxes such as the carbon tax can internalize the negative externality associated with greenhouse gas emission and help bring emissions to a socially optimal level. Such taxes can be adapted to internalize the full cost of environmental pollution effects, and to incentivize adoption of environment-friendly products like electric vehicles. Further, these taxes raise revenues that can be used to finance environmental projects and subsidize environment-friendly technology such as solar power.

On the other hand, reform and/or removal of tax expenditures such as income tax incentives and accelerated depreciation, as well as direct subsidies on fossil fuels industries, can help achieve environmental policy goals. Income tax arrangements such as credits for purchases of electric vehicles, accelerated depreciation for plant and machinery that help reduce greenhouse gases, targeted tax expenditures for environmentally sensitized infrastructure, etc. can also support environmental policy goals.

Low and medium income jurisdictions should consider reform of tax systems to ensure that activities with negative environmental impacts are discouraged, and positive behaviours are encouraged. It should also be borne in mind that these reforms can have different impacts on different jurisdictions, sectors, and groups of people, and such differences incur political and economic challenges that national governments and international organizations must address. It is especially important to ensure that environmental tax reforms do not create new inequality.

3.5.2 Carbon pricing and taxes

It is now generally considered that carbon pricing is the most cost-effective method of reducing carbon emissions. Carbon pricing creates incentives for households and businesses to shift towards greener options because the alternatives become more expensive when priced to take emissions into account. This makes green investments more attractive and levels the playing field between renewable energy and fossil fuels.

Although Asia currently produces almost half of the world's carbon emissions, IMF research indicates that a progressive carbon price that rises steadily from a low base could help Asian jurisdictions reach their goals under the Paris Climate Agreement[9] in the next 10 years. Carbon pricing is however a complex issue and there are a number of competing approaches possible. This issue should therefore be studied in parallel with more immediate approaches such as use of excises and road tolls that will yield short-term revenue.

Carbon taxation should be considered as a way to combat global warming and at the same time raise more tax revenue. Jurisdictions need to show stakeholders that the tax reforms are in their own interest. Carbon taxes can raise substantial government revenues, which could be used to increase public investment in health,

8 IMF (2021). *A Post-Pandemic Assessment of the Sustainable Development Goals*, https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2021/04/27/A-Post-Pandemic-Assessment-of-the-Sustainable-Development-Goals-460076.

9 UN. *The Paris Agreement*, https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement.

education, and skills re-training, in addition to supporting households.

3.5.3 Example: China

China's national carbon emissions trading system for the power sector began operation in 2021 with the gradual transitioning of existing regional emissions trading system (ETS) pilots into the national scheme. The scheme sets limits on emissions relative to a firm's energy output instead of imposing a cap on total emissions. The system is supported by reporting and verification of emissions data from emission-intensive sectors; the development of a national registry; the national enterprise greenhouse gas reporting system; and establishment of the legislative and regulatory framework.

The IMF has suggested that the coverage of the system could be increased by moving to a cap on total emissions; gradually adopting more challenging targets; tightening compliance; extending the system to other sectors; and raising revenue from the allocations, for which there is currently no charge.[10]

3.5.4 Other tools to lower emissions

Other tools that could be used by jurisdictions to help meet climate goals include "feebate" schemes that aim to reward efficient practices and discourage high-carbon activities. These could be combined with stronger regulation of emissions and energy efficiency.

Regulatory instruments can be used to encourage the diffusion of particular technologies, for example, the use of recycled products can be facilitated by relabelling by-products of steel production from "waste" to "product". A circular economy can be encouraged by the use of minimum content requirements.

3.5.5 Stronger international cooperation on environmental measures

Reaching agreement on differentiated carbon price floors is one important area for international cooperation. The international community also needs to make available the climate finance and technology transfers needed by developing economies to increase their efforts to reach climate goals. International cooperation is also needed to increase transparency by improving the quality of climate disclosure. Jurisdictions also need to harmonize global green finance standards and share best practices.

3.6 Tax Administration

3.6.1 General

Jurisdictions need to modernise tax revenue administration to improve taxpayer compliance and collect tax revenues from sectors that are currently hard to tax, so the size of the informal and shadow economies can be reduced. A detailed analysis of the potential for revenue growth and improvement of the tax-to-GDP ratio was undertaken in a previous issues paper from the International Tax and Investment Center.[11]

That paper argued that tax administrations in developing jurisdictions have focused the bulk of their resources on measures aimed at large taxpayers in the formal sector. Research has shown that while reformed revenue agencies appear to be quite impressive and influential organisations, they have not led to significant increases in revenue collection.[12] The paper argued that returns from these investments had started to diminish, and tax administrations should consider if resources could be better employed in other areas. It would appear that some of those considerations are still valid, and more effort should be applied to bring the informal sector into the tax net, especially through the use of emerging mobile technologies and a growing fintech sector.

10 IMF (2021). *A Post-Pandemic Assessment of the Sustainable Development Goals*, https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2021/04/27/A-Post-Pandemic-Assessment-of-the-Sustainable-Development-Goals-460076.

11 David Hartnett and Hafiz Choudhury (2014). *Tax Administration Priorities in Emerging and Frontier Markets*, https://www.iticnet.org/s/TaxAdministrationPrioritiesInEmergingAndFrontierMarkets.pdf.

12 Moore, M., *Revenue Reform and State Building in Anglophone Africa*, ICTD Working Paper 10, London, May 2013.

3.6.2 Digitalisation of tax administration procedures

The move to remote working during the pandemic has created challenges for the normal operations of tax administrations. In this period the tax administrations have had difficulties in dealing with documents such as letters and forms; field audits; communication with taxpayers; and systems maintenance. Also, the tax administrations had to take on additional tasks in providing financial and other support to individuals and businesses in the pandemic.[13]

It has become clear that the digitalisation of tax administrations can significantly help in dealing with the crisis. Tax administrations have been moving many of their processes online in recent years, replacing in-person communication with virtual or digital communication, and the pandemic has reinforced this trend. The changes in terms of adjusting to a remote working environment and developing new digital services have been challenging and carried certain risks in relation to the security of data.

The urgent need to support individuals and businesses in the pandemic has required tax administrations to adapt their existing IT project development practices, with many adopting flexible project development methodologies. The experience gained during the crisis has influenced the future strategies of tax administrations and their methods of engagement with taxpayers. A number of tax administrations are preparing to make additional changes to increase the resilience of their IT systems to prepare for future crises.

Tax laws and regulations need to take into account the capacity available to the tax administration. Otherwise effective tax laws may be difficult to implement if they require resources that are beyond the reach of tax administration. For this reason jurisdictions need to consider simplified systems such as presumptive taxes that can bring more taxpayers into the system while remaining relatively cheap to administer.

3.6.3 Example: Pakistan

Pakistan is implementing reforms to tax policy and revenue that it is estimated could increase the tax to GDP ratio by more than 3 percentage points over a four-year period.[14] Legislation had already been introduced before the crisis to strengthen transfer pricing rules, require country-by-country reporting by multinationals and allow for greater exchange of information with other jurisdictions.

The tax reforms would include broadening the tax net to include more individuals and businesses. Pakistan has historically had the problem that a relatively small proportion of the population is actually within the tax net, a situation that has been tackled over the years using presumptive taxes for small businesses and other measures. In the 2021 budget the Finance Minister has proposed changes to tax audit procedures to ensure fair treatment of taxpayers and a sales tax system for small businesses is to be introduced.

4. Building a Stronger Economy

4.1 Achieving the Sustainable Development Goals while Building back Better from the Pandemic

Since March 2020, governments throughout the world have spent around US$16 trillion to support businesses and individuals through the pandemic.[15] Deficits are at their highest level since 1945, but the liquidity provided by the central banks prevented the recession in 2020 from getting worse. Investment now needs to be channelled to new ideas and businesses, and governments should monitor the labour market and provide support for job seeking and

13 OECD (2021). *Tax Administration: Digital Resilience in the COVID-19 Environment.*

14 World Bank. *Pakistan Raises Revenue,* https://www.worldbank.org/en/news/factsheet/2019/11/18/pakistan-raises-revenue-prr.

15 UN. *Financing for the Development in the Era of COVID-19 and Beyond Initiative (FFDI),* https://www.un.org/en/coronavirus/financing-development.

re-training to help workers return to jobs in more dynamic sectors of the economy.

The competition authorities need to tighten their enforcement of merger control, ensuring that the criteria used to determine deals to review should cover all the relevant cases including those where a small enterprise could grow to compete with dominant firms. The competition authorities should also actively enforce prohibitions on the abuse of their position by dominant firms in the market. A market investigation could reveal harmful business practices even if there is no reported breach of the law.

There should be more effort to ensure competition in input markets, such as the labour markets. Rules to prevent "no poaching" pacts between firms could improve competition. The authorities should note that "non-compete" clauses in some retail job contracts present difficulties for employees to make a move to better-paid jobs.

Competition authorities also need to keep pace with the digital economy, where the use of big data and artificial intelligence are allowing the dominant firms to increase their advantages in the market. The facilitation of data portability and compatibility of systems could allow new firms to better compete with the more established firms.

Investment may be required to increase sector-specific expertise at a time of fast technological change. An example is the Digital Markets Unit in the UK that is to supervise the behaviour of dominant digital platforms.

The monetary and fiscal stimulus still being provided in the pandemic can become a springboard to a more sustainable economy rather than just a support helping firms to survive the crisis. Comprehensive growth-enhancing reforms affecting product, labour, and financial markets could increase annual growth of per capita GDP by more than 1 percentage point in emerging market and developing economies over the next ten years.[16] The developing jurisdictions could then greatly increase the speed of their convergence with living standards of advanced economies by comparison with the pre-pandemic period. Reforms could be carried out with the help of recovery spending to achieve greater prosperity.

Higher growth assisted by appropriate reforms could help advanced economies to reduce the amount of debt taken on when providing support in the pandemic. Economic growth would create fiscal space for greater investment and would reduce the need to improve government finances by raising taxes. Reforms to target the supply-side can achieve growth without increasing the inflationary risks from increased demand arising from policies in some jurisdictions such as the United States.

Reforms can strengthen the economic position of emerging market jurisdictions and increase investor confidence. The low income jurisdictions that find themselves without enough policy space for the required spending could use the returns from growth-oriented reforms to avoid fiscal austerity, protect social and health spending and increase their capacity to invest in their human capital.

4.2 The SDGs and South-South Economic Cooperation — the Role of BRI

The BRI offers opportunities to participating jurisdictions to learn from each other in developing its economy and transitioning to a major economic player. The BRI provides a further opportunity for developing jurisdictions to make use of foreign investment to build up their infrastructure, including digital infrastructure, and their productive capacity. The improvements can help developing jurisdictions to further integrate themselves into regional and global supply chains.

The BRI can lead to shared development among developing jurisdictions, for example,

16 World Bank (2021). *Global Economy to Expand by 4% in 2021; Vaccine Deployment and Investment Key to Sustaining the Recovery*, https://www.worldbank.org/en/news/press-release/2021/01/05/global-economy-to-expand-by-4-percent-in-2021-vaccine-deployment-and-investment-key-to-sustaining-the-recovery.

through the creation of corridors through which trade can flow and in which infrastructure can be upgraded to assist the flow of goods. In this way a jurisdiction's infrastructure development can be compatible with that of neighbouring jurisdictions and assist them by speeding up the flow of goods through a trade corridor or along a sea route. Physical and digital development and upgrades can assist a jurisdiction and indirectly benefit its neighbours by improving the stability of regional supply chains.

4.3 The Role of Tax Rules in Fostering Capital Formation and More Efficient Allocation of Capital

In general terms an efficient allocation of capital is made possible by a neutral tax system that does not encourage behaviour that could cause capital to flow to sub-optimal purposes. The right climate for savings and investment is created by political and economic stability, strong institutions of government, consistent policies and good governance.

The first step in capital formation is to ensure that the levels of creation and mobilisation of savings and levels of investment are sufficiently high. These can support the necessary projects to improve infrastructure, ensure that the necessary plant and equipment are available and thereby raise productivity. A jurisdiction requires strong savings and investment institutions that can promote confidence in their reliability and therefore encourage savings.

Tax incentives can encourage saving but they must be sufficiently effective in achieving their objective to justify the tax expenditure on the relief, given the urgent revenue needs of jurisdictions following the pandemic. Appropriate tax incentives can be framed specifically to apply only to the type of savings behaviour where the incentives are designed to encourage.

To avoid the abuse of tax incentives, they should be constantly monitored by collection of statistics on relief given and assessments of the effect that the tax incentive has had on taxpayer behaviour and decisions. Where there is evidence that a tax incentive is being abused or not sufficiently well targeted to achieve its objective, the government must introduce appropriate modifications to make the incentive more specific and targeted. Tax incentives for investment should target projects that would benefit infrastructure, build up digital capacity and lead to the use of more efficient plant and equipment.

4.4 Creating a Favourable Investment Climate

Jurisdictions need to encourage investment and business activity by introducing measures to stimulate job creation, investment and innovation. Incentives can be designed to create incentives for aligning business practices with sustainable development. In the short term, support is required from governments to ensure that businesses remain solvent and to keep people employed. As the economic recovery gets under way, governments can invest in sustainability.

Global foreign direct investment (FDI) fell by 42% in 2020 compared with the previous year with ongoing investment projects delayed and a collapse in foreign affiliate earnings.[17]

17 UN (2020). *Global Foreign Direct Investment Fell by 42% in 2020, Outlook Remains Weak*, https://unctad.org/fr/node/31924.

Merger activity fell to a low point with many mergers and acquisitions suspended or cancelled. Investment in developing and transitional economies (excluding China) decreased by 22% in 2020, and international private investment flowing to developing and transitional economies were weakened in sectors of the economy which are important for reaching the SDGs.

Future trends in investment depend on a number of factors such as public spending levels, interest rates and progress of the pandemic (including the speed of vaccine roll-out) and this is especially true for developing jurisdictions. Changes already occurring in international supply chains owing to technological changes have accelerated during the pandemic. As a result of the introduction of new technologies, the business operations of multinationals are less dependent on investment in physical assets. There is more pressure from public opinion and government policy for more national or regional autonomy in productive capacity and multinationals are more anxious than before the pandemic to ensure the security of their supply chains and ensure they are resilient in future crises.

A separate, but related area is the role of investment agreements and trade agreements, both bilateral and multilateral. This subject and the relationship of double tax agreements to trade and investment agreements is a large subject on its own. The authors intend to explore this area in the context of BRI jurisdictions in a forthcoming paper; this will build on a prior paper by Jeffrey Owens and Hafiz Choudhury on the topic.[18]

4.5 Promoting a Greener Economy

4.5.1 General

In addition to the use of carbon taxes, carbon emissions systems and other measures to discourage polluters, jurisdictions will need to look at investment in green technologies which are among the industries of the future. Investments in initiatives in relation to green

18 Jeffrey Owens and Hafiz Choudhury (2014). *Trade Agreements and Taxation: Removing the Final Barrier to Trade*, https://static1.squarespace.com/static/5a789b2a1f318da5a590af4a/t/61041d6313c2f47d7935854e/1627659619855/ITIC_Issues_Paper__Trade_Agreements_and_Taxation___Removing_the_Final_Barrier_to_Trade_by_Mr__Hafiz_Choudhury_and_Dr__Jeffrey_Owens.pdf.

energy, green transport and green manufacturing could all be encouraged by well targeted tax incentives.

Governments can use grants as well as tax incentives, and can also attract investment by offering the appropriate infrastructure for companies and ensuring fast access to any licenses or other registrations required by companies establishing themselves in the jurisdiction. Other initiatives such as the creation of knowledge hubs and fostering cooperation between industry and the academic world are also available to governments.

4.5.2 Examples from recent legislation: Kazakhstan, Pakistan

The need to encourage greener development may be a spur to consideration of policy measures in a number of jurisdictions, such as Kazakhstan's commitment to achieving zero carbon emissions by 2060. The Ministry of Ecology, Geology and Natural Resources of Kazakhstan is currently working on the development of a draft Concept for low-carbon development that is likely to have implications for investment policy and incentives.

Under legislation passed in December 2020, Pakistan has set up a Special Technology Zone Authority with legislation offering income tax, customs duties and sales tax incentives to companies operating in the zones and tax incentives for zone developers.

5. Conclusion and Recommendations

Support provided to individuals and businesses during the pandemic should be continued as long as necessary. However, the emphasis needs to be gradually shifted to spending to encourage employment and growth. It is important to phase out measures and introduce new ones at the right time, so that there is a smooth transition out of the pandemic and into an era of economic growth and employment creation. Tax policy, and by extension, international tax measures, are an important component of the policy mix.

Governments should therefore consider the balance of tax policy and administrative measures necessary for their specific circumstances. Given the dislocations caused by the pandemic, corporate and individual income taxes may not generate significant revenue in 2021. The temptation to rely on indirect tax measures such as VAT, excise and to a lesser extent, customs duties, must be tempered by a consideration of the effects of such policy. On the other hand, measures such as improved taxation of the digital economy and opportunities to identify hitherto undisclosed income sources from the new global agreements, such as Automatic Exchange of Information (AEOI), should be applied to the fullest extent.

It will also be appropriate to consider the current application of tax incentives, and only consider targeted tax incentives for businesses in the industries of the future including digital and green energy sectors. The incentives should be specifically framed and targeted so as to achieve the maximum effect, and the impact of the incentives should be constantly monitored so that the measures can be reviewed and if necessary amended to gain a greater benefit for the cost incurred. At the same time, inefficient incentives and other tax expenditures should be measured and removed.

For individuals, the support given in the pandemic should give way to measures to enhance employment and permit transition of workers to the growth industries, by support for job searches, provision of re-training and incentives to encourage businesses to train workers on the job. Building back better after the pandemic should involve measures to create a more favourable investment climate and encourage investment in growth industries, including green energy, clean transport and sustainable manufacturing.

The overall recommendations are thus to consider and implement a balanced approach that will improve domestic revenue mobilization and also encourage further mobilization of private capital both from domestic and foreign investors. The dialogue processes under the BRITACOM can help jurisdictions within the BRI gain important insights from peer experiences and technical support in implementing the right policies.

Digitalisation of Tax Administrations: A Business Perspective *

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Abstract: The rapid trend of digitalisation in government services, and in particular for tax administrations, is a key strategic business topic with great potential to increase the efficiency and effectiveness of business and government operations in general. As many tax administrations digitalise their processes, businesses are faced with interesting dynamics where they need to adapt their systems and processes to information and communication technology systems designed by the public sector, which could increase administrative complexity and compliance costs for businesses. ICC supports continued efforts to ensure that digitalisation enhances the efficiency and effectiveness of processes for both businesses and tax administrations and is of the view that closer collaboration with all stakeholders, and the consideration and application of key principles in digitalisation strategies and processes, will help ensure that these systems are a benefit, rather than a hindrance, to business supply chains and government operations. This article explores COVID-19 implications on tax digitalisation; key principles and objectives for digitalisation, as well as the key components of a successful digital transformation and the pre-requisites from a business perspective. It highlights how these steps will play an integral role in realising optimal benefits of efficient digitalisation for tax administrations and businesses.

Keywords: Tax; Digitalisation; Compliance; BRITACOM; ICC; ICT

1. Background

The digitalisation of society is taking place at unprecedented speed. Digitalisation impacts almost every area of an

* The International Chamber of Commerce (ICC), as a world business organization, advocates for a consistent global tax system founded on the principle of stability, certainty and consistency. Hence, ICC welcomes the opportunity to provide an updated report to the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) on the digitalisation of tax administrations. The ICC Report will contribute to deliberations in the context of the Second Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF) and the Business and Industry Tax Dialogue on tax digitalisation held on 7-9 September 2021 which brought together over 70 BRITACOM parties.

individual's daily life extending from the way individuals communicate, shop to how they pay bills. In the business environment, the digitalisation in factories has allowed for a seamless integration of designing, testing, manufacturing and billing. It has been integrated to accounting systems and other business support processes, which allow for the analysis of available data to gain insight to better manage each respective process. This holds especially true for tax processes within businesses. It is, therefore, logical that tax administrations would also implement digitalisation in their processes, with an emphasis on the interaction between the taxpayers and tax administrations.

Tax authorities around the world are grappling with the challenge of adapting revenue collection models to a global economy that is continually reshaped through transformative digital technologies. As government services become increasingly digitalised, businesses are faced with evolving trends and strategic questions. Many tax administrations are undergoing a global revolution in tax compliance as they seek to digitalise their processes to enhance efficiency and effectiveness. This is creating interesting dynamics where complex business systems and processes need to adapt to information and communication technology (ICT) systems designed by the public sector.

1.1 COVID-19 Implications

The COVID-19 pandemic posed an unprecedented health and economic crisis, affecting the lives and livelihoods of workers, as well as the operations of businesses and governments globally. With the onset of lockdowns and containment measures during the crisis, businesses and governments had to adapt in real time to ensure business and operational continuity, which included providing employees with adequate digital infrastructure and tools to work remotely and ensure connectivity in a relatively seamless manner.

This digital revolution was necessarily accelerated by the prevailing conditions of the pandemic which required a dramatic shift in the management of daily functions both on a personal and professional level. The global health crisis led to a sharp decline in economic activity that, according to the Organisation for Economic Co-operation and Development (OECD), is without precedent in recent history.[1]

The pandemic impacted the working dynamics of businesses and governments globally, including the day-to-day operations of tax administrations. With the onset of lockdowns, tax administrations needed to adapt to full or remote working which reshaped their usual functions and operations. In-person relationships were replaced by virtual interactions. It is therefore evidently clear that the transition to the use of technology to digitalise processes was imperative to ensure functions, operations and taxpayer services continued relatively seamlessly.

The OECD report on the digital resilience of tax administration[2] notes that in the aftermath of the pandemic crisis, around 60% of tax administrations considered making some changes to the strategies regarding the digitalisation of tax administration processes, including:

- The conversion of paper records into digital formats which would permit the extraction of relevant data, storage and notification to the appropriate tax officials;
- Prioritizing projects on automation, digitalisation and electronic services, with specific focus on the creation of cloud systems and digital services offices; and
- Highlighting the advantages of a remote working system.

As tax administrations had to quickly find digital means that are able to replace in-person

1 OECD (2021). *Tax Policy Reforms 2021: Special Edition on Tax Policy during the COVID-19 Pandemic*, https://www.oecd.org/ctp/tax-policy-reforms-26173433.htm.

2 OECD (2021). *Tax Administration: Digital Resilience in the COVID-19 Environment (April 2021)*, https://www.oecd.org/coronavirus/policy-responses/tax-administration-digital-resilience-in-the-covid-19-environment-2f3cf2fb/.

and paper communication, different approaches were adopted, such as:

- Providing information and guidance on the tax administration's website;
- Using general communications such as advertising and social media; and
- Directly contacting individual taxpayers (SMS or phone).

A corollary of this shift included necessary changes, such as the acceptance of e-signature and scanned documents.

Nevertheless, managing compliance risk in the COVID-19 environment has proved to be more challenging. The shift to remote working impacted compliance-related aspects, particularly audit processes. The OECD report on Tax Administration 2019[3] notes that 90% of surveyed tax administrations were able to shift parts of their field audit work to a virtual or digital environment. These changes generally received positive feedback and it is expected that the majority of these tax administrations plan to retain digital/virtual audit work going forward.

It goes without saying that information technology (IT) systems have been indispensable during the ongoing crisis. As such, the adequate functioning of IT systems is absolutely imperative and any failure in the operation of IT systems could have far-reaching consequences. A significant amount of investment and attention was required to develop or enhance existing IT solutions in relation to internal processes or taxpayer services in order to incorporate new responsibilities to assist with broader government support in the COVID-19 situation. The COVID-19 crisis has on the other hand shown how effective digitalised tax administrations are with regard to real time monitoring of COVID-19 assistance measures — the availability of real time data, e.g., that from invoices, proved to be helpful to check if private consumption really improved or stabilized due to lower VAT rates for certain goods.

1.2 Transition to Remote Working for Tax Administrations

A further OECD report on *Tax Administration: Towards Sustainable Remote Working in a Post COVID-19 Environment*[4] identifies the key aspects for consideration to ensure that tax administration staff had the necessary IT equipment or remote access to the internal IT systems, namely:

- Availability of ICT systems — computer systems, IT equipment, hardware, software;
- Internal and external communication systems;
- Information systems with attention to data collection and processing; and
- Adoption of user-friendly digital platforms for filing and communication.

The OECD report on digital resilience shares that two thirds of the tax administrations surveyed had to make systems change to enable the rapid move to remote working and to purchase or rent IT equipment for staff.

Whilst there are recognized advantages to remote working, such as improved work-life balance, enhanced resilience and cost reductions, nevertheless there are evident drawbacks, especially with respect to dealing with sensitive information and taxpayer data. For the business community, the importance of information security, data protection and data privacy cannot be overstated, and could be compromised to some degree in the context of relatively unsecure locations such as employees' homes. In particular, this situation may create:

- Greater risks of exposure of confidential information through possible weaknesses or deficiencies in the systems used to connect to the tax administrations;
- The vulnerability to the theft of equipment or information; and

3 Ibid., at 14.

4 OECD (2021). *Tax Administration: Towards Sustainable Remote Working in a Post COVID-19 Environment*, https://www.oecd.org/coronavirus/policy-responses/tax-administration-towards-sustainable-remote-working-in-a-post-covid-19-environment-fdc0844d/.

- The possibility that external individuals may have access to confidential taxpayer information.[5]

It is, therefore, essential to invest in software which provides a secure connection between the employees' homes and the tax administrations, e.g., virtual private network connection (VPN) or two-factor authentication to reinforce the mechanisms for remote authentication.[6]

ICC notes the interesting insights into the digital transformation plans of China's State Taxation Administration, and in particular that "digitalisation has been hugely important in enhancing the efficiency and effectiveness of tax administration in both supporting voluntary compliance and in the use of more sophisticated analytical tools to identify compliance risks. In addition, digitalisation has also improved the robustness and resilience of tax administrations to external shocks, as shown during the COVID-19 crisis".[7]

2. Principles for Digitalisation

A good tax system is one which minimises administrative, compliance and distortion costs to the economy. Therefore, a key feature of good tax administrations is sound information system. This includes the adoption of technology for creating the system and the application of accompanying taxpayer services. This adoption and application will not only build confidence among taxpayers, but also improve compliance measures.[8]

It is, nevertheless, important to exercise some caution in adopting new approaches as technology is evolving rapidly and the future of digitalisation is unclear.

The following principles[9] should therefore, where possible, be considered to ensure the maximum benefits of systems for both the private and public sectors.

2.1 Efficiency

- ***"Provide data only once" principle*** — Digitalisation should be aimed at alleviating the burden on taxpayers created by the existing requirements to provide the same data multiple times to tax and other public or law enforcement authorities. The systems should not add to but reduce, and, if possible, replace pre-existing functionally equivalent requirements.
- ***Consistency*** — Digital systems should be consistent and remain stable over time. Systems should be designed and operated in such a way that businesses are not confronted with contradictions or conflicts across their geographic or sectoral obligations. In addition, consistency among legal, process and technical requirements involved in business compliance with digital systems should be sought as requirements and practical conditions for access and use of digital systems evolving over time within each relevant jurisdiction.
- ***Interoperability*** — Digital systems should be interoperable among jurisdictions from a legal, technical and operational perspective.
- ***Harmonisation*** — Digital systems should seek to be harmonised and uniform in technical, legal and process specifications, both in domestic and international scenarios, aiming to

5 For the further elaboration on the challenges related to a remote working mode, see Collosa Alfredo (2020). *The Digitalisation of the Tax Administrations: An Analysis of Teleworking within the Scenario of Coronavirus Forced Restrictions*, https://www.gccfintax.com/articles/the-digitalization-of-the-tax-administrations-an-analysis-of-teleworking-with-in-the-scenario-of-coronavirus-forced-restrictions--1359.asp.

6 OECD (2020). *Tax Administration Responses to COVID-19: Business Continuity Considerations*, pp. 13, https://www.oecd.org/coronavirus/policy-responses/tax-administration-responses-to-covid-19-business-continuity-considerations-953338dc/.

7 OECD (2021). *Forum on Tax Administration — Commissioner Conversations: Digital Transformation — The View from China*, https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/commissioner-conversations/.

8 http://www.nipfp.org.in/publications/working-papers/1781.

9 ICC (2020). *ICC Practice Principles for Implementation of CTCs*, https://iccwbo.org/publication/icc-continuous-transaction-control-ctcs-practice-principles/.

satisfy public and private sector needs. Where digital systems are deployed, the design should whenever possibly use accepted international standards for data, security and transmission protocols that are already widely deployed in practice.

• ***Robustness and continuity*** — Digital systems should be operationally stable, maintain appropriate response and processing times, publish service level agreements, communicate effectively in case of problems meeting such service levels, and specify the controls they perform on submitted data.

2.2 Balance

Digital systems should be designed and operated in a way that considers the need for balance between the legitimate interests of governments and businesses:

• ***Economic benefits*** — Digital systems should be aimed at safeguarding VAT revenues and keeping compliance costs for business as low as possible, which are clear benefits for tax administrations and businesses. An initial period of voluntary adoption, based on clear benefits (e.g. reduced archiving time; tax efficiency incentives; fewer periodic reporting requirements), should always be considered prior to mandating the system to taxpayers.

• ***Encourage automation*** — Digital systems should contribute to the promotion of standard-based business process automation.

• ***Flexibility*** — Digital systems should leave enough flexibility to allow for the implementation of compliant processes that maximise efficiency across jurisdictions within a common framework of varying digital systems and other tax or legal requirements. They should accommodate and follow existing business and commercial processes and avoid creating a "separate universe" of document types, process orchestration and technical standards or setting up a new system that is incompatible with existing business transaction automation platforms.

• ***Proportionality*** — Digital systems should be proportionate to the benefits sought and avoid disproportionate burdens and costs to businesses. Disruption of business operations and distortion of competition should also be avoided.

• ***Consultation with business and appropriate lead time*** — It is vital to have a robust consultation with business from conception to implementation. It allows time for business to be involved in upfront testing and granting business the appropriate lead time to implement new technology-driven practices. The more novel the system, the more lead time will be necessary. Appropriate transition rules, including penalty relief, should also be considered.

3. Continuous Transaction Controls

Digitalisation might include the concept of "continuous transaction controls" (CTCs) which enable law enforcement agencies, such as tax administrations, to harvest data associated with business activities that are relevant to the exercise of their function. Such data is obtained directly from business transaction processing and/or data management systems, in real-time or near real-time. Before adopting CTCs, in addition to the principles set forth above, governments need to consider additional factors.

First, real time data may be of poor quality. Therefore, harvesting data in real time or near real time may lead to inaccurate results. Allowing business to follow-up and correct inaccurate data before submitting it may lead to more accurate results.

Second, taxpayers must be confident that data privacy will always be respected, even when jurisdictions have disputes among themselves.

As for applying CTCs for purposes of the corporate income tax, there may be complexities and inaccuracies. Information in the taxpayer's system will be initially prepared and reviewed by internal accountants. They may not be required to consider the tax consequences of the data entered into the internal systems. For example, the accountants might not be concerned about the accuracy of inter-company transactions because the transactions will be eliminated upon consolidation for accounting purposes. Without tax reviews first, extracting data directly from the taxpayer's accounts may lead to unnecessary audits. In addition, tax rules are often different from audit rules, so extracting data prior to adjusting the financial accounts for these differences would also lead to inaccuracies and unnecessary audits.

Extensive work is underway at the OECD around the use of financial accounts as a basis for the income determination as well as different mechanisms to address temporary differences between tax and financial accounting. The objective would be to limit adjustments for permanent differences to reduce complexity and compliance costs.[10] The use of unadjusted numbers taken from financial accounts would unlikely produce accurate results for tax purposes. The adjustments being considered by the OECD are complex; they are, however, working towards a goal of a single tax base for purposes of the global minimum tax. The complexity of using CTCs based on financial statement information is greater because jurisdictions are not attempting to create a common tax base. Hence, the adjustments would need to be varied for different jurisdictions.

Lastly, different businesses have different business models. The related data processes and systems are varied. Some may even involve manual elements that are not captured by systems. In light of this, in order to implement CTCs or "real time data", both taxpayers and tax administrations may be faced with very significant technical challenges.

4. The Objectives of Digitalisation

Digitalisation by the tax administration should be considered as a fundamental change and does not solely digitise the existing processes. The term digitisation refers to "the action or process of digitising; the conversion of analogue data (esp. in later use images, video, and text) into digital form".[11]

Tax administrators in each jurisdiction have different objectives, policies and roles. In order to gauge/measure the efficiency of tax administration, it is important to understand the broad capabilities that a tax administration aims to achieve in the digitalisation process. These are:[12]

- *Information management*: A core digital tax system provides support, automation, workflow management, and authorisation management to tax administration functions; gathering commercially available information from external and internal sources which shall assist in increased collection of tax revenues;
- *Taxpayer compliance*: An e-tax system provides information, education, and support to taxpayers and facilitates and eases compliance and administration;
- *Tax risk management*: A compliance performance system deploys risk-based procedures to detect and deter non-compliance; and
- *Administration*: A management information system that facilitates the collection and dissemination of performance information to staff and management reduces tax collection cost and also raises revenue through combatting tax avoidance/evasion.

More generally, objectives for investing in digitalisation include the following:

- Gain efficiency by digital interfaces, auto-

10 *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf.

11 Parviainen Päivi, Tihinen Maarit, Kääriäinen Jukka and Teppola Susanna (2017). Tackling the Digitalisation Challenge: How to Benefit from Digitalisation in Practice, *International Journal of Information Systems and Project Management*, 5(1), pp. 64, https://ijispm.sciencesphere.org/archive/ijispm-0501.pdf#page=67.

12 Jimenez Guillermo, Mac an tSionnaigh Niall and Kamenov Anton (2013). Information Technology for Tax Administration. USAID Bureau for Economic Growth, *Education and Environment, Office of Economic Policy*, https://pdf.usaid.gov/pdf_docs/PNAEA485.pdf.

mated data gathering, data processing and data analysis (tax audit risk) etc.;

- Enhance compliance with applicable tax law by better understanding and analysing available data — pre-tax audit or within a tax audit;
- Improve macro socio-economic predictability to close tax gaps;
- Enhance taxpayer service by increasing efficiency for the taxpayer and improving communication flow;
- Improve taxpayer trust through increased transparency of strategy, processes and investments, through structured and/or visually-supported data, which has been proven to increase taxpayer satisfaction and voluntary compliance; and
- Enable real-time secured cooperation within the tax eco-system, among tax administrations and taxpayers (businesses and individuals) as well as cooperating with tax advisors, banks, employers, stock exchange committees, chambers of commerce, etc.

Currently, certain technology trends, including Big Data, analytics, artificial intelligence (AI), machine learning (ML), the Internet of Things (IoT), mobility and cloud computing all have impacts on tax administrations. Taken individually or together, these trends have the power to increase taxpayer satisfaction, empower tax agency employees, optimise operations and modernise services.

5. Key Components of a Successful Digital Transformation

Digitalisation is a holistic approach that incorporates six key components of a successful digital transformation, as indicated in Figure 1.

Although digitalisation can achieve the same goals as outlined above, they are not necessarily exclusive and, at best, could be addressed at the same time via a fully integrated digitalisation concept.

From a business perspective, ICC supports the areas identified, however, respectfully notes a number of prerequisites for consideration.

• *Data security*

These are key questions to any digitalisation project. Each tax authority is required to safeguard the confidentiality of data and to ensure that the data may not be used by third parties.[13] The information exchanged via digital interfaces needs to be secure. It is imperative for business confidence that the law enforcement authority or certified private entity treats submitted business data in accordance with internationally accepted standards and legal commands for data protection, data privacy and data security. Particularly, the confidentiality of business data is paramount. Such consistency should be an integral and prioritised objective in the system design.

This includes the need for tax administrations to ensure that the digital interfaces do not create a gateway for viruses or other digi-

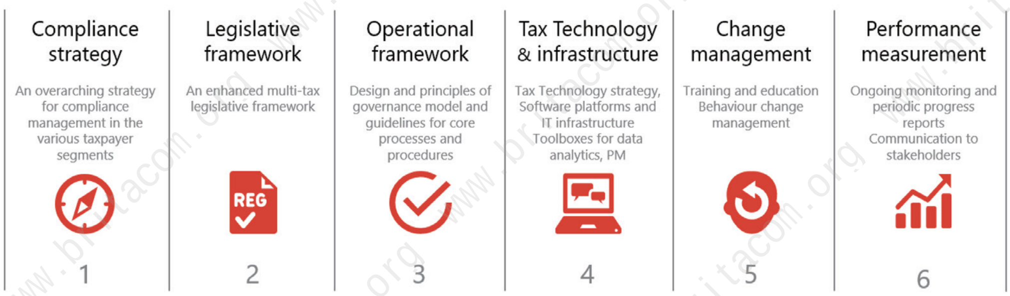

Figure 1. Key components of a successful digital transformation
Source: Microsoft and PWC (2018). *The Data Intelligent Tax Administration Whitepaper*, pp.8, https://www.pwc.nl/nl/assets/documents/the-data-intelligent-tax-administration-whitepaper.pdf.

13 This is in accordance with some existing regulations such as the European General Data Protection Regulation.

tal threats to the Information Technology (IT) systems of taxpayers, including harvesting of tax and personal data for misuse. The European General Data Protection Regulation (GDPR) is a key requirement that applies to tax related information. Accountability for security breaches needs to be considered.

Without data protection, taxpayers will not be willing to comply with new digitalisation concepts, which could lead to a situation where a company refrains from investing in a certain jurisdiction to avert the risk of exposing privileged data to the risk of a third party hijack.

• ***System requirements***

Some systems and interfaces on the sites of tax administrations do not easily cooperate with systems on the sites of taxpayers, therefore interoperability is paramount when deciding on the technology to adopt. Another key aspect is the scalability of the platform as the data volumes are ever growing and require adequate compute power.

The disadvantage of digitalisation is that it will, in the first instance, lead to increased compliance costs. Recent e-filing, e-accounting (i.e., the specific taxonomy) and the country-by-country (CbC) reporting requirements demonstrate that the introduction of new digital methods results in additional compliance costs, and imposes an additional burden on the taxpayer. At the same time, recent digitalisation measures require the taxpayer to produce its company information into a pre-defined format which does not necessarily align with the actual facts and circumstances in all relevant cases. On a global scale, there is, of course, additional risk of various, ambiguous or conflicting domestic rules to be followed by MNEs.

Variations in systems or rules can be concerning for businesses in terms of the impact on business processes and systems, the lack of cross-border transaction interoperability, data level differences and data process fragmentation. The harmonisation of data formats would be a welcome development in this regard.

Country example: Germany introduced e-accounting in 2012. All companies are required to file their annual accounts in accordance with a specific format (taxonomy) each year electronically. Whereas in general, the system works appropriately, the taxonomy has been criticised as being too rigid. Taxpayers have generally been overwhelmed by the formats and unable to report certain transactions appropriately. This has led to controversies in audit.

• ***Data availability***

Businesses often have to maintain dedicated staff to ensure compliance via tax-specific processes in traditional tax enforcement. The use of modern technology plays an important role in safeguarding revenue and gaining efficiencies for both tax administration and business. In order to achieve this goal and gain the maximum benefit for all stakeholders, the use of modern technology needs to be based on a consistent legal framework in the context of a cooperative compliance regime, connecting the business/commercial and the tax administration processes.

The balance should be weighed between the expected benefit of data and the additional effort for taxpayers to provide the data that may not always be easily available from their existing systems.

• ***Reasonable use of data***

While the goal of transparency is clearly desirable, there is an imminent and realistic risk that tax administrations will accumulate vast amounts of data (big data) without providing for the means to test and analyse it. Therefore, data will be stored without any particular purpose; legally infringing upon the taxpayer's fundamental right to data privacy while bearing the risk that — without proper comprehensive screening — the data will be used randomly to serve ad-hoc purposes (e.g., supporting tax audit adjustments). Without a proper, detailed and verifiable analysis, the data would not lead to a fair tax system.

Data classification and governance are paramount to embarking on the digitalisation journey.

• ***Transparency***

It is important for taxpayers to understand the purposes for which tax administrations are compiling their data. The same is true for specific audit algorithms that tax administrations use. Taxpayers should be involved in every step of the process. On the one hand, to protect their data privacy rights and on the other, to develop an efficient data collection and taxing regime which provides for equilibrium between the tax authority's right and its procedural need for transparency and verification, and the taxpayer's legitimate interest in minimising the storage and use of company/personal data as well as in reducing compliance costs.

As an example, a company may use different enterprise resource planning (ERP) systems globally. With global digitalisation and cross-border exchange of information, it is vital to streamline the information deduced from such ERP systems. Companies are likely best suited to determine the internal transformation protocols and systems they use.

• ***Taxpayers identity***

Making the digital world an organic part of tax administrations requires improving identity and security solutions and delivering contemporary online tools/services in multi-channels for personalised, digital engagement with citizens.

• ***Consistency***

Consistency across tax jurisdictions, particularly around the interface between taxpayers and tax administrations will be paramount to reducing the burden on the taxpayer. Additionally, timelines will vary for taxpayer compliance and implementation by tax administrations, which should be taken into account in this evolution.

The digital transformation journey for tax and revenue agencies will naturally be guided by best practices on cloud security, privacy and compliance due to the sensitive and private nature of the data they manage.

6. Tax Technology and Infrastructure

To optimise the benefits of tax technologies as well as manage compliance risks and rising future revenues, tax administrations should consider developing a strategy to guide the direction of innovations and provide a clear picture of the end-state design of a tax technology infrastructure. New technology has its own set of requirements, including a suitable physical environment for installation, continuous support in the day-to-day environment, ongoing maintenance and license costs, new security requirements, monitoring and planning for future improvements, etc. Many of these challenges can be resolved through service level agreements with a trusted cloud service provider, to ensure that data remains secure and that strict data privacy measures[14] are adhered to. The Tax Technology Strategy guides the direction for all innovations and provides a clear picture of the end-state design of a tax technology infrastructure for the tax administrations. Given the rapid evolution of the current regulatory environment, it is important to consider agility in the implementation of digitisation to ensure that infrastructure and approach can be managed over time. Often, in times of change, taxpayers revert to tools and processes that are more agile rather than less rigid infrastructure tools.

According to the United Nations E-Government Survey 2018,[15] good governance is an enabler of technological development and innovation. In addition, the three most commonly used online services in 2018 by governments across the globe are utilities payment, submission of income taxes, and registration of new businesses. The survey reports that approximately 140 Member States provide at least one transactional service online, i.e., filing income taxes online. Therefore, whilst it is evident that tax administrations have embraced technology, it is clear that the related impact regarding the use of technology has not yet reached its full potential.

14 They refer to data privacy rules such as the European General Data Protection Regulation or other local data protection rules.

15 UN (2018). *UN E-Government Survey 2018*, https://publicadministration.un.org/egovkb/en-us/Reports/UN-E-Government-Survey-2018.

7. Benefits from Efficient Digitalisation of Tax Administrations

The efficiency of tax administrations has considerable impact on the performance of their tasks, and thus, the application of tax law in practice. The efficiency of tax administrations means the efficiency of its structures, which translates into the efficiency of action. Tax administrations that focus on process improvement and a sound model can inject operational efficiency. Having a sound process and efficient operation at the back end can significantly improve the experience at front end. Efficient operations, as suggested in this document, can benefit in multiple ways such as:

- The ability to measure and reduce the tax gap ratio;
- Reduced tax collection costs and increased benefits;
- Improved productivity and service delivery resulting in better tax collection;
- Increased taxpayer satisfaction which results in a better trust factor;
- No redundant efforts leading to minimum wastage; and
- Increased participation and engagement among tax administrators on core tasks.

Table 1: Benefits from efficient digitalisation of tax administrations

Benefits for taxpayers	Benefits for tax, finance and customs agencies
• Enable 365 24/7 self services and quick access to relevant information • Know their tax position (personal, VAT, business, etc.) and regulations and initiatives that affect them • Make it easier to register, pay, receive notifications, and comply • Process quicker tax refunds by leveraging automation of processes	• Receive more information on taxpayers; gain insights to offer more targeted citizen services • Enable greater transparency: where revenues are invested as well as their impact • Implement automated fraud prediction and prevention models • Leverage intelligence to impact jurisdiction priorities and create intelligent policies • Allow taxpayers to take control of monitoring basic compliance requirements

Proper management of risks regarding the fulfilment of tax obligations allows tax administrations to focus the burden of audit on non-compliant taxpayers, increase the level of voluntary compliance of taxpayers and weigh the possibilities that a compliant taxpayer could become non-compliant.

The OECD Interim Report on Tax Challenges Arising from Digitalisation[16] recognized that digitalisation has already had a three-fold positive impact on tax administration: enhancing the effectiveness of tax compliance, improving taxpayer services and reducing tax compliance burdens.

8. Conclusion

ICC considers the trend of digitalisation in government services as a key strategic business topic with great potential to increase the efficiency of business and government operations in general. Unfortunately, there are currently high risks and substantive costs to companies — engendering broader economic implications — due to a lack of coordination among the governments in introducing new digitalisation systems. ICC is of the view that closer collaboration with all stakeholders, and the consideration and application of key principles in digitalisation strategies and processes, will help ensure that these systems are a benefit, rather than a hindrance, to business supply chains and government operations. ICC remains committed to providing knowledge and expertise on behalf of business with a view to identifying solutions to ensure that trends and the use of technology have a positive impact on trade.

16 OECD (2018). *Tax Challenges Arising from Digitalisation — Interim Report 2018 (Inclusive Framework on BEPS)*, https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm.

New Technologies and Transfer Pricing in the BRI Jurisdictions*

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Abstract: This paper explores the linkage between emerging new technologies and transfer pricing, and the mechanisms available to minimise and resolve disputes in this area. It explores the way that these technologies can help achieve a better application of the Arm's Length Principle (ALP) which remains the bedrock for transfer pricing around the world. It also identifies the way that both MNEs and Tax Administrations can use these technologies to get access to more comparable information and to achieve greater consistency in the allocation on the basis of the ALP. Finally some new ways of achieving more effective cross-border resolution mechanisms in the BRI jurisdictions are explored.

Keywords: Transfer pricing; Technology; Cross-border tax disputes; Tax certainty; BRI jurisdictions

New technologies are transforming the approach to transfer pricing (TP) for both tax administrations and taxpayers. We stand at the crossroads of this growing connection between technology and transfer pricing. This article is based upon the lessons learned over the last three years and aims at furthering the ongoing dialogue between BRI jurisdictions. Researchers at the WU Transfer Pricing Center and Global Tax Policy Center at the Institute for Austrian and International Tax Law at WU (Vienna University of Economics and Business) have focused on the potential of new technologies (e.g., artificial intelligence (AI), machine learning, and blockchain) to transform the approach to TP analysis, minimize disputes and resolve them more effectively, all aspects of relevance to the BRI jurisdictions.

1. Taxpayers' Experiences in the TP Areas Leveraging New Technologies in the BRI Jurisdictions

New technologies (e.g., AI, machine learning, and blockchain) at the disposal of taxpayers can help improve transfer pricing analysis by better data collection

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and management, price setting, price testing and benchmarking, compliance and documentation.

In addition, they can improve the effectiveness to deal with changes in the business processes of multinationals (MNEs), such as the ones brought about by the COVID-19 pandemic in BRI jurisdictions. Already new technologies are changing the way that MNEs address their TP functions. These changes bring about challenges for TP Departments of MNEs, which have to adopt new technological tools to comply with the increasing reporting requirements set out by tax authorities. MNEs have implemented technological solutions for TP analyses either by developing these tools in-house or through external commercial off-the-shelf (COTS) applications.

Moreover, although in-house TP departments have to deal with more numerous compliance requirements set out by tax authorities, many MNEs lack the time, resources, knowledge or control over the TP data to deal efficiently with these new requirements. Ideally, taxpayers would leverage technology to face these problems, leaving in-house professionals with more time to focus on value-added tasks, but in reality, the ways in which MNEs mitigate challenges tend to be far from technological.

The quality of the outputs obtained using new technologies depends closely on the quality of the information. Errors in accounting entries might hamper the technology from getting quality results. What is required is to establish harmonized processes with other departments within an MNE (e.g., accounting department) to ensure the quality of the data input.

Some of the technological tools already in use by some MNEs involve:

- documentation management applications for local and master files;
- invoices processors;
- benchmarking tools for qualitative screening;
- tools for analysing TP risks stemming from CbCR requirements;
- repositories of intracompany agreements, rulings and APAs;
- hallmarks reporting tools for the Directive on Administrative Cooperation 6 (Directive 2018/822, DAC); and
- tools to address challenges posed to governments, business and MNEs in implementing the Pillar One of BEPS 2.0 by the OECD.

The implementation of new technologies should take into account the environment in which MNEs operate, especially the value chain and the structure of the organization. A first analysis of this aspect would help in determining what processes should be adopted to retrieve data, make efficient use of new technologies, and clarify the attribution of roles and responsibilities.

The adoption of new technologies for the TP function can provide accurate data from the very beginning, allowing MNEs to expand the scope and frequency in which they carry out their TP activities, e.g., price setting, financial analysis to support TP reports and CbCRs. Furthermore, the ongoing transformation of TP departments due to the adoption of new technologies, allows TP specialists to focus on more substantive aspects, such as fixing the value chain, and evaluating what the commercial reality of a transaction is and how the MNE will change as it extends its BRI activities.

Technology is an enabler to provide good quality information for the tax authorities and helps in getting organized and real-time data before the audits begin. This permits the MNE to defend informed and well-grounded positions and consequently improve the quality of the discussion with the authorities.

All these developments raise the question of whether the tax administrations should audit the technology itself as a part of the Tax Control Framework of MNEs: an unresolved issue.

An important point on the adequacy of new technologies is how they may need adaption as the BRI supply chain expands. The pandemic showed how fast businesses reacted to changes by implementing remote working and changing value chains. When it comes to the adequacy of new technologies to deal with these changes, the answer depends on the flexibility of the technology adopted. However, it is not easy to develop a tool like this in the first

place; thus, data, although powerful, cannot predict business changes, which will be accounted for only with human intervention.

The long-term future of technology for TP in the BRI needs to focus on how in the BRI jurisdictions they can be used to ease the compliance of taxation obligations in such a way that it would not be a burden for the business. In some areas, automation might be possible, particularly where there is repetition, e.g., data reconciliation. In addition, technology can play a role in real-time analytics, forecasting, and avoiding human errors.

2. Tax Administrations' Experiences in the TP Areas Leveraging New Technologies in the BRI Jurisdictions

From the perspective of BRI tax administrations, technology has a two-fold purpose. On one side, technology can be used to deliver better and more efficient services to the taxpayer (the so-called "e-services"). On the other side, technology can be used to analyse the high amount of data collected by tax authorities, i.e., data analytics technologies.

In relation to e-services, BRI tax administrations have been investing time, resources, and budget in the past decades towards the creation of digital applications with the aim to facilitate compliance and interaction with taxpayers, and the BRI jurisdictions have identified some best practices. The earliest examples of e-services are online service portals (for online tax returns filings and payments, for instance), which are now available to taxpayers of several BRI jurisdictions. Other examples of e-services include mobile APPs and compliance communications tools. More recently, pre-populated tax returns and electronic invoicing (e-invoicing) services were introduced in some jurisdictions. It is emphasized that governments should focus on the implementation of e-services, especially integrated e-services (e.g., development of mobile APPs in order to shift from consultation to execution). In this area, Russia, China and United Arab Emirates (UAE) are three good examples of countries that have made important progress in the last few years on the implementation of integrated e-services.

As for data analytics, BRI tax administrations have access to a large amount of data collected through tax returns, assessments, tax collection, automatic exchange of information (AEOI), EU DAC, external sources (utility contracts, bank information, insurance contracts), etc. Authorities need to manage the immense amount of information and data processing is a major challenge for most jurisdictions. The approach taken by some tax authorities focuses on risk analysis and selection of relevant information through advanced analytics techniques, such as machine learning and AI. These techniques allow for a faster and more accurate analysis. In that sense, an increased investment in tools and skills, as well as the IT infrastructure of a government is determinant. It is also important to put together a tax team, which includes professionals with different backgrounds (such as IT professionals, economists and statisticians). Other advanced tools may be considered as well, such as network analysis, text mining and web scraping.

Opportunities to use technology for transfer pricing purposes include detecting deviations from expected prices, detecting relations among companies, finding comparable transactions more efficiently, obtaining relevant information and exchanging it with other jurisdictions, and resolving cross-border disputes (e.g., joint audits, mutual agreement procedures (MAP), and advance pricing agreements (APA)) more efficiently.

An important outcome of applying technology to the tax administrations' processes is to provoke a change in taxpayer behaviour. Tools applied, such as AI, have the capacity of learning to identify recurrent mistakes or fraud attempts made by taxpayers.

One challenge faced by governments is to get access to commercial databases and proprietary software, which are usually developed by a consortium of private companies and often at a high price. Ideally, governments should have shared access to databases and have qualified staff to understand the technology on an equal level as private companies' personnel, perhaps with groups of BRI jurisdictions making a collective approach to the commercial providers.

3. Using New Technologies to Minimise and Resolve Disputes in the BRI Jurisdictions[1]

Technologies may contribute to the effectiveness of the MAP while preserving the necessary security standards.

In the framework of MAP, a customized and personalized system can be achieved by implementing a web application through which a large amount of taxpayer data is gathered, matched with each taxpayer's tax identification number and used to create a profile for each taxpayer. This profile could be accessed by both taxpayers and competent authorities (CAs) by means of a code.

3.1 Cloud Computing

The migration of the web service applications to cloud computing systems would also accommodate economies of scale and allow a significant extension of the above-mentioned services. Cloud computing refers to "a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e. g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction".[2] At its core, cloud computing relies on the sharing of hardware and software by many users, at the same time, from wherever they are located. The administration of a cloud platform requires the optimal allocation of resources among users at any given time. To this end, following a user's request, the administrative program of the cloud platform allocates resources based on availability at the time of request. This requires a calculation of the computing resources required to fulfil the request as well as the total resources available at the time of the request. In order to be able to track resources, copies of the user data and the relevant software are made available to other servers. Whenever a request is submitted to a competent authority, it is directed to whichever server the data of that user and the necessary software are stored on, regardless of the location of the user.

This approach involves a certain amount of risk in terms of the security of the data stored on the servers. The potential security risk might be mitigated by the implementation of additional security measures although this could potentially increase the cost of the cloud service provided and thus, somewhat diminish its benefits. One possible way to reach a compromise between security and cost effectiveness is to make the cloud private instead of public. A private cloud differs from a public one in that the "computing services [. . .] may be offered

1 This section draws upon article on: Sriram Govind, Christina Dimitropoulou & Laura Turcan (2018). Applying Modern, Disruptive Technologies to Improve the Effectiveness of Tax Treaty Dispute Resolution. 46 *Intertax* 11, Part 1.

2 Peter M. Mell & Timothy Grance (2011). *The NIST Definition of Cloud Computing*, https://www.nist.gov/publications/nist-definition-cloud-computing.

either over the Internet or a private internal network but only to select users instead of the general public. It offers many of the benefits of a public cloud — including self-service, scalability, and elasticity — with the additional control and customization available from dedicated resources over a computing infrastructure hosted on-premises. In addition, private clouds deliver a higher level of security and privacy through both company firewalls and internal hosting to ensure operations and sensitive data are not accessible to third-party providers".[3]

ICT can help improve the MAP not just by assisting in the avoidance of disputes, but also by increasing the effectiveness of the MAP process itself.

New technologies can help communication between the taxpayers and the competent authorities of another jurisdiction by minimizing in-person contact. Interactive communication through video conferencing, apart from saving travel costs, may also preserve the effectiveness of a face-to-face meeting. Video-conferencing technology, thus, contributes to the transparency of the procedure between CAs and to building trust.

3.2 Big Data Technology

Big data technology could be applied not only to cut down the costs and duration of the MAP, but also to assist in dispute avoidance, in particular, by using predictive analytics. According to the OECD, "Predictive analytics…aims simply to anticipate likely problems — for instance with the accuracy of a tax return or the timeliness of a payment — so that tax administrations can consider which actions should be taken and when…"[4]

"Big data" may be useful after an MAP request is filed as well. Predictive analytics can be used to cross-check information in tax returns with the information included in the MAP request and automatically flag any differences, thus alerting tax authorities to the potential need for further enquiries in that case. This could help

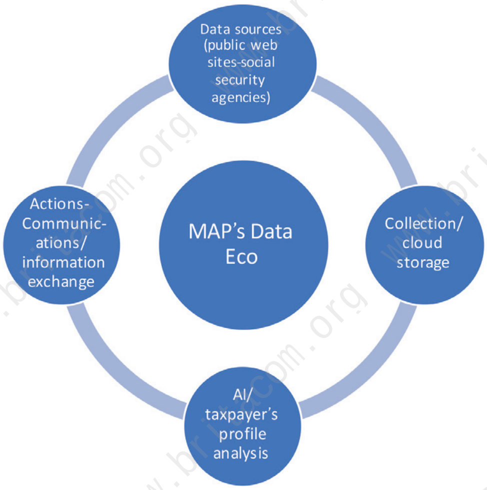

Figure 1. MAP's data ecosystem illustration

save valuable time in the assessment stage of the MAP request.

All of these improvements (see Figure 1) can help minimize the time that competent authorities spend on:

- reading the MAP request sent along by the competent authority;
- retrieving the audit file;
- checking it against the MAP request;
- checking it for additional relevant information;
- compiling the results of the analysis (usually in the form of a standardized report); and
- sending the report to the competent authority.

3.3 Machine Learning

Machine learning, applied to the inventory of MAP cases, could enable the identification of the main drivers of disputes and the types of cases in the inventory. Broadening the scope of the analysis to past cases and how they were resolved would enable the identification of patterns of resolution. Routine cases, for which straightforward solutions were provided, as well as groups of cases involving the same fact pattern with the same partner country, which thus received similar resolutions, could be identified.

3 Microsoft (2021). *What Is a Private Cloud?*, https://azure.microsoft.com/en-us/overview/what-is-a-private-cloud/.

4 OECD (2016). *Advanced Analytics for Better Tax Administration: Putting Data to Work*, https://doi.org/10.1787/9789264256453-en.

Where a case fails to meet the criteria on the admissibility, a standard answer would be produced by the system itself and the case would be considered solved without any human involvement. In case an MAP request is not blatantly inadmissible, but considered low risk, i.e., routine and merely fact-based, an automated response seems feasible.

All these technology-based approaches can reduce the number of pending MAP cases. Thus, potentially, a significant part of the pending MAP cases may be decided through automation. When an MAP request for a more difficult case is received, the software would alert the case worker assigned to the case of the similarity between the current request and past cases. Moreover, by using machine learning, a rough solution could already be suggested based on an extrapolation of the previous solutions and taking into account the specific facts and circumstances involved in the new case. The competent authority would then merely adapt this rough draft of the solution based on his/her own judgment and the special requirements of the case.

Additionally, the identification of patterns in MAP cases based on their level of difficulty, or the competent authorities involved, or similarities in the fact patterns, or even based on the tax official assigned to them, may contribute to an optimized allocation of tasks within the hierarchical structure of the tax administration and thus, significantly increase the effectiveness of the MAP.

3.4 AI

AI could also help the CA with time management concerning MAP cases by sending out the deadline within which the MAP has to be resolved and the timeframes recommended for certain actions. This alert notification would prevent an MAP from being automatically transferred to arbitration and generally accelerate the resolution of cases.

Finally, the automatic electronic assignment would avoid conflicts where a tax official may be assigned multiple cases which expire on the same date and which cannot be handled by the same tax official appropriately. Moreover, taking into account that competent authorities are likely to raise the same arguments in multiple MAP cases across different time periods, or claim the same evidence documentation, AI could have a valuable contribution in allowing for a more accurate and much swifter retrieval of information about previous arguments made and the documentation used in supporting them, thus increasing time and cost efficiency.

3.5 Web Portal

The use of a web portal in the framework of MAP would allow far-ranging customization of tax services based on the individual taxpayer's profile, which would encompass all data available on that taxpayer in the tax administration system, including data gathered from the MAP requests. In addition, web-based applications aid in ensuring continuity of records, especially in developing countries where the staff in charge of MAPs frequently changes.

The web portal for MAP might, for instance, be partially based on the case management system used in many jurisdictions for judicial case management. Again, any costs would need to be shared among jurisdictions to permit the participation of developing countries. Such a well-secured public cloud would provide the same advantages as a private cloud.

3.6 Capacity Building

The importance of capacity building through training and similar initiatives should also be emphasized. Sophisticated technologies may aid in this process such as training through video conferencing, the use of big data to assign training modules and evaluate the performance of staff (including provision of incentives), the use of AI to improve and develop training models, etc. Ideally these programs will take a format of multilaterally e-training systems under the framework of the BRITACOM program for capacity building, especially the BRITACEG. In this respect, the work of the BRI training program on international tax cooperation in developing such online training modules that are made available to developing countries must be commended.

An Overview of CFC Rules and Their Application in SAARC Regions

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Abstract: A Controlled Foreign Company (CFC) is a company set up to do business in a foreign jurisdiction by a multinational company (MNC). There is a tendency among the MNCs to erode the tax base and shift profits to no- or low-tax jurisdictions and defer the payment of tax on foreign source income by holding funds in CFCs abroad. CFC rules are adopted to prevent MNCs from being involved in such activities. Under these rules, the income of a foreign CFC is deemed to be distributed to its shareholders at the end of each tax year and residents are taxed on the part of their income when it is earned, even though it is yet to be distributed by the CFC. By now, CFC rules have been implemented by about 60 jurisdictions, including three out of eight South Asian Association for Regional Cooperation (SAARC) member countries. Whether the other SAARC countries should adopt CFC rules depends upon the conditions of a particular jurisdiction. They may not be applied in some jurisdictions which do not have serious BEPS activities or deferral of tax payments by residents on their income earned through a foreign CFC.

Keywords: CFC rules; MNC; Control; BEPS activities; SAARC regions

1. Background

A multinational company (MNC) can set up a subsidiary in a foreign jurisdiction to carry out its business. A subsidiary is treated as an independent legal entity separate from the MNC (i.e., parent company). An MNC, which is required to pay taxes on its worldwide income, does not have to pay taxes on the income generated through its foreign subsidiary until the income is distributed by the subsidiary to the MNC in the form of dividends. An MNC can defer or reduce the payment of taxes on foreign source incomes by creating a subsidiary in a no- or low-tax jurisdiction and retaining the income of its subsidiary in a foreign jurisdiction for a long time. By doing so, an MNC can reduce its effective tax rate due to the time value of money.

This can be illustrated with another example. Let us suppose the US based MNC decides to invest in the XYZ Company resided in Mexico in order to expand its business. If MNC invests directly in XYZ Company, then it will have to pay taxes on the dividends received from the XYZ Company. In order to avoid the payment of taxes, MNC creates a shell company by the name of PQR Company in Bermuda and invests in XYZ Company through PQR Company. Dividends distributed by XYZ Company to PQR Company are not subject to taxes in Bermuda as there is no corporate income tax. PQR Company, instead of distributing dividends to the MNC, retains profits for a long time to reduce or defer the US tax liability of the MNC.

It has been common among the MNCs to set up foreign companies in no- or low-tax jurisdictions to avoid or defer the payment of domestic taxes by holding foreign source income abroad for a long time as it is not taxed until it is received by the MNC in the form of dividends. It has aggravated the problem of tax base erosion and profit shifting (BEPS) and revenue loss in different jurisdictions.

In this situation, controlled foreign company (CFC) rules are developed to discourage BEPS activities and avoidance or deferral of payment of taxes by MNCs (resident shareholders/taxpayers) on foreign source income. Under these rules, MNCs are required to pay taxes on income derived by CFCs in the year when it is accrued rather than when it is distributed. As a result, MNCs cannot avoid domestic tax on foreign source income by diverting it to a subsidiary established in no- or low-tax jurisdiction.

2. Introducing CFC

2.1 A Brief Introduction

A CFC can simply be defined as a foreign company that is either directly or indirectly controlled by a resident taxpayer.[1] Investopedia defines a CFC as "a corporate entity that is registered and conducts business in a different jurisdiction or country than the residency of the controlling owners".[2] BEPS Action 3 recommends adopting a broad definition of CFC to include, in addition to corporate entities, "certain transparent entities and permanent establishments (PEs) if those entities earn income that raises BEPS concerns and those concerns are not addressed in another way".[3]

In general, a company established to do business in a foreign jurisdiction by a domestic company is a CFC. It may be defined broadly to include, in addition to a subsidiary company, a trust, a partnership firm, or a PE of a resident company "to ensure that companies in the parent jurisdiction cannot circumvent CFC rules just by changing the legal form of their subsidiaries".[4]

2.2 Criteria to Determine Control

The concept of control is critical to the CFC rules. Control may be legal, i.e., the ownership of shares of the CFC, or economic, i.e., the right to the profits, as well as capital or assets of a CFC in certain circumstances such as dissolution or liquidation.[5] Another important aspect of control is the appropriate level of control threshold. BEPS Action Plan 3 recommends a control threshold of more than 50%. In practice, while generally a CFC is treated as controlled when residents hold 50% or more, some jurisdictions use thresholds above or below 50%. For example, most European jurisdictions treat a foreign subsidiary as a CFC if one or more related domestic companies own at least 50% of the foreign subsidiary.[6] On the other hand,

1 https://qdd.oecd.org/subject.aspx?Subject=CFC.

2 https://www.investopedia.com/terms/c/cfc.asp.

3 OECD/G20 (2015). *Base Erosion and Profit Shifting Project (BEPS), Designing Effective Controlled Foreign Company Rules, Action 3-2015 Final Report*, pp.24.

4 Ibid., at 21.

5 Ibid.

6 Zvinys A. Kristina (2020). *CFC Rules in Europe, Tax Foundation*, https://taxfoundation.org/controlled-foreign-corporation-rules-cfc-rules-in-europe-2020/.

while a foreign corporation is defined as a CFC if more than 50% of its vote or value is owned by residents in the United States,[7] under the Finnish CFC rules the control is established if the Finnish person/company either alone or together with related parties has a control of at least 25%.[8]

The level of control could be established either through the interest maintained by a single resident shareholder in the CFC or "through the aggregated interest of related parties or unrelated resident parties or from aggregating the interests of any taxpayers that are found to be acting in concert".[9] It is also common to fix a minimum threshold for the ownership for each shareholder in order to establish control over the CFC. For example, in the United States the interests of all residents in the CFC are aggregated so long as each interest is higher than 10%.[10]

Control may be direct or indirect through one or more non-resident interposed companies. For instance, in the example given in Section 1, if an MNC has a direct control over PQR Company and PQR Company has a direct control over XYZ Company, then the MNC has an indirect control over XYZ as it maintains control over XYZ through an interposed entity, i.e., PQR Company. CFC rules generally apply to both the direct and indirect control.

2.3 Exceptions to CFC Rules

CFC rules do not apply to each and every foreign company controlled by a resident or income earned by a foreign company that is under the control of a resident. Generally, CFC rules apply only to those foreign companies which are set up by domestic taxpayers to avoid or defer tax liability. From another angle, they generally do not apply to a foreign company that is established for a genuine purpose. Different jurisdictions have adopted different criteria regarding the exemptions of CFC rules. A synopsis of these criteria is given below:

(i) Control test: CFC rules do not apply to those foreign companies when direct and indirect capital or voting rights held by a resident person in that company is less than a specified percent, or if a resident person is entitled to receive less than a specified percent, generally less than 50% of the profits and capital or assets of that company. For example, the German CFC rules do not apply when a German-resident shareholder owns below 50% of the foreign company.[11]

(ii) Income/profit test: An income test has several dimensions. In some jurisdictions such as Austria, the Czech Republic, Germany, Greece, Lithuania, the Netherlands, Slovenia, and Spain, CFC rules do not apply when the foreign company realizes active income only.[12]

Active income exemption can take a transactional or entity approach. Under the transactional approach, each individual item of income derived by a CFC is examined to determine whether it is active and the active income stream is exempt from the tax. On the other hand, under the entity approach, a CFC that is engaged primarily in industrial and commercial activities is treated as an active CFC and its entire income is exempt from attribution, irrespective of the actual nature of any specific item of income.[13]

7 Scott P. Michelle (2021). *Global Intangible Low-Taxed Income (GILTI)*, https://www.investopedia.com/global-intangible-low-taxed-income-gilti-definition-5097113#citation-1.

8 PWC (2021). *Finland, Corporate - Group taxation*, https://taxsummaries.pwc.com/finland/corporate/group-taxation#:~:-text=According%20to%20the%20old%20CFC,control%20of%20at%20least%2025%25.

9 OECD/G20 (2015). *BEPS, Action 3-2015 Final Report*, pp.21.

10 Ibid., at 27.

11 Dueñas Sebastian (2019). CFC Rules around the World. *Tax Foundation, Fiscal Fact* 659, pp.22.

12 https://taxfoundation.org/controlled-foreign-corporation-rules-cfc-rules-in-europe-2020/.

13 *The Tax Treatment of New Zealand Firms' Offshore Subsidiaries NZ*, pp.143-144, http://www.nzlii.org/nz/journals/AukULawRw/2009/6.pdf.

Some jurisdictions have adopted De Minimis threshold where CFC rules do not apply when the profit or income of a CFC is below a certain amount. For example, according to Article 7 of the 2016 Anti-Tax Avoidance Directive (ATAD) of the European Union (EU), CFC rules do not apply if the accounting profits of a CFC are less than EUR750,000, and non-trading income is less than EUR75,000; or if the accounting profit is less than 10% of its operating costs for the tax period.[14]

(iii) Active/substantial economic test: Foreign companies controlled by a resident can be exempt from CFC rules on the basis of the presence of active/substantial economic activities.[15] Under these rules, CFC engages in substantive economic activities such as industrial, manufacturing, commercial, and shipping business through an office, a shop or a factory with staff, equipment and assets, which can be exempt from the CFC rules.

(iv) Public quotation test: If a foreign company's shares are traded on a stock exchange recognized by law of a jurisdiction where the CFC is a resident for tax purpose, this company may also be exempt from CFC rules. For example in Ukraine, CFC rules do not apply to a public company traded on a stock exchange.[16]

(v) Location test: Some jurisdictions also use a location test to exempt a foreign company from the CFC rules, though location is defined in different ways. For example, in Spain, the CFC rules do not apply to EU resident companies.[17] Australia has adopted a "white list" approach where companies resident in jurisdictions with an income tax system comparable to Australia's tax system are exempt from CFC rules.[18] When the CFC rules were first introduced in New Zealand, they were not applied to foreign companies which were resided in one of the seven "grey-list" jurisdictions, viz., Australia, Canada, France, Germany, Japan, the UK and the USA.[19] The UK CFC rules exempt a foreign subsidiary of a UK resident which is resident in one of the "excluded territories", where the income tax rate applied to a CFC exceeds 75% of the UK corporate income rate. In contrast, Kazakhstan exempts foreign companies from CFC rules that are registered in jurisdictions with which Kazakhstan has concluded tax treaties.

(vi) Taxation test: Taxation test is used to exempt companies/income from different ways. Some jurisdictions exempt those foreign companies from CFC rules, if they are located in a jurisdiction where the nominal corporate income tax rate is equal to or above the specified percent of the home jurisdiction corporate income tax rate. Some jurisdictions compare the actual tax burden of a foreign company with what would have been the tax payable if the domestic tax applied to that company, in order to decide whether to exempt that company from domestic tax liability. For example, under the Spanish CFC rules, income derived from foreign subsidiaries is not subject to taxation in Spain if the corporate income tax effectively paid is more than 75% of the Spanish tax.[20]

(vii) Motive test: A foreign company cre-

14 Article 7(4) of the Council Directive (EU) 2016/1164 of 12 July 2016 lays down rules against tax avoidance practices that directly affect the functioning of the internal market.

15 https://qdd.oecd.org/subject.aspx?Subject=CFC.

16 https://www.mondaq.com/tax-authorities/968468/controlled-foreign-companies-cfc-rules-in-ukraine.

17 Dueñas Sebastian (2019). CFC Rules around the World. *Tax Foundation, Fiscal Fact* 659, pp.27.

18 There is a practice to include high-tax jurisdictions in the "white list" and exempt CFCs resided in these jurisdictions from CFCs rules. On the contrary, no or low tax jurisdictions are included in the "black list" and CFCs resided in these jurisdictions are subject to CFC rules.

19 Smith Andrew M C and Sawyer Adrian J. (2020). Chapter 25 Controlled Foreign Company Legislation in New Zealand, in *Controlled Foreign Company Legislation*, International Bureau of Fiscal Documentation, pp.466, https://www.researchgate.net/publication/345749213_Chapter_25_Controlled_Foreign_Company_Legislation_in_New_Zealand.

20 Dueñas Sebastian (2019). CFC Rules around the World. *Tax Foundation, Fiscal Fact* 659, pp.27.

ated for genuine reasons is exempt from CFC rules. These rules apply to a company where there is a tax avoidance motive or purpose.[21] For example, the CFC rules in the ATAD aim to tax undistributed income of the CFC from non-genuine arrangements that have been put into place to obtain tax advantage. CFC rules of several jurisdictions including Belgium, Estonia, Hungary, Ireland, Latvia, Luxembourg, and Slovakia apply to all income associated with non-genuine arrangements.[22]

(viii) Other tests: Some jurisdictions apply other tests to exempt CFC from CFC rules. For example, in Ukraine, CFC rules do not apply to a CFC if it is a charitable organization.[23] Moreover, CFC rules may not apply to a foreign company that regularly distributes its profit to its parent. For example, in China, CFC rules apply to a foreign company if it does not distribute, or insufficiently distributes its profits without justifiable operational reasons.[24]

CFC rules do not apply to those CFCs that pass one or more of the aforementioned tests specified by the jurisdiction concerned.

2.4 Definitions of Income

Generally CFC rules apply to the passive income, which is defined as income generated through non-traditional production activities such as income from capital gains, dividends, interest, rents, or royalties.[25] Such incomes are highly mobile and not location-specific as their derivation generally requires little or no physical activity on the part of the income earner.[26] For example, in the example in Section 1, the MNC may transfer its ownership of shares of XYZ Company to PQR Company, which then receives dividends from XYZ company resided in Mexico and can retain them for a long period to avoid or defer the US tax. By the same token, a resident MNC can transfer or license patents or trademarks to PQR located in Bermuda which in turn licenses to related or unrelated foreign parties and can receive royalties which it can accumulate for a long time without distributing it to its parent company i.e., US MNC. Similarly, it is easy to shift interest and financing income by the parent into the CFC, possibly leading to over-leveraging of the parent and overcapitalization of the CFC.[27] These activities ultimately erode the domestic tax base.

As there is a risk of shifting passive income by the resident of a high-tax jurisdiction into a subsidiary under its control that is resided in the no- or low-tax foreign jurisdiction, resulting in the decline in the domestic tax base, many jurisdictions around the world have taken an approach to tax passive income of a CFC in the jurisdiction of the resident shareholder when it accrues, even though it was not repatriated by the CFC to the resident shareholder.[28]

In general, the CFC rules attribute the passive income as it accrues in a CFC — even if it is not distributed — to the resident sharehold-

21 OECD/G20 (2015). *BEPS, Action 3-2015 Final Report*, pp.33.

22 Zvinys A. Kristina (2020). CFC Rules in Europe. *Tax Foundation*, https://taxfoundation.org/controlled-foreign-corporation-rules-cfc-rules-in-europe-2020/.

23 Eurofast Global Ltd (2020). *Ukraine: Controlled Foreign Companies (CFC) Rules in Ukraine*, https://www.mondaq.com/tax-authorities/968468/controlled-foreign-companies-cfc-rules-in-ukraine.

24 Jiang Allan (2020). How Controlled Foreign Corporation Rules Works in China. *China Tax*, https://www.linkedin.com/pulse/how-controlled-foreign-corporation-rules-works-china-allan-jiang/?trk=read_related_article-card_title.

25 https://qdd.oecd.org/subject.aspx?Subject=CFC.

26 *The Tax Treatment of New Zealand Firms' Offshore Subsidiaries*, pp.140-141, http://www.nzlii.org/nz/journals/AukULawRw/2009/6.pdf.

27 OECD/G20 (2015). *BEPS, Action 3-2015 Final Report*, pp.44.

28 *The Tax Treatment of New Zealand Firms' Offshore Subsidiaries*, pp.140-141, http://www.nzlii.org/nz/journals/AukULawRw/2009/6.pdf.

ers as per their proportionate ownership or influence on the CFC. The resident shareholders become taxable on this attributed income in the jurisdiction where it is resident for tax purposes.[29] Income is computed as per the rules of the parent jurisdiction rather than the rules of the CFC jurisdiction. On the other hand, CFC losses are permitted to be used only to offset the profits of the same CFC or other CFCs in the same jurisdiction.[30] Any taxes levied on such income in the CFC jurisdiction should be credited against the residence jurisdiction tax to prevent or eliminate the risk of double taxation.[31]

3. The Application of CFC Rules

CFC rules were first developed by the US in the 1960s and have since then been spreading around the globe. In 1996, The Organization for Economic Co-operation and Development (OECD) Report on Controlled Foreign Company Legislation indicated that 14 OECD member countries had already implemented CFC rules by the late 1990s.[32] The widespread use of CFC rules was influenced by the 1998 OECD Report on Harmful Tax Competition,[33] which recommended that jurisdictions not having CFC or equivalent rules "consider adopting them and jurisdictions that have such rules ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices".[34] According to Arnold and Dibout, 23 jurisdictions had adopted a CFC regime by 1 January 2001.[35]

CFC rules have attracted even more attention after the issuance of the OECD BEPS Report in 2015. BEPS Action Plan 3 advocates for the comprehensive and effective CFC rules to reduce the incentive to shift profits from a market jurisdiction into a low-tax jurisdiction[36] and defer tax liability by a domestic company. Besides, ATAD has also influenced the application of CFC rules.[37] According to Article 11 of the ATAD, all member states of the EU must have adopted and published the necessary national laws to comply with the Directive by 31 December 2018, and these national measures should have been applied from 1 January 2019.

CFC rules actually have become a standard part of the international tax systems of many jurisdictions, including a few members of the South Asian Association for Regional Cooperation (SAARC).[38] As indicated in Table 1, they have been implemented by 59 jurisdictions by 2021.

29 Council Directive (EU) 2016/1164 of 12 July 2016 lays down rules against tax avoidance practices that directly affect the functioning of the internal market.

30 OECD/G20 (2015). *BEPS, Action 3-2015 Final Report*, pp.10.

31 Ibid., at15.

32 OECD (1998). Harmful Tax Competition: an Emerging Global Issue. *Organization for Economic Cooperation and Development*, pp.41.

33 Arnold Brian J. (2019). The Evolution of Controlled Foreign Corporation Rules and Beyond. *Bulletin for International Taxation*, pp.631.

34 OECD (1998). Harmful Tax Competition: an Emerging Global Issue. *Organization for Economic Cooperation and Development*, pp.67.

35 Dunbar David, A Historical Review of the CFC & FIF Regimes: Part One 1987 to 1 December 2003. Working Paper No. 13 pp.37, extracted from Brian J Arnold and Patrick Dibout (Franc) Cahiers – de droit fiscal International. International Fiscal Association 2001 San Francisco Congress VOL LXXXVII pp25-88, at pp28 and 59.

36 https://qdd.oecd.org/subject.aspx?Subject=CFC.

37 Directives Council Directive (EU) 2016/1164 of 12 July 2016 lays down rules against tax avoidance practices that directly affect the functioning of the internal market.

38 Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka are members of the SAARC.

Table 1: The widespread use of CFC rules

Year	Jurisdiction	Cumulative number	Year	Jurisdiction	Cumulative number
1962	USA	1	2002	Nepal	25
1972	Germany	2	2003	Israel	26
1976	Canada	3	2004	Lithuania	27
1978	Japan	4	2006	Turkey	28
1980	France	5	2008	People' s Republic of China	29
1984	UK	6	2010	Iceland	30
1988	New Zealand	7	2013	Latvia (2013-natural person; 2019-company), Peru	32
1989	Sweden	8	2014	Greece, Chile	34
1990	Australia	9	2015	Poland, Russia	36
1992	Norway	10	2016	Columbia, Taiwan of China	38
1995	Brazil, Denmark, Finland, Indonesia, Kazakhstan, South Korea, Portugal, Spain	18	2017	Belgium, Indonesia	40
1997	Hungary, Mexico, South Africa	21	2018	Liechtenstein, Romania, Slovak Republic	43
1999	Argentina	22	2019	Austria, Bulgaria, Czech Republic, Croatia, Cyprus, Gibraltar, Ireland, Malta, Mauritius, Pakistan, Luxembourg, Slovenia, The Netherlands	56
2000	Estonia	23	2020	Maldives, Mongolia	58
2001	Italy	24	2021	Ukraine	59

Sources: (i) https://qdd.oecd.org/data/CFC/.ALL; (ii) https://taxfoundation.org/controlled-foreign-corporation-rules-around-the-world-united-states/; and (iii) https://taxfoundation.org/controlled-foreign-corporation-rules-cfc-rules-in-europe-2020/.

4. The Application of CFC Rules in the SAARC Region

CFC rules have not been popular in the SAARC region. Of the eight member countries, only Nepal, Pakistan and Maldives have adopted these rules. While Nepal adopted CFC rules before the issuance of BEPS Action Plan 3 in 2015, Pakistan and Maldives adopted these rules in recent years.

4.1 Nepal

Nepal is the first country in the SAARC region to adopt CFC rules. It introduced these rules in 2002 when the new Income Tax Act

2002 was adopted. Under this act, a CFC is defined as a non-resident company in which an associated resident person holds an interest, directly or indirectly through one or more interposed non-resident companies. Similarly, a non-resident company is also treated as a CFC if the associated person and the not more than four other associated resident persons hold an interest, directly or indirectly through one or more interposed non-resident companies.[39] Thus under the Nepalese CFC rules, a foreign company controlled by one or a small group of Nepalese resident taxpayers is defined as a CFC.

A CFC is treated as distributing its unallocated income/dividends to its beneficiaries at the end of each income year. The distribution is assumed to be made proportionately in accordance with the beneficiaries' rights to that income upon distribution. If those rights are not reasonably certain, the distribution of income by a CFC to its beneficiaries will be done in such a manner as the Inland Revenue Department of Nepal thinks appropriate in the circumstances. Dividends distributed during an income-year, except those deemed distributions of unallocated income to beneficiaries of a CFC, are exempt from tax. Foreign tax relief may be available to the resident shareholders.

It is internationally common to define control as a situation where a resident shareholder holds an interest of 10%, or more resulting in a single or combined ownership of 50%, or more in a CFC. Such a provision of aggregating interests of all residents in the CFC so long as each interest is higher than 10% facilitates the attribution of income to resident shareholders. However, the Nepalese CFC rules fail to fix the minimum percentage of ownership of a Nepalese-resident shareholder in the foreign company. They rather focus on the number of owners, which should not be more than five. This means a Nepalese resident will be subject to CFC rules regardless of his ownership percentage in the CFC, which raises administrative and compliance concerns. Similarly, the provision, saying that when the beneficiaries' rights are not reasonably certain, the distribution of income by a CFC to its beneficiaries will be done as per manner specified by the Inland Revenue Department, is also a matter of concern from a taxpayer's point of view.

Besides, the Nepalese CFC rules lack many elements of current CFC regimes adopted by different tax jurisdictions. For example, they do not provide exemptions to active income or businesses, publicly listed companies or companies that are located in high or comparable tax jurisdictions. The scope of CFC rules is unnecessarily wide. The bona fide businesses as well as tax administration will have to unnecessarily bear more onerous compliance and administrative burden.

It is not internationally common to apply CFC rules to all types of foreign companies controlled by residents, or all kinds of income generated by foreign companies controlled by resident shareholders. It is, therefore, necessary to align the Nepalese CFC rules with the rest of the world by defining a CFC as a foreign corporation in which more than 50% of the vote or value is owned by the Nepalese shareholders who each owns 10% or more of the CFC during any day of the taxable year and introduces different kinds of exclusion tests.

4.2 Pakistan

Pakistan introduced CFC rules through the income tax law in 2018, which became effective from tax year 2019. Under these rules a non-resident company is treated as a CFC if:

- more than 50% of its capital or voting rights are held, directly or indirectly, by one or more persons resident in Pakistan, or more than 40% of its capital or voting rights are held, directly or indirectly, by a single resident person in Pakistan;
- in the jurisdiction of which it is a resident, it does not pay taxes equal to or more than 60% of taxes payable in Pakistan;
- it does not derive active business income;

39 The Income Tax Act 2002 Section 69.

and

- it is not a listed company in the jurisdiction of which it is a resident.

A foreign company is not subject to CFC rules if:

- direct and indirect capital or voting rights held by the resident person is less than 10% in the foreign company;
- foreign company's income is less than Rupees 10 million; and
- shares of the foreign company are traded on any stock exchange of the jurisdiction where it is a resident.

Income of a CFC is determined according to the income tax law in Pakistan as if that CFC is a resident taxpayer. Income attributable to the CFC is included in the taxable income of a resident person for a tax year and taxed at the rate applicable to dividend income, i.e., 15%. As income attributable to the CFC is taxed prior to distribution, no further tax is levied at the time of actual distribution.[40] In order to avoid double taxation, the resident person is allowed a tax credit equal to the lesser of (i) foreign tax paid on the dividend; and (ii) tax payable in Pakistan for the tax year in which the dividend is received by the resident taxpayer.[41]

4.3 The Maldives

The Maldives became the third country to introduce CFC rules in the SAARC region. Under the Income Tax Act 2019, a foreign company, partnership, trust or other entity is treated as a CFC when five or fewer tax residents of the Maldives have a controlling interest in it.[42] A resident of the Maldives that holds a share in the capital of the foreign entity must include in its taxable income, with its share of the taxable income of the foreign company prior to distribution. CFC's income is calculated and taxed in accordance with the provisions of Maldives' Income Tax Act 2019. Any amount included in the taxable income of a resident of Maldives is not included in its taxable income when the CFC distributes any of that income to the resident taxpayer.

4.4 Other SAARC Countries

Five of the eight SAARC member countries have not adopted CFC rules. Whether these countries should adopt CFC rules depends upon the conditions of a particular country. One of the important elements to determine the need to introduce the CFC rules is the volume of outbound investment of a jurisdiction. For instance, some jurisdictions with no or little foreign investment and weak tax administration may not need to introduce complicated CFC rules.[43] By contrast, CFC rules may be required in a large economy like India where not only big Indian companies have subsidiaries abroad, but also many foreign companies have been creating parent companies in India which may have subsidiaries in various foreign jurisdictions. In this way, CFC rules may be introduced to prevent MNCs from eroding the tax base and shifting profits to no- or low-tax jurisdictions and to prevent the deferral of payment of tax on foreign source income by MNCs.

5. Concluding Remarks

A CFC is a company set up to do business in a foreign jurisdiction by an MNC. There is a tendency among the MNCs to establish a subsidiary in a no- or low-tax jurisdiction to avoid or defer the payment of taxes. CFC rules are developed to prevent MNCs from being involved in BEPS activities and deferring the payment of domestic tax on "income earned by and accumulated in CFCs until that income

40 https://taxsummaries.pwc.com/pakistan/corporate/group-taxation#:~:text=Controlled%20foreign%20companies%20(CFCs)&text=A%20company%20shall%20be%20classifiable,a%20single%20Pakistani%20resident%20person.

41 Section 109a (11) of the Income Tax Ordinance (2001). Amended up to 30 June, 2020.

42 Section 70 of the Income Tax Act 2019.

43 https://files.taxfoundation.org/20190617100144/CFC-Rules-Around-the-World-FF-659.pdf. pp.33.

is distributed to the resident shareholders of the CFC".[44] Under these rules, the income of a foreign CFC is deemed to be distributed to its shareholders at the end of each tax year and residents are taxed on the part of their income when it is earned, even though it is yet to be distributed by the CFC. Residents do not have to pay taxes on the income when it is actually distributed.

CFC rules were first created in the US in 1962 and have been adopted by about 60 jurisdictions around the globe by 2021. It is mandatory for 27 EU member states to adopt CFC rules. Of the 37 OECD member countries, all have implemented CFC rules except Switzerland. Apart from OECD countries, large economies like China, Russia, Brazil, South Africa, Pakistan and Indonesia have adopted CFC rules. These rules also have been introduced by landlocked jurisdictions like Nepal and Mongolia and island jurisdictions like the Maldives. These rules have largely concentrated on the developed capital exporting jurisdictions which encounter issues related to BEPS and the deferral of payment of taxes by MNCs.

CFC rules have not been common yet in the SAARC region, where out of the eight member countries only Nepal, Pakistan and Maldives have adopted CFC rules without enforcing them. Although these jurisdictions have used CFC rules, they do not contain various elements of good international practices developed particularly after the issuance of the BEPS Action Plan 3. Whether the remaining SAARC countries should adopt CFC rules relies on the specific situations of a particular jurisdiction, such as the volume of their outbound investment. These rules may not be applied in some jurisdictions which neither make much foreign investment, nor have serious BEPS activities or deferral of tax payment by residents on their income earned through a foreign CFC.

44 Arnold Brian J. (2019). The Evolution of Controlled Foreign Corporation Rules and Beyond, *Bulletin for International Taxation*, pp.633.

Article 5 of the OECD Model Convention: Overview and Open Issues

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Abstract: Even though Article 5 is one of the most relevant and long-standing articles of the OECD model, its application often tends to raise issues. This is given by the circumstance that the application of this article heavily depends on the interpretation of both factual and legal circumstances and that there are still several open issues that were never clearly dealt with by the OECD Commentary. Finally, even though the last amendments made to Article 5 (especially to the agency permanent establishment rules) seem to be effective in order to counteract some common practices used to avoid giving rise to a permanent establishment, such amendments fall short of tackling the main challenge of our time: the digitalisation of economy.

Keywords: Permanent establishment; Article 5 of the OECD Model; BEPS Actions; Digitalisation of the economy

1. Foreword

Article 5 is one of the most known and studied articles of the OECD Model Convention. However, the application of the article still raises several issues. That is mainly due to the circumstance that several terms used in Article 5 are not defined in the OECD Model Convention and also that the presence of a permanent establishment (PE) needs to be assessed by taking into consideration both legal and factual features.

Recently, the OECD amended Article 5 in order to tackle some particular schemes aimed at avoiding the existence of a PE in foreign Countries as well as to tackle some of the challenges arising from the new ways business is carried out.

This article aims at providing an overview of Article 5 at stake as it is reported in the 2017 version of the OECD Model Convention.

2. The Permanent Establishment Article: Overview

With the term "permanent establishment", the OECD Model Convention identifies a minimum standard of territorial connection with a given State. In other words, a permanent establishment represents a minimum threshold of presence in a given State; above such threshold presence, from a political tax standpoint, the OECD Countries have deemed it acceptable for a State to tax a foreign enterprise.[1]

Throughout the years and the amendments made by the OECD to the Articles of the Model Convention, Article 5 did not suffer from a lot of amendments.

Article 5 of the OECD Model of 1963 differs in three respects from 2017 version:

a) for the presence of a single "positive list", it contains the hypotheses that constitute the permanent establishment, which in the subsequent models finds a separate discipline in paragraph 3;

b) for the presence of a "negative list" that contains the cases of exclusion except for the combination of activities of a preparatory or auxiliary nature, provided instead currently in letter f) of paragraph 4; and finally

c) for the aspect in derogation of the configuration of the permanent establishment in the case of the *agent clause*.[2]

It is important to note that, even though these were the main (yet not material) differences between the first and the last draft of Article 5, some minor differences in the language of the provisions existed as well.

Such differences, if relevant, will be analyzed in the following paragraphs where a brief overview of the paragraphs of Article 5 will be carried out.

2.1 Para. 1: The Definition of (Physical) Permanent Establishment

The first paragraph of Article 5 of the OECD Model contains the definition of the term "permanent establishment".

In particular, a permanent establishment is defined as a fixed place of business through which the business of an enterprise is wholly or partially carried on.[3]

It is important to note that each and every term inserted in the language of the provision has its own relevance and contributes to defining the criteria and requirements that need to be fulfilled in order for a PE to be deemed to exist.

From the way the Article was amended throughout the years, it was possible to assert that the OECD was very careful in choosing the language of the provision, for example, after 1963 the words "in which" were changed into "through which".

The second wording differs from the first as it made it clearer that the fixed place of business needs to be instrumental to the activity carried out whereas the first wording was somewhat more restrictive and emphasized the circumstance that certain activities must be carried out at a certain location. However, for the purposes of the concept of permanent establishment it is not relevant that a business activity is carried out within a structure, but it is more relevant that the structure is instrumental to the exercise of the business activity.

Going forward with analysis of the language of para. 1, it seems clear that the requirements considered essential for the existence of a permanent establishment are: a) the presence of a "place of business"; b) the permanence of such "place of business" from geographical and temporal points of view; and c) the circumstance that a business activity must be carried out "through" that "place of business".[4]

The term "place of business" has a very broad scope and it should be deemed to include all different kinds of premises, infrastructures, etc.[5] With this respect, it is irrelevant whether or not the foreign enterprise qualifies as the le-

1 On this, refer to B. Arnold (2003). Threshold Requirements for Taxing Business Profits under Tax Treaties. *Bulletin for International Taxation* 10.

2 S. Mayr & B. Santacroce (2016). *La stabile organizzazione delle imprese industriali e commerciali*. (II ed.). Milano, pp.8.

3 OECD (2017). *Model Tax Convention on Income and on Capital*. art. 5, par. 1.

4 OECD Commentary 2017, para. 10.

5 As it was highlighted by the doctrine "Therefore, any 'space' used by the foreign company for the conduct of its business would integrate the requirement of a material permanent establishment". S. Mayr & B. Santacroce (2016). *La stabile organizzazione delle imprese industriali e commerciali*. (II ed.). Milano, pp.19 (unofficial translation).

gal owner of the relevant "place of business".[6] What actually matters is the circumstance that the premises are at the disposal of the foreign enterprise.

In addition, going forward to analyze the second main requirement for the assessment of the presence of permanent establishment, the "place of business" must have the character of "fixed" from both geographical and time perspectives.

From a geographic standpoint, the "place of business" must be located in a precise "geographical point" in the territory where the permanent establishment operates.[7]

With respect to timing issues, the "place of business" should not have a merely temporary nature, i.e., it has to have a certain degree of permanence.[8] However, the OECD Model does not provide for a minimum time threshold beyond which a permanent establishment is deemed to exist, except for the case of a "construction site" permanent establishment. On the basis of the experience gained by various tax authorities, the Commentary specifies that the hypothesis of a physical permanent establishment should not apply if the presence in the territory lasts for a period not exceeding six months.[9]

However, as the Commentary clarifies, a "place of business" is not considered temporary if it is used for short periods of time. This brief use takes place regularly on an annual basis for several years.

Finally, with regard to the third requirement, namely, the fact that the non-resident company carries out all or part of its activity through this fixed place of business, a link is required between the activity carried out by the fixed place of business and the activity carried out by the foreign company.[10]

It is also important to underline that the presence of personnel operating on a permanent basis within the fixed place of business is not in itself a determining characteristic for the purposes of the configuration of the permanent establishment. In fact, a permanent establishment can also exist when the business activity is carried out mainly by means of automatic equipment that requires staff only for its installation, control and maintenance. Therefore, automatic equipment can constitute a permanent establishment if the foreign company carries out, through it, an activity that goes beyond the mere initial installation, except in the case where it transfers the use of the equipment to third parties.[11]

2.2 Para. 2: The Positive List

The second paragraph of Article 5 of the OECD Model states that the term "permanent establishment" includes: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop; and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.[12]

As of the 1977 OECD Model, this list became merely an example whilst the original 1963 Commentary considered the above examples to be given rise to a permanent establishment a priori.

Accordingly, after 1977, in order for each and every example set forth in para. 2 to con-

6 K. Vogel (1991). *Double Taxation Conventions*. Kluwer, pp. 205: The fixed place of business must be more than merely temporary at the enterprise's disposal. A fixed place of business owned by an enterprise but placed at the disposal of a third party for the latter's own (and hence not for the enterprise's) would not be a permanent establishment of the enterprise.

7 OECD Commentary 2017, para. 21.

8 OECD Commentary 2017, para. 10.

9 OECD Commentary 2017, para. 10; A. Dragonetti, V. Piacentini & A. Sfrondini (2016). *Manuale di fiscalità internazionale*. Milano, pp. 96.

10 OECD Commentary 2017, para. 46.

11 K. Vogel (1991). *Double Taxation Convention*. Kluwer, pp. 208.

12 OECD (2017). *Model Tax Convention on Income and on Capital*. art. 5. par. 2.

stitute a permanent establishment, it is necessary that all the requirements described in sec. 2.1 above are met.

It is also important to note that the OECD does not provide for an exact definition of the words reported in the list but merely states that these expressions are indicated separately from the term "office" as they do not necessarily coincide. However, with regard to the "place of management", the Commentary states[13] that it refers to the place where management activities of a strictly managerial nature are carried out. This is supported by the term "siege de direction" (found in the French version of the OECD Model), which suggests that only the activities of managers are covered and that the decisions taken must be of strategic importance to the foreign enterprise as a whole.

The Commentary does not provide any guidance with respect to the meaning of the term "branch". According to certain scholars[14], this term refers to that part of the company without legal autonomy and dependent on the company itself, with a certain degree of economic and commercial independence and with its own organization and separate accounting records.

The Commentary does not provide for a precise definition of the term "office" either, even though it is mentioned several times in various examples in the Commentary itself.

The term "workshop", on the other hand, appears sufficiently clear in its common meaning. In general, this word indicates the places where firm's most productive processes take place. Specifically, "workshop" refers to that facility (industrial or artisan) in which work is carried out in the field of mechanical constructions.[15]

The last case mentioned by letter f) of paragraph 2 of Article 5 of the OECD Model provides that mines, oil or gas well, quarries or any other place used for the extraction of natural resources may constitute permanent establishments.

The Commentary[16] points out that this letter does not make any reference to the activity of exploration of these resources; therefore, a permanent establishment exists whenever income is generated which can be considered as mere business profit.

Finally, the expression "any other place of extraction of natural resources" should be understood in a broad sense including, for example, all places used for the extraction of hydrocarbons inland or offshore.[17]

2.3 Para. 3: Project PE

The third paragraph of Article 5 refers to the so-called "project PE".

This paragraph was initially introduced in the Treaty concluded between Finland and Sweden in 1931. That treaty provided that "[the] site of a building, the construction of which has exceeded or, as far as can be estimated, will exceed a period of 12 months, shall be regarded as a permanent business establishment within the meaning of the Convention".

The OECD Model Convention of 1963 seemed to take inspiration from the definitions of permanent establishment contained in the above-mentioned conventions, as it provided the following project PE definition "[a] building site or construction or assembly project which exists for more than twelve months".

Subsequently, with the 1977 update, the project PE rule was moved from the second paragraph to an autonomous third paragraph

13 OECD Commentary 2017, para. 46.

14 For a general overview of such term, see B. Arnold (2018). Article 5: Permanent Establishment. Global Tax Treaty Commentary — IBFD 2018, para. 2.

15 K. Vogel (1991). *Double Taxation Conventions*. Kluwer, pp. 214

16 OECD Commentary 2017, para. 46.

17 OECD Commentary 2017, para. 15.

which resembles the one actually inserted in the OECD Model 2017.

The main difference between the PE rule contained in para. 1 and the one contained in para. 3 is the time threshold. While for a physical PE to exist a six-month threshold must be met, the project PE provision rules that a 12-month period is needed in order for a building site to constitute a taxable presence in the other State.

Even though the Commentary clarifies certain relevant aspects (e.g., the relevance of time interruptions with respect to the time threshold[18]), some specific aspects still remain uncertain. For example, the relationship between the provision of para. 1 and para. 3 of Article 5 is barely explored by the Commentary[19] and several aspects of the relationship between these two paragraphs still remain unsolved.[20]

2.4 Para. 4 and 4.1: Auxiliary and Preparatory Activities and the Anti-Fragmentation Rule

The fourth paragraph of Article 5 of the OECD Model Convention contains a negative list with a series of fact patterns that are deemed not to create a permanent establishment because of their auxiliary or preparatory nature.

This paragraph was recently amended in 2017 to try to tackle some issues that were raised at an OECD level with the BEPS Projects and in particular with the report on the Action 7.[21] Before these changes, Article 5(4) of the OECD Model Convention was considered to be one of the most standard paragraphs as its language did not suffer from any amendments since 1977.

In essence, these amendments have the main purpose of preventing companies from implementing strategies aimed at avoiding the configurability of a permanent establishment in order to obtain undue tax advantages. With specific reference to the paragraph here under scrutiny, Action 7 — among the others — tackled the issue of some artificial ways of avoiding the creation of a PE by exploiting the exceptions set forth in para. 4.

In particular, in its Action 7, the OECD noted that some specific activities usually listed in para. 4 can nowadays actually represent the core business of a company. The way the pre-2017 para. 4 was drafted led to some interpretations pursuant to which the auxiliary or preparatory nature of the activities carried out seemed not to be referred to all the activities listed in it.[22]

The 2017 version of the OECD Model Convention was amended in a way that extended the auxiliary and preparatory requirements to all of the activities listed in para. 4. In other words, the auxiliary and preparatory nature is extended to all the activities (or a combination of them) either listed or not listed in para. 4.

Going forward to the analysis of the list of para. 4, letter a) of such list[23] refers to the case where the non-resident enterprise makes use of a facility for storing, displaying or delivering its own goods or merchandise. Therefore, an essential condition for exemption is that the relevant goods belong to the enterprise itself. With the term "storage", clearly the provision refers, for example, to warehouses used to store goods belonging to the enterprise and not to other

18 H. Pijl (2013). Interruptions in Building Site Permanent Establishments to Be Interpreted under the Limited Inclusion Theory. 67 *Bulletin for International Taxation* 7.

19 OECD Commentary 2017, para. 19.

20 See B. Arnold (2018). Article 5: Permanent Establishment. Global Tax Treaty Commentary — IBFD 2018, para. 2; H. Pijl. The Relationship Between Article 5, Paragraphs 1 and 3 of the OECD Model Convention, 33 *Int' l Tax Rev.* 4.

21 OECD (2015). BEPS Action 7: Preventing the Artificial Avoidance of PE Status.

22 B. Arnold (2018). Article 5: Permanent Establishment. Global Tax Treaty Commentary — IBFD, para. 4.

23 That states "a facility is used solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise".

enterprises.

As for the term "display", reference is made to cases where, for example, a foreign enterprise uses a special space for exhibition purposes, as in the case of a stand at a fair. It follows that, if at the end of a fair or exhibition the exhibited goods are sold, this sale does not constitute a permanent establishment, whereas, if goods that have not been exhibited are sold, the exemption referred to in para. 4 does not apply.[24]

Finally, "delivery" refers, for example, to cases in which a warehouse is used by the foreign company for the delivery of goods or merchandise to its customers. In this regard, the Commentary establishes that the mere delivery of spare parts, carried out through a warehouse, does not constitute a permanent establishment. If, however, this delivery activity is accompanied by after-sales activities, which are not considered accessory activities but an integral part of the company's production chain, then a permanent establishment can be deemed to exist.[25]

Letter b) takes into consideration goods or merchandise belonging to the foreign enterprise which is used solely for storage, exhibition or delivery purposes. As the wording of letter a) and b) are quite similar, some scholars argued that both letters include activities ancillary to storage, exhibition or delivery, such as packaging and shipping.[26]

As for letter c), it refers to situations where goods and merchandise belonging to the company are deposited in a warehouse located in a foreign country in order to allow their transformation by a different company. The term "processing" refers to the stage following the production where goods undergo a significant change in qualitative and/or quantitative aspects. If, on the other hand, the foreign enterprise were to carry out the transformation itself, that could be room to maintain that (should all the other requirements be met) a permanent establishment could be found to exist as transformation activities are usually part of the normal production process.[27]

Letter d) refers to cases where a foreign enterprise has a fixed place of business which is used to purchase goods or merchandise or gather information for the company itself. Accordingly, the so-called "purchasing offices" (specific offices of a given enterprise that only carry out purchasing activities) should fall within the scope of the letter at stake as long as such offices do not carry out other activities relevant to the core business of the company.

The last two letters of para. 4 of Article 5 and its last period have been inserted/amended as a result of the above-mentioned Action 7 of the BEPS Project.

In particular, the auxiliary and preparatory exceptions have been extended (through letter e) and f)) to all kinds of activities that a foreign enterprise may carry out as well as any combination of the activities reported in the previous letters of para. 4.

The last period (inserted in 2017) now clarifies that, in order for them not to constitute a permanent establishment, each and every of the activity (or combination of activities) listed in para. 4 must be of an auxiliary or preparatory nature. Activities of a preparatory or auxiliary nature are those that are not essential to the pursuit of the main activity of the foreign company. In other words, it should be ascertained whether the activity of the non-resident company can be achieved without difficulty even if it is deprived of certain activities.

This is one of the main changes brought up by Action 7 of the BEPS Projects as it clarifies that even activities listed in para. 4 of Article 5 may lead to the presence of a PE to the extent that they represent the (or an essential part of the) main business activity carried out by a foreign enterprise.

24 OECD Commentary 2017, para. 62.

25 OECD Commentary 2014, para. 25.

26 K. Vogel (1991). *Double Taxation Conventions*. Kluwer, pp. 234.

27 S. Mayr & B. Santacroce (2016). *La stabile organizzazione delle imprese industriali e commerciali*. (II ed.). Milano, pp. 66.

Another important addition made by the OECD through Action 7 is the insertion of para. 4.1, containing the so-called anti-fragmentation rule.

In a nutshell[28], the main purpose of this new rule is to avoid the possibility that foreign enterprises (especially MNEs) may artificially split the activities that they are carrying out in a given Country (for example, by the way of using different companies part to the same group) to avoid a PE to be deemed to exist in such Country.

The nature of such rule is quite uncertain as it is not entirely clear from its wording and purpose if it has to be interpreted as a further clarification of para. 4 of Article 5 or if it can be deemed to have an anti-abuse nature.[29]

2.5 Para. 5 and 6: Agency PE

The provisions contained in paragraphs 5 and 6 of the OECD Model relate to the activities carried out by a "person" on behalf of an enterprise that may give rise to the existence of a permanent establishment even in the absence of a fixed place of business (the so-called "agency permanent establishment").[30]

As it has happened for the language of para. 4, also the agency PE concept has been heavily amended as a result of Action 7 of the BEPS Projects.

More specifically, the OECD had decided to tackle an issue that frequently arose with respect to the wording of Article 5 as it read before 2017, i.e., the so-called commissionaire arrangement.

Indeed, by exploiting the previous wording of Article 5(5), companies have made use of the so-called commissionaire arrangements with the aim of avoiding the presence of a permanent establishment.

The term "commissionaire arrangement" refers to the agreement whereby a commissionaire acts on behalf of a foreign company but concludes contracts (relating, for example, to the sale of certain products owned by that company) in its own name with third parties. In this way, from a legal point of view, such contracts do not create any link between the non-resident firm and the third parties involved.[31]

Based on the previous wording of the paragraph at stake, it was also possible for enterprises to have a person negotiating all of the relevant clauses of a contract without signing it. In other words, contracts could have been fully agreed upon in the territory of a Country but signed in another Country (usually the residence State of the foreign enterprise). By doing so, it was possible to (at least from a formal perspective) try to avoid to give rise to a permanent establishment in a foreign Country.

It is therefore clear that, through escamotages as the one just described, an enterprise could manage to have a presence in another Country and sell its products therein without actually creating a taxable presence there.[32]

In order to try to tackle these kinds of arrangements, after the issuance of Action 7 Final Report, the OECD decided to amend Article 5(5) by making it clear that an agency PE is deemed to exist if a person acts in the territory of a State on behalf of an enterprise and habitually concludes contracts or plays a decisive role

28 For more details, refer to B. Arnold (2018). Article 5: Permanent Establishment. Global Tax Treaty Commentary — IBFD, para. 4.

29 B. Arnold (2018). Article 5: Permanent Establishment. Global Tax Treaty Commentary — IBFD, para. 4.

30 For a general overview of the issues related to this paragraph and the problems that may arise as a consequence of different meaning in national legislation, refer to S. Roberts (1993). The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One). 21 *Intertax* 9; J. Avery Jones & J. Ludicke (2014). The Origins of Article 5(5) and 5(6) of the OECD Model. *World Tax Journal*.

31 H. Pijl (2013). Agency Permanent Establishments: in the Name of and the Relationship Between Article 5(5) and (6) — Part 1. *Bulletin for International Taxation*.

32 M. Floris de Wilde (2017). Lowering the Permanent Establishment Threshold via the Anti-BEPS Convention: Much Ado About Nothing? 45 *Intertax* 8/9, pp. 558.

in the conclusion of contracts that are routinely concluded without substantial modification by the enterprise and such contracts are: (a) in the name of the enterprise, or (b) relating to the transfer of ownership, or for the grant of the right to use, property of such enterprise or which the enterprise has the right to use, or (c) relating to the provision of services by that enterprise.

The new wording briefly summarized broadened the scope of the agency PE clause as it now covers any activities leading to sale in a given State of goods or services from a foreign enterprise.

However, it is important to note that, even though the scope of this provision is now much broader, the exception provided for para. 6 still applies. Pursuant to this clause, an agent cannot be deemed to exist if such agent (i) is of independent status and (ii) acts in the course of its ordinary business activity.

Even though the main features of this exclusion from the agency PE rule were present even before the BEPS Project, in 2017 a new period was added to Article 5(6). This new period has the main purpose of clarifying the independency requirement under (i) above. In particular, it clarifies that where a person acts exclusively (or almost exclusively) for a given foreign enterprise — or different closely related enterprises — then such person cannot be considered to be independent.

In other words, the OECD seems to take the position that, in assessing the independency requirement, where an agent economically de facto depends on its sole contractor, such person cannot be deemed to be independent, regardless of any legal or factual circumstances that may depose otherwise.

The OECD also deemed it important to clarify what the locution "closely related" contained in para. 6 stands for. In particular, the newly inserted para. 8 now clarifies that persons are considered to be closely related where, based on all the relevant facts and circumstances, one has control over the other or both are under the control of the same entity.

In addition, the second period of para. 8 sets forth a presumption. Where a person possesses, directly or indirectly, more than 50% of an entity, such persons are deemed to be "closely related".

Finally, even though the language of the Article is not clear in this respect, even the agency PE rule suffers from the auxiliary and preparatory exceptions.[33]

33 OECD (2017). *Model Tax Convention on Income and on Capital*, art. 5. par. 5

2.6 Para. 7: Clarification Related to Control over Other Entities

Para. 7 contains a mere clarification that was inserted in the 2017 update to the OECD Model following a series of national court cases where the circumstance that a company has control over another was deemed to give rise to a PE.

Following that, the OECD deemed it necessary to clarify that the mere circumstance that a person has control over another does not automatically follow that such controlling person has a PE where the controlled entity is located.

Even if it was not actually needed, the Commentary further clarifies, however, that where a person controls an entity and has the premises of such controlled entity at its disposal then a PE may be deemed to exist if all the other requirements set forth by Article 5 are met.

Based on the wording of the paragraph itself and on the clarifications reported in the Commentary, it seems clear that the paragraph at stake has to be considered as a mere clarification of principles that were present in model before (and regardless of) its insertion.

3. Conclusion

The amendments occurred to Article 5 of the OECD Model Convention throughout the years and especially as a result of the BEPS Project are mostly aimed at ensuring that such provision may not be exploited for abusive purposes.

However, it seems clear that, even if some of the amendments might prove to be effective, the amendments fall short of tackling the most important challenge raised by our times: the digitalisation of the economy.[34]

Real measures to tackle this phenomenon are clearly needed as the modifications implemented in 2017. Even if it is able to make the Article more resilient to some kind of issues, it does not make this Article in line with the actual way businesses are carried out nowadays.

34 L. Spinosa & V. Chand (2018). A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?. 46 *Intertax* 6/7; Gómez Requena J. A. & Moreno González S. (2017). Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence. 45 *Intertax* 11; D. Blum (2015). Permanent Establishments and Action 1 on the Digital Economy of the OECD Base Erosion and Profit Shifting Initiative—The Nexus Criterion Redefined. 69 *Bulletin for International Taxation* 6/7.

Review of the Second BRITACOF

The BRITACOM Secretariat

The Second Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF) themed "Digitalization of Tax Administration" was convened virtually between 7-9 September 2021, attracting heads and representatives of tax authorities from 61 jurisdictions including Kazakhstan, China, Algeria, United Arab Emirates (UAE), Uruguay, Sierra Leone, Georgia, Singapore, and Russia, and heads of 12 international organizations, as well as representatives from the academia and the business.

1. Snapshot of the Second BRITACOF

The three-day event, hosted by the State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan, features four topics, namely Tax Administration Digitalization, Tax Service Digitalization, New Technologies in Taxation, and Tax-Related Data Governance. It aims to facilitate the establishment of a growth-friendly tax environment, open a new chapter of digitalized tax administration in the information age, promote taxation development against the backdrop of the Belt and Road Initiative (BRI), and contribute to the global economic recovery through sound development of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) and enhanced capacity of tax

administrations.

This BRITACOF comprises Council Meeting and Plenary Session. According to the Council Meeting, Mr. Ali Altynbayev, Chairman of the State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan, was appointed as President of the Second BRITACOF and Chair of the BRITACOM Council. The Vice-Chairs elected of the BRITACOM Council are Mr. Khalid Ali Albustani, Director General of the Federal Tax Authority of the UAE; Mrs. Margarita Faral, Director General of Dirección General Impositiva of the Oriental Republic of Uruguay; Mr. Paata Kiladze, Deputy Head of the Revenue Service LEPL of the Ministry of Finance of Georgia; and Mrs. Tuma Adama Gento-Kamara, Chairperson of National Revenue Authority of the Republic of Sierra Leone. The Algerian Directorate-General of Taxes of the Ministry of Finance will host the Third BRITACOF.

The Plenary Session was held throughout the three days from 7 to 9 September. At the Opening Ceremony, Mr. Ali Altynbayev expressed his cordial welcome and sincere appreciation to participants and encouraged representatives to exchange views and develop practical recommendations in the field of tax administration. Mr. Wang Jun, Commissioner of the State Taxation Administration of China (STA), President of the First BRITACOF and the First Chair of the BRITACOM Council, in his keynote speech on *Seize the Opportunity in the Era of Digitalization for a Better Future*, reviewed progress achieved by the BRITACOM in the past two years, shared measures taken by the Chinese tax authority to boost the development of tax digitalization, and initiated his proposals to enhance BRITACOM cooperation. Mr. Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration of the OECD, delivered his presentation on Digital Economy —The Two-Pillar Solution.

Following the Opening Ceremony, Chair of each Task Force established according to the *Wuzhen Action Plan (2019-2021)* released their final reports as an important outcome of the Second BRITACOF.

At the Closing Ceremony, Mrs. Amel Abdelatif, Director General of Taxes of Algeria extended her appreciation to the BRITACOM, stressed the importance of tax digitalization, introduced measures taken by the Algerian tax authority in this aspect, and invited participants to come to Algeria for the Third BRITACOF.

2. Highlights of the Second BRITACOF

On the second and third day of the Plenary Session, under the four topics of the Plenary Session and in the Business and Industry Tax Dialogue, high-profile speakers gave technical presentations and conducted in-depth discussions.

2.1 Tax Administration Digitalization

Mrs. Tuma Adama Gento-Kamara moderated this topic. Mr. Inkerbayev Zhaidar, Deputy Chairman of the State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan, observed that since 2016, the issue of the e-invoice has been applied on a voluntary basis in Kazakhstan and from 2019, mandatory issue of e-invoices has been provided for all VAT payers. As a result, business conditions are simplified, fictitious transactions and on-site tax audits reduced, and tax revenue increased.

Mr. Rao Lixin, Chief Accountant, State Taxation Administration of China, introduced the STA's 5C Quality Evaluation and Credit Plus Risk 2D Monitoring Systems. According

to him, the 5C system (Customer, Collection, Control, Check, and Correct) helps improve taxpayer service, enhance the efficiency of tax administration, and serve the macro-level decision making. The dynamic credit plus risk 2D monitoring system is primarily used to evaluate the dynamic credit worthiness and risk levels of taxpayers so as to implement differentiated services and administration. Chinese tax authority will further advance international cooperation, share experience in tax reforms, and boost the modernization of tax administration so as to make greater contribution to the international tax governance.

Mr. Nufransa Wira Sakti, Assistant to the Minister for Tax Supervision Affairs, the Ministry of Finance, the Republic of Indonesia, presented the implementation of data analytics and smart web in the Directorate General of Taxes for compliance risk management of transfer pricing to improve decision making and service quality.

In panel discussion, Mr. Inkerbayev Zhaidar added that e-invoices enable the traceability of goods throughout the entire sales chain and bolster the digitalization of tax administration. Ms. Katherine Baer, Deputy Director, Fiscal Affairs Department, IMF, observed that the digitalization of tax administration is closely related to the strategic design, organizational structure and core functions of tax administrations and that the IMF stands ready to work with various jurisdictions to improve tax administration digitalization.

2.2 Tax Service Digitalization

Mr. Stef van Weeghel, Global Tax Policy Leader of PwC and Professor of International Tax Law, University of Amsterdam, presided over the keynote speech part. Mr. Ayubjon Solekhzoda, First Deputy Chairman, Tax Committee under the Government of the Republic of Tajikistan, briefed delegates on electronic taxpayer services for legal entities and entrepreneurs in the Republic of Tajikistan. He introduced that taxpayers could file their tax returns and pay taxes due online, obtain the information from the Unified State Register, and issue electronic VAT invoices in Tajikistan.

Ms. Angela Ang, Assistant Commissioner, Inland Revenue Authority of Singapore (IRAS), presented measures taken by the IRAS to provide personalized and seamless digital services to taxpayers. Singapore launched two mobile applications, i.e., Singpass and LifeSG. Singpass is a Trusted Digital Identity and platform that bridges access to over 340 government agencies and private sector services and LifeSG connects citizens to the right services and information at their fingertips. In order to advance government digitalization, IRAS will transform government digital services, re-engineer digital government infrastructure, and adopt artificial intelligence (AI) for public sector. IRAS will also set multiple entry points to digital services, leverage data with whole-of-government data dashboard, and build a future-ready workforce with agile capabilities.

In panel discussion, Mr. Marcello Estevao, Global Director of Macroeconomics, Trade, and Investment of WBG, proposed four measures to enhance tax service digitalization, namely, extending the scope of e-filing and e-payment, using technological tools for digital audit and taxpayers services, enhancing the use of third-party data and data analytics, and incorporating international tax issues as part of the information communication technology and compliance strategies for tax administration. According to Mr. Khalid AlBustani, Director General of the Federal Tax Authority of the UAE, tax administrations will evolve into a data analyzing administration. It is imperative for them to collect, analyze, and study data and to leverage AI to advance the development of tax digitalization.

2.3 New Technologies in Taxation

In this topic, Prof. Jeffrey Owens, Director of WU Global Tax Policy Center, delivered his speech on the application, transformation, and benefits of blockchain in taxation. He emphasized that blockchain technology applied to taxation can play an important role in optimizing global supply chains, lowering barriers to cross-border transactions and facilitating trade, as well as conducting real-time tax audits, reducing tax fraud, and lowering compliance and administrative costs.

Mr. Erick Marinkovic, Deputy Commissioner for the Informatics Division of the SII, Chile, expressed that Chile has developed systems for data generation and alerting, tax compliance control, electronic document auditing, applications for internal controller of datasets, social network analysis, and tax analysis of datasets through its work on multi-data fusion. Mr. Mohd Nizom Sairi, Deputy Chief Executive Officer, Inland Revenue Board of Malaysia (IRBM), shared the digital transformation of the IRBM with AI to provide digitalized and integrated services to taxpayers.

The panel discussion in this topic was moderated by Mr. Christopher Sanger, EY Global Government and Risk Tax Leader, and joined by Mr. Erick Marinkovic, Mr. Mohd Nizom Sairi, Mr. Márcio F. Verdi, Executive Secretary of CIAT, and Ms. Josephine Muchiri, Economic Affairs Officer of UN. They discussed the major concerns of tax digitalization, the benefits of building taxpayer information system, and the application of new technologies.

2.4 Tax-Related Data Governance

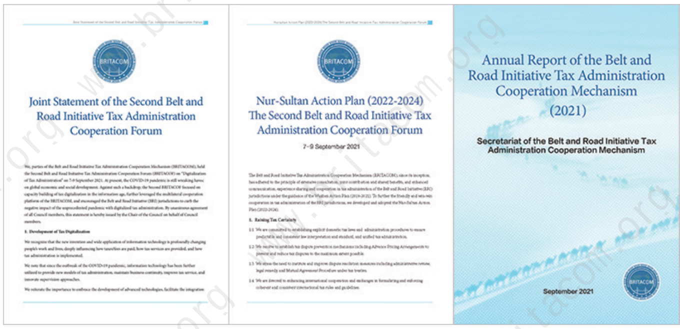
Russian and Italian tax authorities shared their practices and experience respectively in topic four. Mr. Daniil Egorov, Commissioner of Federal Tax Service of Russia, elucidated practices of data exchange and sharing in Russia. He presented that Russia's "online cash registers" generate multitudinous data every day, which has already provided extensive reference to decision making for governmental departments. At present, Russia intends to use AI technology in its "online cash registers". At the same time, verified users can access to Russia's integrated data processing platform, the All-Government Data Exchange, to obtain data for decision analysis.

Mr. Paolo Valerio Barbantini, Deputy Director General, Head of the Taxpayers' Compliance and Enforcement Division, Italian Revenue Agency demonstrated measures taken in Italy to enhance data security control. They mainly focused on infrastructure, data repositories, access control and logging strategies. In addition to technical means, the Italian Revenue Agency conducted regular data security awareness campaigns for IT personnel, employees and taxpayers, among others.

2.5 The Business and Industry Tax Dialogue

After that, Mr. Christian Kaeser, Chairman of Commission on Taxation, International Chamber of Commerce, and Global Head of Tax, Siemens AG, presented *Business and Industry*

Tax Report and presided over the ensuing panel discussion. The Report concluded that well-designed tax administration system could reduce tax compliance costs significantly. In order to ensure the interests of both public and private, tax digitalization should take into account the principles of efficiency and fairness. Mr. TAM Tai-pang, Commissioner of Inland Revenue of Hong Kong, China, summarized that there are five key factors for tax departments to achieve digitalization, i.e., developing efficient implementation strategies; selecting technical means that can meet the needs; revising the legal framework; promoting taxpayer services and cultivating talents. Mr. Samson URIDIA, Head of International Relations Department, Revenue Service of Georgia, believed that digitalization has changed our way of thinking and management. In order to improve tax digitalization, developing countries need to provide technical and financial guarantee to improve capacity building in this aspect. Mr. Daniel A. Witt, President of International Tax and Investment Center, observed that the level of information technology in a country may become a breaking force for multinational enterprises in choosing investment locations and making project decisions. In particular, a good tax system, an optimized business environment coupled with a high level of information technology can be very attractive to foreign investors. At the same time, tax authorities of the BRI jurisdictions should enhance the mutual trust between tax authorities and enterprises to reduce tax disputes. Prof. Jeffrey Owens emphasized that in order to enhance the dialogue between tax administrations and enterprises, it is suggested to expand the training programs of the Belt and Road Tax Academy to representatives of the business community. Mr. Vladimir Konstantinov, Head of Tax Services for Government and Public Sector in PwC Moscow stressed that the change of tax digitalization needs to be promoted by both tax administrations and enterprises.



3. Outcomes of the Second BRITACOF

At the meeting, four important outcomes of the Second BRITACOF were released, namely, *Joint Statement of the Second Belt and Road Initiative Tax Administration Cooperation Forum*, *Nur-Sultan Action Plan (2022-2024), Annual Report of the Belt and Road Initiative Tax Administration Cooperation Mechanism (2021),* and *Final Reports of Five Task Forces of the Wuzhen Action Plan (2019-2021)*.[1]

3.1 Joint Statement of the Second Belt and Road Initiative Tax Administration Cooperation Forum

Joint Statement of the Second Belt and Road Initiative Tax Administration Cooperation Forum is about the high-level consensus achieved by all Council Member tax administrations on the development of tax digitalization and the BRITACOM, and the plan for next steps, serving as a cement for all BRITACOM parties to join hands more closely for a more friendly and digitalized BRI tax environment.

3.2 Nur-Sultan Action Plan (2022-2024)

Nur-Sultan Action Plan (2022-2024) is the annex of the *Joint Statement*. In response to the top priorities of the *Joint Statement* and in accommodation of the needs in the BRITACOM jurisdictions, it sets out 28 clear goals in seven areas from 2022 to 2024, namely, raising tax certainty, promoting tax administration digitali-

1 See more at: https://www.britacom.org/gkzljxz/Documents/.

zation, improving tax environment, reinforcing capacity building of tax administration, establishing a regular exchange mechanism, raising the profile of the BRITACOM, and building an implementation framework.

3.3 Annual Report of the Belt and Road Initiative Tax Administration Cooperation Mechanism (2021)

Annual Report of the Belt and Road Initiative Tax Administration Cooperation Mechanism (2021) presents the development and achievements of the BRITACOM since its establishment in terms of the operation of the Secretariat, the First BRITACOF, conferences and seminars, the Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG), task forces, BRITACOM website and journal, and Advisory Board. It also offers suggestions to advance the high-quality development of the BRITACOM.

3.4 Final Reports of Five Task Forces of the Wuzhen Action Plan (2019-2021)

As outcomes of implementing the *Wuzhen Action Plan (2019-2021), Final Reports of Five Task Forces* presents best practices adopted by BRITACOM jurisdictions, demonstrates progress made by the BRITACOM in terms of raising tax certainty, expediting tax dispute resolution, enhancing the capacity building of tax administration, streamlining tax compliance, and digitalizing tax administration, and offers solutions to certain issues in BRI jurisdictions.

4. Summary and Vision of the Second BRITACOF

At this Second BRITACOF, BRITACOM Member Tax Administrations agreed on:

- Embracing the development of advanced new technologies to promote the modernization and digitalization of tax administration so as to chart the course for the future development of the BRITACOM;
- Following the principle of extensive consultation, joint contribution, and shared benefits, adhering to the guidelines of win-win cooperation, openness, inclusiveness, and mutual learning, and striving to build a growth-friendly tax environment; and
- Setting the direction and identifying priorities for future development of the BRITACOM, and reiterating the importance of strengthening cooperation with international organizations to facilitate the development of the BRITACOM.

On the sidelines of the online meeting, a Virtual Exhibition is also held on the official website following the forum to showcase the achievements of tax digitalization in various tax jurisdictions.[2]

Going forward, the BRITACOM will continue to play its role as a bridge for closer communication and interaction, and make unremitting efforts to raise tax certainty, promote tax administration digitalization, improve doing business tax environment, and reinforce capacity building of tax administration, with an aim to build a growth-friendly tax environment.

2 See more at: https://www.britacom.org/news/exhibition_2/.

Experts' Views on Digitalization of Tax Administration

The BRITACOM Secretariat

Katherine Baer
Deputy Director
Fiscal Affairs Department
IMF

Marcello Estevao
Global Director
Macroeconomics, Trade, and Investment
WBG

Josephine Muchiri
Economic Affairs Officer
UN

Disruptive technologies are reshaping the economy of the world by creating new business models with new products and services. While bringing challenges to tax administrations on their traditional way of interaction with taxpayers, the new development in modern digital world also provides new opportunities for tax administrations to collect taxes, support taxpayers and enhance compliance via new technologies and tools. Focusing on the theme of digitalization of tax administration, the Second Belt and Road Initiative Tax Administration Cooperation Forum was very much honored to have Ms. Katherine Baer, Deputy Director of Fiscal Affairs Department of the International Monetary Fund (IMF), Mr. Marcello Estevao, Global Director of Macroeconomics, Trade, and Investment of the World Bank Group (WBG), and Ms. Josephine Muchiri, Economic Affairs Officer of the United Nations (UN) share their insights on tax administration digitalization, tax service digitalization, and new technologies in taxation. The Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) Secretariat edited their speeches for our readers.

1. Tax Administration Digitalization

Ms. Katherine Baer highlights that one challenge in implementing digitalization of tax administration is having a strategy, especially clarity in terms of the objectives, and some kind of evaluation of what went right and what went wrong. She argues that resources are also the challenges for countries, especially those with lower capacity. According to her, in order to resolve the challenges, we need to bring to the table the importance of having a plan as simple as it might be, and then assign resources to digital modernization efforts throughout the life of a project so that tax administrations are able to reach their goals by adopting the new digital technologies or new systems. This is not an easy task.

As for the role of technology in countering cross-border tax evasion, she thinks digital technologies and the exchange of information across borders have very considerable potential of addressing tax evasion and other types of non-compliance related to cross-border trade and tax-related transactions. Besides, she believes that accurate taxpayer identification is key to making the exchange of information.

2. Tax Service Digitalization

Mr. Marcello Estevao notes that investing in digital transformation is essential to improving taxpayer services, bringing taxpayers onto digital platforms with greater assurances of compliance, and reducing the costs of administration. World Bank experience shows that leadership matters in driving through change, building trust within and outside the tax administration, and managing what are often technically complex projects. The COVID-19 crisis has further highlighted the importance of digital solutions for business continuity, e.g., e-filing, e-payment, offsite audits, and taxpayer hotlines. Looking towards the future, many governments will invariably focus their digitalization efforts on VAT, which accounts for the largest increase in revenues in recent decades. Here, e-invoicing will play a key role.

The recently endorsed World Bank Domestic Revenue Mobilization approach aims to help countries raise revenues in a fair way. As the largest provider of concessional financing for tax reform, the World Bank is also committed to supporting tax administrations throughout their digitalization journey. The World Bank also provides support to member governments in close cooperation with other partners through technical assistance, leadership training (e.g., Executive Program), and analytical tools (e.g., VAT Toolkit).

3. New Technologies in Taxation

Ms. Josephine Muchiri expresses her opinion on using artificial intelligence in tax administration. One of the things that she thinks revenue authorities need to embrace is the use of the no-wrong-door policy. When they're dealing with their taxpayers, all these reforms take place as new technologies come into play. Taxpayers need guidance on how the reforms affect them, and what they must do, so that they can comply. Taxpayers could interact with their system and ask any sort of question, regardless of their location and items of taxation by using artificial intelligence. She also pinpoints that artificial intelligence enables the one-stop shop services that will drive compliance and taxpayer education.

She maintains that with cloud computing, tax administrations are able to integrate different systems, so that pre-populated tax returns have accurate information of taxpayers. Therefore, this will drive the compliance rates and also assist in the ease of complaints. Taxpayers do not have to struggle so much to comply with various regulations, so that they can pay their taxes and meet their other obligations.

Capacity development will be very important to keep tax administrations up to date with the technology. Therefore, the BRITACOM is needed to bring together its parties and help build their capacities.

2021

June - October 2021

Virtual Course on Tax Service

The virtual course on Tax Service was held from 14 June to 31 October 2021, mainly covering the art of tax administration, country practices of tax services, etc. with the total duration of 5 hours. Nearly 160 tax officials from 14 jurisdictions attended this course.

28 July - 2 August 2021

Virtual Seminars on *Wuzhen Action Plan (2019-2021)* Task Forces

From 28 July to 2 August 2021, a string of virtual Task Force meetings of the BRITACOM were successfully held online to discuss work progress of the final reports of the five Task Forces established at the First BRITACOF, with a variety of views obtained from relevant parties and next steps proposed.

Chairs of five Task Forces hosted the meetings and updated participants on the progress of drafting the final reports on Enhancing Tax Administration Capacity, Expediting Tax Dispute Resolution, Following Rule of Law and Raising Tax Certainty, Digitalization of Tax Administration, and Streamlining Tax Compliance. Members of the Task Forces and Advisory Board expressed views on how to improve the final reports, proposed effective solutions to practical difficulties and measures to further task force work, and reached broad consensus on next steps.

7 - 9 September 2021

The Second BRITACOF

The Second BRITACOF themed"Digitalization of Tax Administration" was convened virtually on 7-9 September, attracting heads and representatives of tax authorities from 61 jurisdictions including China, Kazakhstan, Algeria, UAE, Uruguay, Sierra Leone, Singapore, and Russia, and heads of 12 international organizations, as well as representatives from the academia and the business.

The three-day event, hosted by the State Revenue Committee of the Ministry of Finance of Kazakhstan, features 4 topics, namely, Tax Administration Digitalization, Tax Service Digitalization, New Technologies in Taxation, and Tax Related Data Governance. It aims to facilitate the establishment of a growth-friendly tax environment, open a new chapter of digitalized tax administration in the information age, promote taxation development against the backdrop of the BRI, and contribute to the global economic recovery through sound development of the BRITACOM and enhanced capacity of tax administration.

Four outcomes were released during the BRITACOF, namely, the *Joint Statement of the Second Belt and Road Initiative Tax Administration Cooperation Forum*, the *Nur-Sultan Action Plan (2022-2024)*, the *Annual Report of the Belt and Road Initiative Tax Administration Cooperation Mechanism (2021)*, and the *Final Reports of Five Task Forces of the Wuzhen Action Plan (2019-2021)*.

7 September 2021

New Leadership of the BRITACOM Council

During the Council Meeting on 7 September, Mr. Ali Altynbayev, Chairman of the State Revenue Committee of the Ministry of Finance of Kazakhstan, was appointed as BRITACOM Council Chair. Mr. Khalid Ali Albustani, Director General of the Federal Tax Authority of the United Arab Emirates, Ms. Margarita Faral, Director General of Dirección General Impositivaof Uruguay, Mr. Paata Kiladze, Deputy Head of the Revenue Service LEPL of the Ministry of Finance of Georgia, and Ms. Tuma Adama Jabbi, Chairperson of National Revenue Authority of Sierra Leone were elected BRITACOM Council Vice-Chairs.

9 September 2021

Host of the Third BRITACOF

The Third BRITACOF will be hosted by the Algerian Directorate-General of Taxes of the Ministry of Finance. Mrs. Amel Abdelatif, Director General of Taxes of Algeria extended her appreciation to the BRITACOM, stressed the importance of tax digitalization, introduced measures taken by the Algerian tax authority in this aspect, and invited participants to attend the Third BRITACOF in Algeria during the closing ceremony of the Second BRITACOF on 9 September 2021.

15 October and 16 December 2021

Virtual Seminars on Resolution of Tax Disputes and Digital Transformation of Tax Administrations

The virtual seminars on Resolution of Tax Disputes and Digital Transformation of Tax Administrations were held on 15 October 2021 and 16 December 2021 respectively. Representatives from BRITACOM Council Member Tax Administrations, Observers, and members of the Advisory Board, and business attended the meeting. All participants and speakers contributed to this informative and engaging event.

December 2021

Elementary Level Courses of the BRITACEG

The Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG) is planning courses on tax dispute resolution, digitalization of tax administration, taxpayer service, and VAT reform. The Secretariat is planning to design these courses in three tiers for tax officials with different seniority and backgrounds. The elementary level, presented via online programs, is best suited for tax officials with rudimentary experience; the intermediate level fits officials who are moderately experienced in the field and is delivered in the form of online lectures and case studies; and the advanced level is for veterans and is taught on-site with lectures, seminars and group discussions. Since October 2021, the elementary level course on tax dispute resolution and digitalization of tax administration have been open to all BRITACOM parties, and elementary level courses on the other two topics will be available online by the end of this December.

Contributions Invited

Dear readers and writers,

We highly appreciate your contribution to the *Belt and Road Initiative Tax Journal* (BRITJ), and look forward to your continuous support in the future.

As an official journal sponsored by China Taxation Magazine House in collaboration with the BRITACOM Secretariat, BRITJ is committed to serving as a platform for communication and cooperation among tax administrators, academia, tax practitioners and other stakeholders around the world, and providing strong theoretical support and international reference for tax reform and administration among the Belt and Road jurisdictions.

Given your expertise and reputation in the tax arena, we sincerely invite you to contribute papers to the journal on such themes as tax issues concerning the Belt and Road Initiative, the latest development and reform of tax system and tax administration as well as hot topics in the field of international taxation. Papers written in English with less than 5,000 words and sent in a WORD format would be highly appreciated.

Papers can be sent to britj@britacom.org. For more information, please visit our website: www.britacom.org.

Kind regards,

Li Wanfu

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